भारतीय दिवाला और शोधन अक्षमता बोर्ड
Insolvency and Bankruptcy Board of India

Azadi Ka Amrit Mahotsav

नवदृष्टि

Emerging Ideas on IBC

ABOUT THE PUBLICATION

Insolvency and Bankruptcy are complex legal concepts that can have significant economic and social consequences for businesses and individuals. This publication brings together research papers in these areas which provide valuable insights into various processes under the Insolvency and Bankruptcy Code, 2016. The publication is a compact collection of research papers from leading academicians and practitioners in the field of insolvency and bankruptcy, presented at the 2nd International Research Conference on Insolvency and Bankruptcy held in association with IIM Bangalore at their campus from 23rd to 25th February, 2023. With 30 multidisciplinary papers, this publication aims to provide a platform for the dissemination of cutting-edge research and ideas that can assist policy-making, practice and further research. We hope that this publication will contribute to a better understanding of the challenges and opportunities associated with insolvency and bankruptcy, and to the development of more effective and efficient insolvency and bankruptcy regimes around the world.

नवदृष्टि
Emerging Ideas on IBC

2023

Insolvency and Bankruptcy Board of India

7th Floor, Mayur Bhawan, Shankar Market, Connaught Circus, New Delhi-110001

www.ibbi.gov.in

978-81-947537-3-5

Title: नवदृष्टि **: Emerging Ideas on IBC**

Published by:
Insolvency and Bankruptcy Board of India.
7th Floor, Mayur Bhawan, Connaught Circus, New Delhi - 110001
Email: research@ibbi.gov.in

ISBN: **978-81-947537-3-5**

Typeset, Printed and Bound by:
M/s. Indu Cards & Graphics
Delhi-110006, India

Any views and feedback on the publication may be emailed at research@ibbi.gov.in

CONTENTS

FOREWORD

The approach to policy making known as evidence-based policy emphasizes the importance of utilizing empirical evidence and scientific research in order to inform and guide policy decisions. Its target is to ensure that policies are based on reliable evidence and are likely to be effective in achieving their intended objectives.

For Government, evidence-based policy making is an indispensable strategy because it helps to ensure that policies are based on sound facts and are economical, effective and efficient. By demonstrating that policy decisions are driven by sound evidence, Government can improve public trust in their decision-making process. It involves meticulous research methods and data analysis to inform policy decisions and to assess the effectiveness of the policies that have already been implemented. This requires Government to invest in research and developing a culture that values evidence and use of data for informed policy decisions.

India has been making considerable efforts to incorporate evidence-based policy making in recent years. In 2022, the NITI Aayog in collaboration with Ministries and State Governments launched a transformational open data platform called 'National Data and Analytics Platform', which is aimed at bringing together data from various sources to provide evidence-based insights for policy making. It uses cutting-edge methodologies to link diverse datasets from across the Government and enables the use of several types of data at once.

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) was introduced in India as a comprehensive legislation to address the problem of non-performing assets in the banking system and to provide a streamlined and effective mechanism for the resolution of distressed assets. Since then, the IBC has undergone several changes to address various challenges and issues that have arisen during its implementation. Over the years, the Code has played a critical role in developing a creditor-friendly environment, boosting investor confidence, enhancing recovery rates for the creditors, and so on. This has helped improve India's ranking in the World Bank's Ease of Doing Business Index and has made India an attractive destination for foreign investment.

Introduction of the IBC has provided a much-needed impetus to research opportunities related to insolvency and bankruptcy. Researchers can study the impact of the IBC on the resolution of insolvency cases, the role of various stakeholders in the insolvency resolution process, and the effectiveness of the IBC in promoting a culture of credit discipline among borrowers and lenders. The IBC has been in effect for a few years now, and it is essential to evaluate its impact on the Indian economy and various stakeholders, including lenders, borrowers, and investors. Research in this area can help identify the positive and negative impact of the IBC and suggest ways to mitigate the negative effects. Since the Code has been successful in resolving many insolvency cases, it is crucial to identify the best practices that have contributed to this success. Thus, research would help discern these practices and suggest ways to replicate them.

Data plays a crucial role in research as it provides the raw material for analysis and insights that can lead to informed decision-making and improved outcomes. It can be used to identify patterns and trends that might not be apparent otherwise. Currently, the Insolvency and Bankruptcy Board of India (IBBI/ Board) offers a lot of data on its website being the primary repository. Quantitative information is available with respect to various processes under the Code viz., corporate insolvency resolution process (CIRP), liquidation process, voluntary liquidation process, resolution of financial service providers, pre-packaged insolvency resolution process, and insolvency and bankruptcy process of personal guarantors to corporate debtors. CIRP data is the largest chunk of information that IBBI currently gives out, which forms the core of our 'Quarterly Newsletter'. It also publishes data in its Annual Reports and Information Brochures. It consistently posts information pertaining to orders issued by Tribunals (NCLT and NCLAT) and higher Courts, the details of Insolvency Professionals and their performance, Insolvency Professional Agencies, Information Utilities, Insolvency Professional Entities, Registered Valuers, and Registered Valuer Organisations.

IBBI also has its Research Initiative Guidelines which were first launched in 2019. This Initiative aims to promote research - legal, economic, and interdisciplinary, and discourse in areas relevant for the evolving insolvency and bankruptcy regime in general, and that in India. More than 80 different themes are indicated in the guidelines for researchers to work upon.

The 2nd International Research Conference on Insolvency and Bankruptcy organized in association with IIM Bangalore, was the result of consistent effort, fervor, and the zeal of young students as well as professionals from the fields of insolvency and bankruptcy. International experience in insolvency was shared and discussed by international scholars from countries like Australia and England, as part of the Conference. The Conference offered a unique opportunity to listen to thought leaders and policy makers in three panel discussions planned, along with the technical sessions in which 39 papers were presented. This was followed by a workshop on data driven insolvency research which gave valuable insights on the importance of data in the field of research and the extensive amount of data currently available for research. This Conference has enhanced our understanding of the IBC, its impact on the economy and society and most importantly, has provided insights for way forward for this law.

This publication titled '**नवदृष्टि** : Emerging Ideas on IBC' is a compilation of 30 thought provoking research papers presented during the 2nd International Research Conference on Insolvency and Bankruptcy. I am hopeful that this publication will further the cause of scholarly studies and research in the field of Insolvency and Bankruptcy.

(Ravi Mital)
Chairperson
Insolvency and Bankruptcy Board of India

PREFACE

Economic reforms refer to a set of policy measures and structural changes aimed at improving the performance of an economy. It can take many forms but generally involves a shift in the role of the Government, restructuring of economic institutions and a change in the incentives faced by the economic agents. They help foster economic growth, development and competitiveness in a country. Over the years many such reforms have been undertaken in India which reduced government regulations, opened up the economy to foreign investment, and facilitated the ease of doing business.

In 2016, India enacted the Insolvency and Bankruptcy Code, 2016 (IBC/Code), which was a landmark reform to the nation's financial system and the first comprehensive law to regulate insolvency and bankruptcy. Historically, India has suffered from fragmented framework of insolvency laws that either did not give lenders adequate powers to recover their debts upon default or were time-consuming and complex. The IBC is a comprehensive insolvency and bankruptcy law that, since its enactment, has had a significant role in reducing the problem of non-performing assets in our banking system. The Code has resulted in resolution of 678 cases till March, 2023 and the creditors have realised ₹2.86 lakh crore under these resolution plans. Moreover, 25,107 applications for initiation of insolvency resolution process were withdrawn before their admission resulting in resolution of underlying debt of ₹8.81 lakh crore, thus indicating improved debtor-creditor relationship.

Designing any business regulation involves the creation of rules and policies that govern the operation of businesses so as to protect consumers, promote fair competition and ensure that businesses operate in a responsible and sustainable manner. Research plays an essential role in identifying regulatory gaps in the framework where they may be insufficient; providing a cost-benefit analysis of a particular regulation; formulating a basis for engaging stakeholders in regulatory development process.

As a regulator of insolvency and bankruptcy processes and associated professionals, the Insolvency and Bankruptcy Board of India (IBBI/Board) plays a critical role in promoting a dynamic and responsive regulatory regime for the IBC ecosystem. IBBI as a regulator performs its role under a unique provision that mandates public discussion and economic analysis as precursors before issuance of a regulation. IBBI has been in the forefront of developing research to get detailed analytical and critical exploration of various facets of insolvency ecosystem.

Insolvency research has become increasingly interdisciplinary, with scholars from different fields working together to explore the complex legal, economic, and social dimensions of insolvency. The 2nd International Research Conference on Insolvency and Bankruptcy was one such initiative jointly organized by IBBI and IIM Bangalore (IIMB) from 23rd to 25th February, 2023 at the IIMB campus. The infrastructure and faculty support from IIMB was instrumental in providing a unique platform for participants to share their experiences, engage in vibrant dialogue on the challenges and opportunities presented by the legislation and institutions established by it. The exchange of ideas between experts and young minds was especially valuable, as it fostered new perspectives and fresh thinking on complex issues. The speeches by distinguished guests underscored the importance of IBC in fostering economic growth and stability and highlighted the need for ongoing research and innovation in this field. The panel discussions that followed were equally enlightening with leaders from various industries sharing their opinions on diverse topics ranging from insolvency of MSMEs to next generation reforms in the field of insolvency and the perspective of key stakeholders.

The conference received a staggering response from the beginning. A total of 219 research proposals were received for the conference,out of which after shortlisting, 90 papers were received at the final stage, and 39 of these were presented during the conference. The presentations covered a wide spectrum of topics with speakers belonging to diverse backgrounds. International experience was shared and discussed by speakers from Australia and England. The technical sessions were thought-provoking, engaging and held the audience's interest. Of the presented papers, 30 papers are a part of this publication.

Research studies have made an attempt to trace the international instruments devised for the purposes of dealing with cross-border insolvency situations, India's thoughts in adopting these frameworks and the challenges that lie unaddressed prior to the adoption of such a framework. Studies examined the experience of foreign jurisdiction in relation to communication and cooperation in cross-border insolvency proceedings and relevant protocols. It has even highlighted the factors determining the success of court-to-court cooperation and insolvency protocols.

Studies have delved into predicting insolvency which have highlighted the challenges faced by MSMEs and how AI/MI based applications would be an appropriate fit for risk assessment. By offering valuable insights, studies have also equipped regulators with the knowledge to identify early warning signs of financial distress, thereby mitigating the costs borne by stakeholders during times of distress, with earning management and auditor change being a predictor of bankruptcy.

Within the realm of emerging topics, studies have explored various subjects related to the Code, including creditor rights, real estate insolvency, and economic analysis of processes and outcomes under the Code, unraveling insightful perspectives in the process. Conducting meticulous sectoral analysis, studies have probed into the effectiveness of the IBC to unravel the specific hurdles contributing to delays in resolution thereby identifying potential industry-specific delays, if present. Furthermore, some have explored the relationship between managerial ability and the likelihood of bankruptcy, revealing a notable negative correlation between the two. These findings underscore the crucial role of effective management in mitigating the risk of bankruptcy.

Law, as a concept, is not static; it is continuously evolving so as to reflect the values and norms of the society these govern. As society progresses, new values and perspectives emerge, and laws need to adapt accordingly. There exists a symbiotic relationship between evolving laws and research, through which policymakers can create legal frameworks that are well-informed, adaptive and aligned with the needs and aspirations of society. The 2nd International Research Conference on Insolvency and Bankruptcy has helped deepen our understanding of the legislation and provided a new direction for research and practice in the field of insolvency and bankruptcy.

We are grateful to researchers and professionals who drive knowledge, innovation, problem-solving, and evidence-based decision-making. The insightful presentations and active participation during the Conference have enriched and elevated the quality of discourse. As we reflect on the collective knowledge shared and the fruitful discussions that have taken place, we are optimistic about the impact this Conference will have on the insolvency and bankruptcy landscape.

(Jayanti Prasad)
Whole-time Member
Insolvency and Bankruptcy Board of India

2nd International Research Conference on Insolvency and Bankruptcy from 23rd to 25th February, 2023 at IIM Bangalore

2nd International Research Conference on Insolvency and Bankruptcy from 23rd to 25th February, 2023 at IIM Bangalore

2nd International Research Conference on Insolvency and Bankruptcy from 23rd to 25th February, 2023 at IIM Bangalore

Panel Discussion on 'Insolvency Resolutions: A Special Case for SMEs'

Panel Discussion on 'Next Generation Reforms in Insolvency'

Panel Discussion on 'IBC: Perspectives of Key Stakeholders'

Workshop on Data Driven Insolvency Research

1 INSOLVENCY OF A PUBLIC LISTED COMPANY

-Ajanta Gupta and Ritesh Kavdia

EXECUTIVE SUMMARY

In deep financial trouble, gradual and sudden fall of the company into insolvency dilutes the ownership and controlling rights of equity holders in favour of creditors and equity hold a back seat under waterfall mechanism. The Insolvency and Bankruptcy Code, 2016 (IBC/Code) has shifted the debtor in possession regime to creditors in control model for insolvent companies. Since the inception of the IBC, the much have been deliberated on affected creditors and protecting their interest during insolvency. However, under the processes of the IBC, the position of listed stock affecting general public shareholders remains unattended. The present paper attempts to track the performance of the resolved public listed companies under the IBC and proposes to address the trading and listing of securities issues to comprehend the interplay between IBC laws and Securities law for public listed insolvent companies.

Keywords: Public Listed Companies, IBC Performance, Trading of Shares during Insolvency, Delisting, Equity

INTRODUCTION

The capital structure of the company comprises of debt and equity. For a business to operate and expand, it is crucial for businesses to raise capital in the right form, at the right time, and price in a cut-throat and rapidly evolving business climate. When the company enters the capital market, ownership of a publicly listed company is characterised by promoters (the company's founders or controlling owners) and non-promoters (other shareholders including minority shareholders). Nevertheless, shielding the interest of public/minority shareholders lies in the heart of legislatures, be it in company law or securities law. The IBC has shifted the debtor-in-possession regime to creditors-in-control model for corporate debtors (CDs). In deep financial trouble, the entry of the company into insolvency dilutes the ownership and control rights of equity holders in favor of creditors and equity holds a back seat.

The 'creditors-in-control' under the Code empowers the committee of creditors (CoC) constituted under section 21 of the Code to control the CD and evaluate the options to revive the CD. Interim Resolution Professional (IRP) is appointed by the Adjudicating Authority (AA) on the admission of the CD into corporate insolvency resolution process (CIRP) and later, Resolution Professional (RP) is appointed by the CoC who conducts the entire corporate insolvency resolution proceedings under the Code. To execute its functions, the IRP/RP is vested with the power of management of the affairs of the CD. The powers of the Board of Directors or the partners of the CD are suspended and the same are to be exercised by IRP/RP to run the CD. Section 17(2) and section 25 of the Code authorize the IRP/RP to act and sign any deeds, receipts, and other legal documents in the name and on behalf of the CD. Sections 20 and 25 of the Code mandate the IRP and RP respectively, to take all reasonable steps to safeguard and maintain the value of the CD's property and manage its activities in a going-concern manner. The primary goal of the Code is to resolve the CD in a time-bound manner in order to maximize its value. This can be done more effectively if the CD keeps up its status as a going concern. In order to protect the CD's assets, the Code's design imposes a moratorium under section 14. Further, section 19 of the Code mandates the personnel, promoters, or any other person associated with the management of the CD to extend all assistance and cooperation to the IRP/RP in managing the affairs of the CD. Therefore, the IRP/RP's job is to do all possible to ensure that the CD continues to operate as a going concern.

The Insolvency and Bankruptcy Board of India (IBBI) vide its circular[1] dated January 03, 2018, clarified that CD undergoing the CIRP needs to comply with all the relevant Acts, Rules and Regulations, Circulars, Guidelines, Orders, Directions, etc. unless a provision is expressly exempted by the competent authority or becomes inapplicable for the CD by the operation of law. It further quoted the example that every provision of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI Listing Regulations) must be complied with by a CD under CIRP if the CD is listed on a stock exchange. Additionally, it directed the IRP/RP under the Code that he must exert reasonable care and diligence and take all necessary measures to ensure that the CD complies with the relevant legislation. Also, it clarified that the IRP/RP would be held accountable for any violations of the provisions of the relevant laws if they result from his non-actions. A similar provision found a place in the Code, when the Code was amended in June, 2018 under sub-section 2 of section 17 stating that '*The interim resolution professional vested with the management of the corporate debtor … be responsible for complying with the requirements under any law for the time being in force on behalf of the corporate debtor*'.[2] By virtue of section 23, mandates of section 17 also apply to RP. So, the present framework puts the onus on the IRP/RP to comply with the compliance related to the listing.

PROBLEM STATEMENT

Since the inception of the Code, much has been deliberated on affected creditors and protecting their interests during insolvency. However, under the processes of the Code, the position of listed stock affecting general public shareholders remains unattended. Unpredictability and volatility in the prices of securities of the CDs under speculation of its fate under the Code create a turbulent environment for the stockholders, further aggravated by information asymmetry. Presently, trading of shares of publicly listed companies during the CIRP continues. Neither securities law nor insolvency law requires discontinuation of trading during CIRP in India. In 2018, the Securities and Exchange Board of India (SEBI) floated a consultation paper[3] seeking comments on whether it is appropriate to introduce limits on stock exchange trading to limit the transferability of shares of listed CDs under insolvency. But the SEBI is yet to issue any regulations, circulars, or guidelines on this subject. To continue or suspend trading at the CIRP stage entails diverse opinions. Also, there is no explicit provision about trading of shares/delisting of shares of companies undergoing the liquidation process under the Code.

Further, in November, 2022,[4] the SEBI floated another consultation paper to protect the interest of minority shareholders, proposing that the opportunity to purchase shares of the diluted capital structure of the new entity up to the minimum public shareholding percentage (which is 25% at present) should be made available to the existing public equity shareholders of the CD. The pricing conditions must be the same as that of resolution applicant. It proposed for non-availability of delisting exemption for the resolution applicant without a mandatory offer to public shareholding. Nevertheless, such proposal impairs the options before the resolution applicant to revive the CD. Provisions of the Code placed the insolvency of the publicly listed CD at par with other CDs, except with added responsibility that additional laws applicable to publicly listed CDs are also to be complied during the process. The expectations of public shareholders, and proposed intervention of the SEBI demand the review of the provisions for publicly listed CDs during the tenure of insolvency with respect to the resolution process.

RESEARCH OBJECTIVES

In view of the foregoing discussion, the present paper aims to address the following issues to comprehend the interplay between IBC laws and securities law for public listed companies and to study the trends of resolved publicly listed CDs.

(a) Tracing the prints of listed securities of resolved CDs under the Code: To depict the trend of public listed companies resolved under the Code in terms of listing, delisting, market capital, income from operations, profit before depreciation, interest, tax and amortisation (PBDITA), profit after tax (PAT), and employment and to get some insights about tangible outcomes of the IBC beyond recoveries through performance of the companies prior to admission and post resolution.

(b) Listing and trading of securities during CIRP: This paper examines the listing status of securities of the CDs going under the CIRP and continued trading of securities thereof.

(c) Role of RP with respect to listed stock in public listed CD: This paper also discusses the role of Insolvency Professional (IP) in complying with the listing requirements of CD during CIRP and in the resolution plan approved under section 31 in the creditors-in-control regime. Information asymmetry, insider trading, and herd behaviour create an imbalance of powers in transactions. The present paper studies the role of RP in protecting the interest of retail investors under the Code with various statutory mandates.

(d) Relaxations and delisting exemption for resolution: This paper also enlists the reliefs granted by SEBI to facilitate the resolution of distressed CDs. However, recently the SEBI has proposed to restrict the delisting exemption for resolution plan in lieu of minimum public shareholding. This paper also analyses proposal of granting delisting exemption to subject to a mandatory offer to public shareholders to acquire 25% shareholding in the new CD.

(e) Delisting /trading of securities during liquidation: During liquidation, this paper also examines whether shares lose their transferability or continue to be traded when CD is undergoing liquidation process.

METHODOLOGY AND DATA SOURCE

The provisions of listing requirements, suspension of trading of securities and minimum public shareholding in the resolution plan of public listed CDs have been studied keeping in view present applicable laws in India. International practices across various jurisdictions have been referred to study the provisions regarding the delisting and trading of securities under the insolvency regime. Further, to depict the trend of resolved listed CDs in terms of listed and delisted, the sources of data are IBBI published data for resolution plans approved by AA up to June 30, 2022 and Ministry of Corporate Affairs (MCA) master data. The performance of resolved distressed public listed companies (PLCs) post-resolution have been attempted in terms of market cap, operations, earnings etc. The value of the market cap is taken for the date falling in that month's end and for other indicators, in that financial year (FY). The study of performance of CDs is limited to the PLCs entered into CIRP and resolved under IBC, whether listed or unlisted. Firm-level database from the prowess database collected by the Centre for Monitoring the Indian Economy has been used. Further, information about continuation of listing post liquidation order has been gathered through www.moneycontrol.com, company information available on the website of National Stock Exchange (NSE) and Bombay Stock Exchange (BSE).

TRACING THE PRINTS OF LISTED SECURITIES OF RESOLVED CDs UNDER THE CODE

IBBI published data regarding CIRPs yielding resolution plans as on June 30, 2022 counts that the total number of 517 CDs have been resolved since the enactment of the Code. On further study, it is found that out of 517 CDs, 91 CDs were PLCs. Of these 91 PLCs including one financial service provider (FSP) i.e., DHFL, which entered the resolution process under the Code and resolved, 45 CDs have continued to be listed (in short 'PLCs-listed') post resolution under the IBC regime and the remaining 45 CDs resolved as unlisted (in short 'PLCs-unlisted'). Thus, under IBC 50% of the PLCs which have been resolved continued to be listed companies. The same has been presented under Figure 1 and Figure 2 provided below.

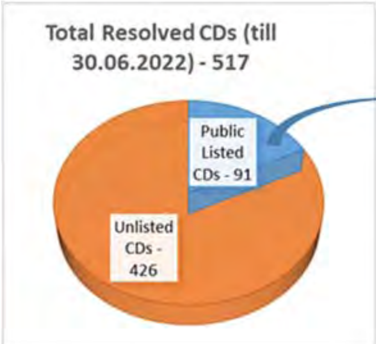


Fig.1

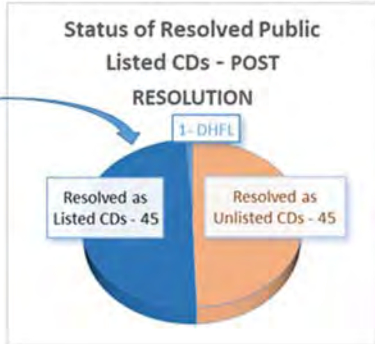


Fig.2

Source: *IBBI published data regarding CIRPs yielding resolution plans as on June 30, 2022, MCA Master data, CMIE, company information available at NSE and BSE, and resolution orders delivered by Hon'ble AA.*

The key benefit that PLC have is their capacity to access the financial markets by selling or issuing securities to raise capital for new projects and expansion. For analyzing potential investments, market capitalization (market cap) reflects the price investors are prepared to pay for a company's stock, gauges how much a business is worth on the open market as well as how the market views its prospects for the future. The total market cap of a company's outstanding shares is determined by multiplying the total number of shares in a corporation by the share's current market value. The 45 PLCs-listed have been studied in terms of the market cap of the CD i.e., the value of the CD traded on the stock market, assessing in time series split into pre- and post-CIRP of the CD at intervals of one year. Market cap has been studied for pre-CIRP period i.e., three years prior to the date of admission of the CD into CIRP, on the date of admission of the CD into CIRP, during CIRP, date of resolution and post-resolution i.e., three years from date of resolution. Market cap has been captured to study how the stock market values these distressed resolved CDs under the IBC.

	PRE CIRP-3	PRE CIRP-2	PRE CIRP-1	Admission	CIRP	Resolution	POST CIRP -1	POST CIRP -2	POST CIRP -3
Total 45 PLCs resolved listed	24,059	15,354	9,480	5,360	3,530	7,884	30,595	52,218	69,645
21 PLCs (resolved till 31.03.2020)	15,826	7,043	4,444	4,192	2,980	5,991	24,249	49,689	69,645
8 PLCs (01.04.2020- 31.03.2021)	262	469	599	227	80	150	2,421	2,530	
16 PLCs (01.04.2021- 31.06.2022)	7,971	7,843	4,436	942	470	1,742	3,924		

Fig. 3

The graph of the market cap shown above in Fig. 3 indicates the upward trend from the date of resolution to the post-resolution of 45 PLCs under the IBC. The market cap stretched from around ₹ 7,800 crore to ₹ 69,600 crore posing an increase of over seven times from the date of resolution to the third year of post-resolution. Whereas, three years prior to admission witnessed a downward trend from ₹ 24,000 crore dropped to around ₹ 5,300 crore on the date of admission. This could be attributed due to various factors such as weak financial performance, product failures, burdened financial cost, failure of expansion strategies, sectorial depression, etc. During CIRP (date between admission and resolution), uncertainties about revival further worsened the investor's confidence, and the market cap lands at around ₹ 3,500 crore. However, the noteworthy is positive investor's sentiment on resolution and post-resolution. The graph shows an upward trend with a significant increment of around tenfold from the year of the resolution, which goes on increasing on a year-on-year basis. Increases in market capitalization is a sign that investors are upbeat about a company's prospects for the future, and they are placing a higher value on the resolved corporation. In this analysis, it is considered required that the trends are also observed excluding Ruchi Soya with an approximate 8000% price increase post-resolution, which might be considered as an outlier. The same has been depicted in Fig. 4 below:

Fig. 4

Post excluding Ruchi Soya, the trends of resulting 44 CDs also show an upward moving trend post-resolution with a slight downfall in first year post resolution and hitting around ₹ 28,500 crore in third year of post-CIRP. In conclusion, resolved CDs stocks have upward-moving prices and better liquidity to gauge the value of listed stocks. Indubitably, the momentous upward-moving market cap could be seen as one of the leading milestones measuring the extraordinary outcome of the IBC. However, it's critical to note that market cap should only be one factor among several that should be considered when evaluating a company's current and future prospects. To summarize, the PLCs resolved by the CoC in its commercial wisdom along with the approval of AA, have gained the tremendous confidence of stakeholders over period of three years post-resolution. Though there are various other metrics to evaluate PLCs, the market cap does depict an estimate measuring the size of the company taking into account its risk/reward profile.

Similar to market cap, the income from operations, PBDITA and PAT has been studied during the pre-CIRP, on admission, resolution, and post-CIR period. To study trends for three years post-resolution, only those PLCs which have been resolved with listed status (in short 'PLCs-listed') till March 31, 2020 (availability of quarterly reports) i.e., 21 and PLCs that resolved as unlisted (in short 'PLCs-unlisted') till March 31, 2019 i.e., 9, have been taken. For these 30 PLCs (21 PLCs-listed and 9 PLCs-unlisted), the indicators such as sales, PBDITA, PAT, and employment have been bifurcated at intervals of one year for the period three years prior to the date of admission (Pre-CIRP), date of admission, date of the resolution and three years post-resolution (Post-CIRP). In view of annual financial statements, the data has been collected based on the date falling in a particular financial year. However, for the year 2023, data is taken from available quarterly financial statements. Due to unavailability of data for the last quarter March, 2023 and figures from corresponding last March, 2022 have been used without marking up of growth percentage, keeping in view the conservative approach. Thereby, the trends of pre-CIRP and post-CIRP income from operations (sales), PBDITA and PAT are portrayed in the Fig. 5 below:

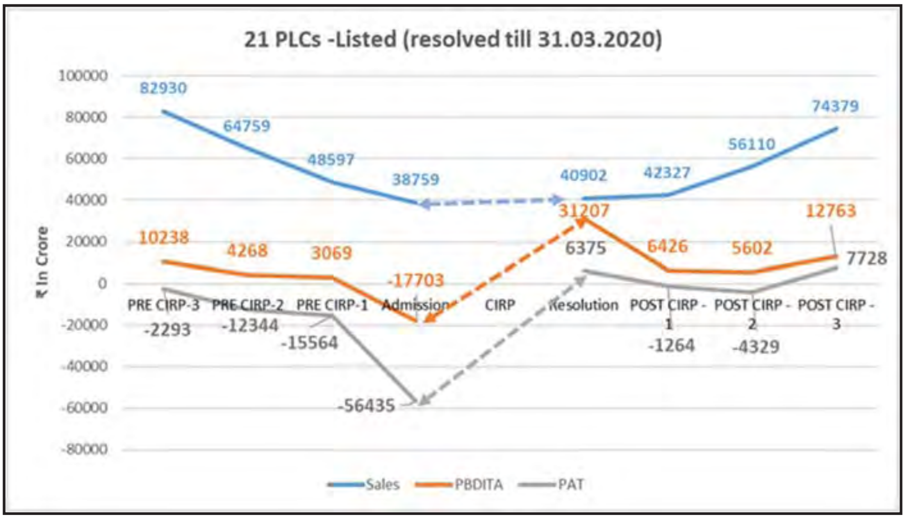


Fig. 5

In 21 resolved PLCs-listed (*Ref.: Fig. 5 above*), revenue from operations/sales is around ₹ 74,300 crore in third FY of post-resolution from around ₹ 38,700 crore in the FY of admission and ₹ 82,900 crore in the three FY prior to admission. The above graph depicts how income from operations which were around ₹ 82,000 crore in three years prior to date of admission, had been declining by around 22%, 25% and 20% year on year. But post-resolution, it shows an increasing trend. Since inflation has not been factored in figures, it appears that the annual increase in income from operations would be with a slow pace. It may be deduced that distressed companies need some gestation period to perform full-fledged. Nevertheless, the income of around ₹ 74,300 crore is a significant contribution to GDP, post-resolution of distressed CDs.

Similarly, the PAT and PBDITA were studied and depicted V-shaped trends. PAT of PLCs portray declining trend year on year with negative figures prior to the year of admission. It would be appropriate to remark that a downward trend with increasing negative PAT signifies the continuing distressed condition of the CDs. The negative PAT of around ₹ 2,200 crore in the third FY prior to admission has declined further to a negative PAT of around ₹ 56,000 crore in the FY of admission and converted into a positive PAT of around ₹ 7,700 crore post-third year of resolution. Post-resolution, PBDITA is increasing year-on-year basis and showing around ₹ 12,700 crore in the third FY. Eye-catching figures are highly negative profits in the FY of admission and positive in the FY of resolution. To comprehend such outcomes, it is observed that impairment of assets based on an assessment made by registered valuers and projections of future cash flows accounted in the current financial statements of the year of admission or during the CIRP. Such amounts are recognized as an impairment loss which is recorded as an expense in the profit or loss account. On the contrary, in the year of approval of resolution plan, liabilities including the loan's principal and interest component had been written off into the financial statement in terms of haircuts accepted by the lenders and creditor. Thereby, profit and loss account is credited with these write offs under exceptional items resulting in exceptional profits in the year of resolution. Post-resolution, the resolved CDs strive to revive with downward trend of negative profits and later in third year, PAT turned positive. A positive after-tax profit margin typically denotes that a business operates profitably taking into account of leverage and giving shareholders more value.

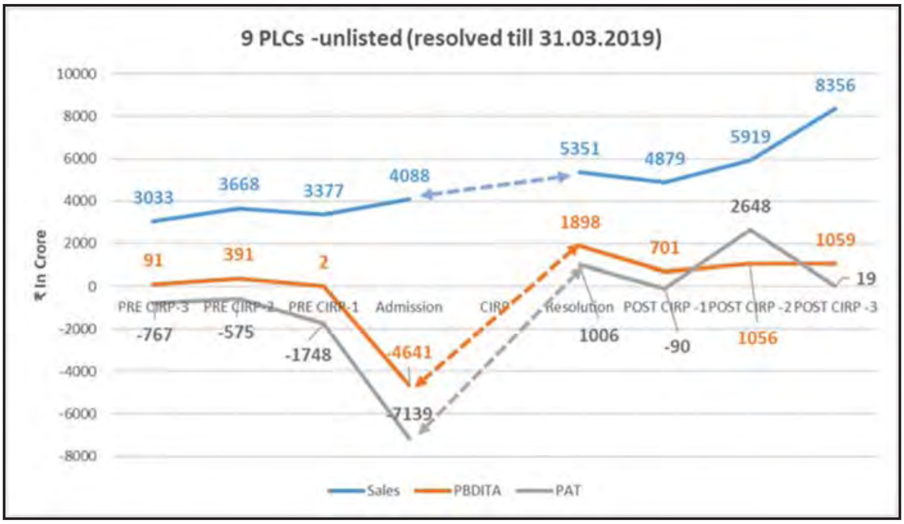


Fig. 6

As shown in Fig. 6 above, the sales, PAT, and PBDITA in the third FY of post-resolution of 9 PLCs-unlisted depict sales around ₹ 8,300 crore with an increase of 175%, PBDITA of around ₹ 1,000 crore with an increment of 10 times and positive PAT of around ₹ 19 crore from negative PAT of around ₹ 700 crore as compared to third FY prior to admission. Overall, 30 PLCs (21 PLCs-listed and 9 PLCs-unlisted) resolved under IBC have contributed to the GDP in terms of revenue to the tune of ₹ 82,000 crore with positive PBIDTA of ₹ 13,800 crore and PAT of ₹ 7,700 crore post-resolution of three years as shown below in Fig. 7 below:

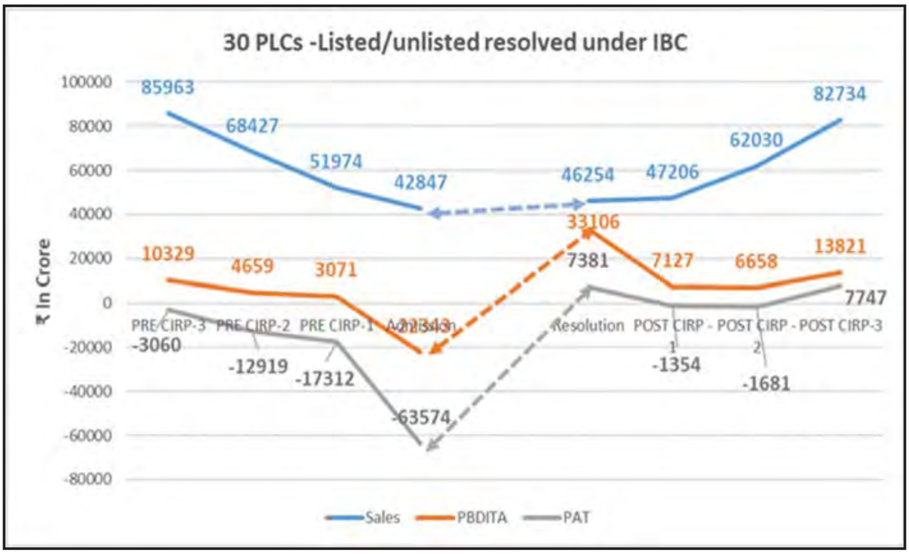


Fig. 7

In addition to foregoing findings, this research has also studied the employment preserved/generated as on March 31, 2022 of 19 resolved public listed CDs under IBC for which data was available. Number of employees in 19 PLCs-listed post-resolution portray the increase of 100%, employing around 86000 workforces as shown below in Fig 8.

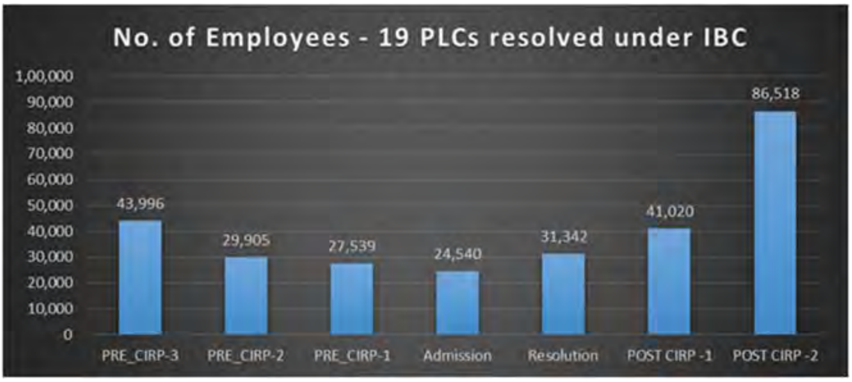


Fig. 8

Furthermore, trends of sales, PBDITA and PAT of resolved PLCs-Listed and resolved PLCs-unlisted have also been studied, subject to availability of data, as shown below:

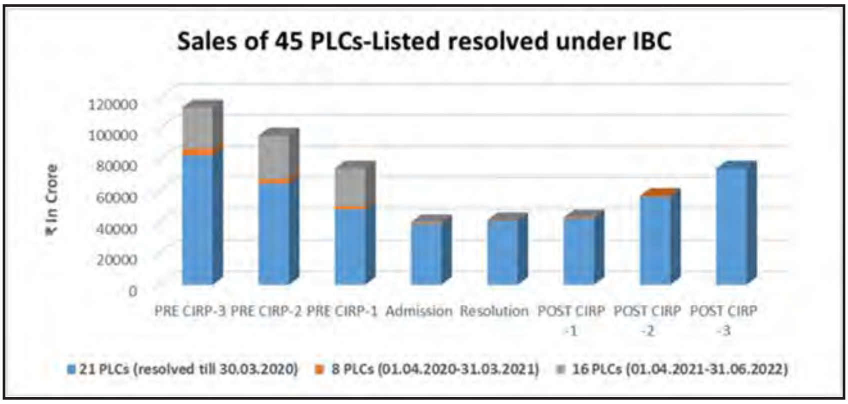


Fig. 9

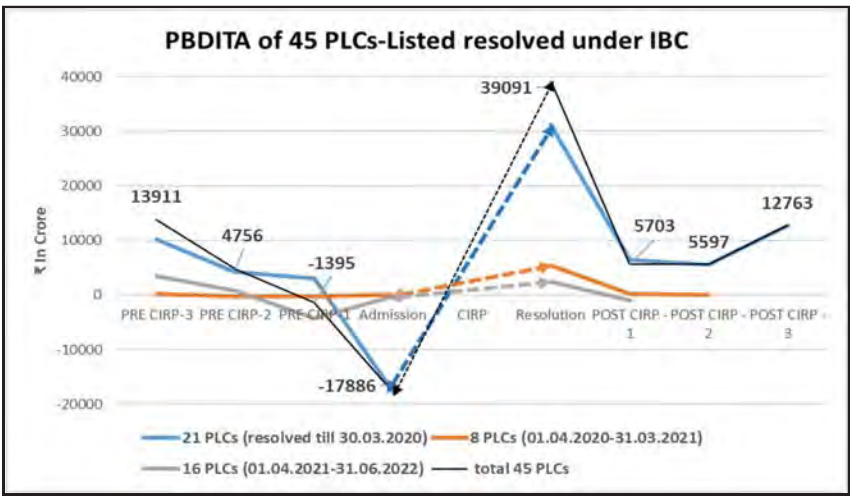


Fig. 10

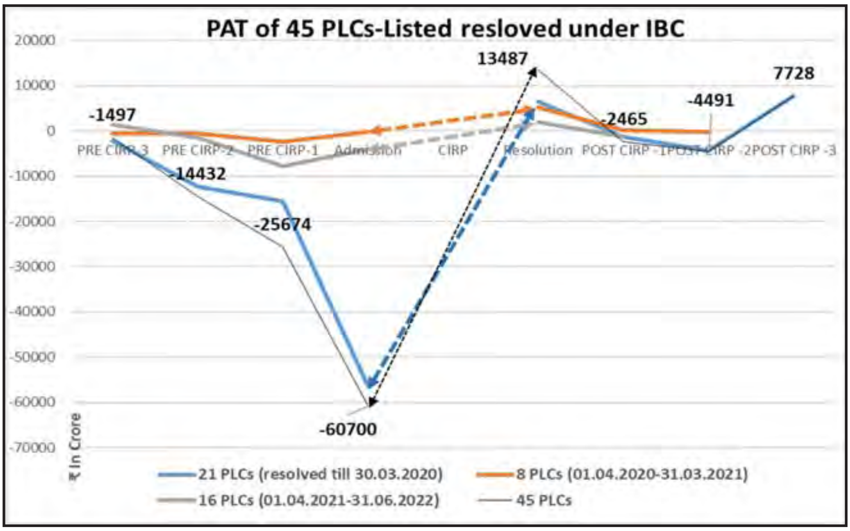


Fig. 11

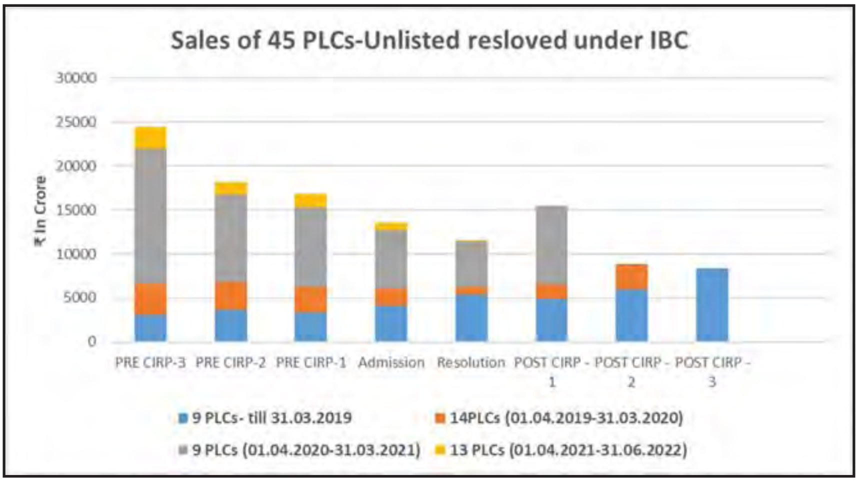


Fig. 12

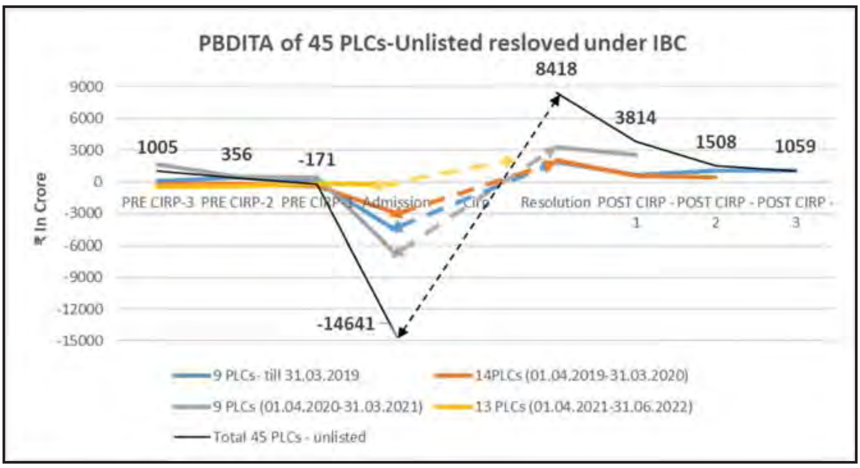


Fig. 13

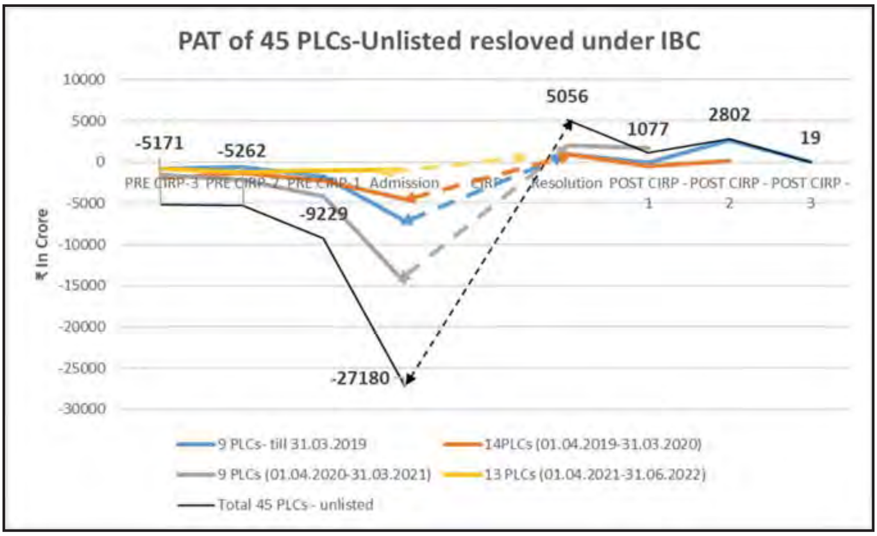
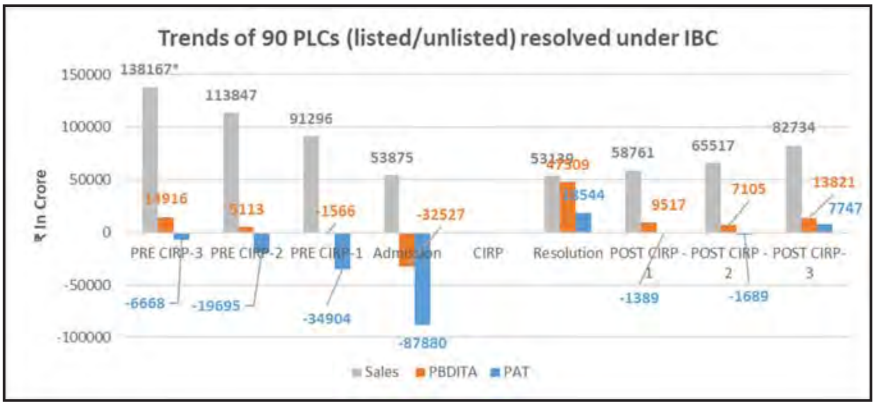


Fig. 14



(*Includes Jet Airways with around Rs.21000 cr. and other CDs resolved in 2022 that yet to be operational)

Fig. 15

In nutshell, rescued distressed companies under IBC showcase a remarkable performance with growing sales, rising PBIDTA, positive PAT, preservation and creation of workforce, and staggering market cap. The spirit of IBC lives in the continuance of businesses. In view of the foregoing discussion, assessment of market cap, income from operations, PAT in pre- and post-CIRP period and employment indicates the splendid outcome of the IBC in terms of successful overhauling the distressed CDs through resolution.

CONTINUED LISTING OF SHARES AND TRADING DURING CIRP

The Code is a unique legislation that provides a framework for freedom to exit, and at the same time opportunity to continue the business as going concern through restructuring. The freedom to exit guides the design of the framework for the Code to facilitate right outcome for dealing with distressed companies, be it a resolution for viable companies or liquidation for unviable ones. The prime objective of the Code is resolving the CD in a time bound manner with maximization of value and serving its stakeholders in the best possible manner. In publicly listed CDs, these stakeholders *inter alia* include retail investors. To serve these retail investors during the CIRP, keeping in mind information symmetry in particular, the Code mandates IRP/RP to comply with all compliance requirements of the SEBI Listing Regulations. Though insolvency of publicly listed CDs requires additional compliance and cost, continuance of listing status supplements the CD in preserving its value through liquidity, marketability, shareholders' trust, additional dealing alternatives for restructuring, etc. Essentially, during CIRP, listing status nudges the IRP/RP to disseminate the information of the CD going through various stages resulting in timely disclosure to investors and better corporate practice. In addition, post-resolution, the continued listing status of the CD could facilitate the new management for raising capital for its expansion plans. Internationally, the insolvency laws of the UK, US, Singapore, and Hong Kong as discussed subsequently also provide for continued listing during the reorganisation process. To sum up, weighing the listing benefits, in particular the going concern value and future prospects for capital over the additional compliance cost, the listing status of shares of the publicly listed CDs undergoing CIRP have been maintained contributing in maximizing its value.

These listed company shares are freely traded in dematerialized form. Unfortunately, initiation of CIRP against the listed CD almost always means an investor losing its investment. The debts are prioritized in sequence for payment and the last in a queue are shareholders. Trading in the securities of a listed firm during its CIRP is not expressly prohibited under the IBC or the SEBI Regulations. In a discussion paper[5] titled 'Compliance with SEBI Regulations by Listed Entities undergoing Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code, 2016' published in May, 2018, the SEBI sought comments on whether it is desirable to introduce trading restrictions on the stock exchange in order to limit the transferability of shares of listed CD. It expressed its position on the trading of shares that in addition to determining the risk-reward trade-off, an investor should consider the investment's liquidity while assessing equity investments. One of the key components of the securities market is a robust and trustworthy secondary market for the buying and sale of shares. Therefore, it would be in investors' best interests for trade to continue in the scrip of a listed CD because it would improve price discovery and transparency. However, these businesses would need to adhere to the exchanges' listing requirements in order for trade to continue on stock exchanges.

International Practice: In US, the stock of companies that file for bankruptcy under Chapter 11 of the Bankruptcy Code continue traded on Stock Exchange.[6] However, the companies under Chapter 11 find themselves unable to continue meeting the listing requirements to trade on NASDAQ or the New York Stock Exchange due to strict norms like trading at the minimum price, financial reporting, etc. and subsequently lead to delisting. Nevertheless, their shares may continue to trade on the OTC or the Pink Sheets even after it is delisted from one of these significant stock exchanges. Thus, trading of securities of corporations that are bankrupt is not forbidden under US federal law. A ticker 'Q' is added to the stock symbol to signify that the company is under bankruptcy. In 2018, Sears Holdings filed for bankruptcy and NASDAQ delisted Sears, and it then traded with the ticker (OTC: SHLDQ). The US Securities and Exchange Commission[7] has advocated the investor by warning them that when purchasing common stock from corporations filing for Chapter 11 bankruptcy, investors should exercise caution, as it is quite dangerous and probably will result in financial loss. Even though a business may survive bankruptcy, in most cases the new owners of the shares are the bondholders and creditors. The majority of the time, the company's restructuring plan will cancel the current equity shares, because secured and unsecured creditors are paid from the company's assets before the common stockholder. Furthermore, when owners do take part in the scheme, their shares typically experience significant dilution.

In UK, the Financial Conduct Authority (FCA)[8] i.e., regulator of the financial services industry may suspend trading if the smooth operation of the market is temporarily jeopardised or it is necessary to protect investors. Rule 5.1 of the Listing Rules provides as to when the FCA may suspend listing as the 'Appointment of Administrators, receivers, or winding up'. Notably, even if the FCA affects such suspension, the company is still required to comply with the Listing Rules; this places an additional burden on the Liquidator and the Administrator given their roles in the respective proceedings. Furthermore, in the event of a suspension, the company's listing may be restored at the discretion of the FCA. Such a restoration is contingent on the FCA's satisfaction that the suspension does not jeopardise market stability or investor protection, and such a decision can be made on a request by the company or on the FCA's own initiative. The FCA may also cancel a company's listing if it has been suspended for more than six months. This is not automatic, and the FCA retains discretion in this matter. However, it is pertinent to note that after the listing is canceled by the FCA, a company can only be admitted to the stock exchange by reapplying for their listing.

In Singapore, the Singapore Stock Exchange (SGX), in accordance with the SGX Mainboard Rules (SGX Rules), regulates the listing and trading procedures that must be adhered to by a listed company under Chapter 13[9] titled 'Trading Halt, Suspension, and Delisting'. According to Rule 1303 of the SGX Rules, the SGX may suspend trading in listed securities if an application to place the company under judicial management. Pursuant to this suspension, a company has the option to remedy it under Rule 1304 of the SGX Rules. Under this Rule, the suspension can be lifted by: first, submitting a resumption proposal within 12 months of the date of suspension and then, second, implementing the proposal within six months. If either of these two requirements is not met, the SGX may remove the issuer from the official list, i.e., delist it from the SGX. In Hong Kong, Rules 6.01[10] of the Rules Governing the Listing of Securities on The Stock Exchange (the Listing Rules) under Chapter 6 titled 'Trading halt, Suspension, Cancellation and Withdrawal of Listing' governs trading and the listing status. It provides that the Stock Exchange may suspend or cancel the listing of any securities when it determines that (a) not enough securities are held by the public; (b) the firm does not have enough assets or operations to support its ongoing listing; or (c) the business is no longer appropriate for listing. Rule 13.24[11] requires an issuer to maintain a sufficient level of activities or to have tangible assets of sufficient worth or intangible assets with a sufficient prospective value to justify the continuous listing of the issuer's securities on the Exchange. Companies that are unable to comply with Rule 13.24 have the following characteristics: (a) financial difficulties that seriously impair an issuer's ability to continue its business or have resulted in the suspension of some or all of its operations; and/or (b) Companies with net liabilities as of their balance sheet date, i.e., whose liabilities exceed their assets. In Hong Kong, there is no formal restructuring procedure. The Companies Ordinance provides for a court-sanctioned scheme of arrangement entered into by a company with its creditors or members, or both, and for companies' amalgamation. Provisional liquidators can be appointed to protect assets between the date the petition is filed and the date an order is anticipated to be issued. Provisional liquidators are also frequently appointed to facilitate a restructuring proposal that is being negotiated between creditors and the Company. When a publicly traded firm is placed in provisional liquidation, the Stock Exchange initiates a delisting procedure and suspends trading in its shares. A listed business subject to provisional liquidation has 18 months to submit a feasible resumption plan to the Stock Exchange to demonstrate it has adequate assets and operations for listing status. Listing status is considered a valuable asset and investors are often ready to pay premiums for distressed listed companies as the listed vehicle can be utilised as a platform to gain access to foreign financial markets and to enable inbound and outbound investments. In Australia, section 437F[12] under Part 5 of the Corporations Act, 2001 provides that unless the voluntary administrator consents in writing or the court grants permission, a transfer of shares in a corporation or modification of the status of shareholders during a voluntary administration will not be effective. The transfer of shares or changing the status of shareholders must be in the best interest of the company overall and must not violate any other provisions of the Corporations Act that deal with shareholder rights. This must be proven to the voluntary administrator or the court. The voluntary administrator has the right to establish requirements that must be met before approving in writing a transfer of stock in a company or a change in the status of a shareholder. The court may grant an application to waive any or all of these terms in the case of a transfer of shares by the present shareholder, the prospective shareholder, or a creditor. Similarly, a shareholder or creditor may ask the court to overturn any or all requirements that must be met for a status change to take effect. If the voluntary administrator rejects the change, a shareholder or creditor may also ask the court to grant permission for the status of shareholders to be altered.

In this regard, it is important to pay heed to the fact that when a firm goes through CIRP, invariably, the liquidation value that belongs to shareholders would be nil, and as a result, shareholders would not receive any exit price at all. The CD's shareholders' sales transactions cannot be viewed as impairing the CD's assets. The depository is responsible for recording share transfers and RP are not burdened to authorize such transactions. Most importantly, trading of shares on stock exchanges during CIRP provides exit mechanism to the minority shareholders that have no significant/adverse impact on the process. Additionally, continued trade would help enterprises participating in CIRP to keep and preserve their status as an ongoing concern. The foregoing discussion suggests that trading in the secondary market during the CIRP not to be tampered with. However, to protect the interest of the retail investor, stock exchange can exercise its right to suspend the trading due to non-compliance, inaccuracy of public information, potential market manipulation, insider trading, etc. The same may not be restricted under the moratorium announced under section 14 of the Code. The sale of a sizable portion of the promoter/promoter groups' shareholdings could qualify as a change in the ownership interest of the CD and would undoubtedly constitute as a disposal of shares by the CD's shareholder. A restriction on the transfer of shares by the CD's promoters can be found in the loan/security creation documents between the CD and its lenders, where the mandatory covenants accepted by the CD's promoters/guarantors typically contain a restriction on transfer of the shares without the lender's prior consent. Therefore, any further restrictions by law may not be required.

ROLE AND RESPONSIBILITIES OF IRP/RP

The companies listed on the stock exchanges are mandated to adhere to the quarterly, half-yearly, annual, event-based and general compliances of SEBI Regulations. Regulation 30 of the SEBI Listing Regulations mandates the listed company to notify stock exchanges of all material events or information as soon as reasonably possible and no later than twenty-four hours after the event or information occur. Initiating the CIRP against publicly listed companies would tend to have a fundamental change in the management and control of a listed firm, so it was deemed necessary to revise the various SEBI Regulations to prevent information asymmetry and protect the interest of investor. On March 28, 2018, SEBI released a discussion paper with suggestions for changing some SEBI Regulations keeping in view of CIRP under the IBC. Pursuant to the aforesaid discussion paper, SEBI Listing Regulations were amended specifying the list of activities to be performed at the time of initiation of CIRP against the publicly listed companies. Regulation 30 of SEBI Listing Regulations, Para A of Part A under Schedule III provides for events or information occurrences in connection with CIRP of the listed company under the IBC, must disclose without using the criteria for materiality outlined in sub-regulation (4) of the regulation (30):

(a) A corporate applicant filing an application for initiation of CIRP that includes the amount of default;

(b) A financial creditor (FC) filing an application for initiation of CIRP against a listed CD including specifying the amount of default;

(c) Admission, rejection or withdrawal of CIRP application, if any.

When insolvency is triggered against the CDs under the IBC, the prime objective is to resolve the feasible and viable units. The creditor-in-control model under the IBC and takeover by new management necessitated amending SEBI Regulations in the case of listed companies to ensure transparency, fair disclosure to investors, and compliance with due process. SEBI vide notifications dated May 31, 2018 effective from June 1, 2018, amended its four regulations namely SEBI Listing Regulations, the SEBI (Delisting of Equity Shares) Regulations, 2009 (SEBI Delisting Regulations), and the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 (SEBI ICDR

Regulations) and the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SEBI Takeover Regulations). Prior to such amendment, in 2017, SEBI amended the SEBI ICDR Regulations to facilitate resolution under the IBC. The changes made in these regulations are discussed subsequently under the Administration of CIRP and Requirements for resolution plan.

1. Administration of CIRP

Post admission of CIRP of the CD, Para A of Part A of Regulation 30 of SEBI Listing Regulations for disclosure of events or information in connection with CIRP of listed company under the IBC and Part B of Regulation 51(2) of SEBI Listing Regulations for disclosure of information having bearing on performance/operations of listed entities/ price sensitive information provided under Schedule III, mandates the IRP/RP to comply with the following:

(a) Admission of the CIRP application by the AA and the amount of any defaults

(b) Public announcement made in accordance with an order issued by the AA under section 13 of the Code

(c) A list of creditors as required to be displayed by the CD under Regulation 13(2)(c) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016

(d) The appointment or replacement of the RP

(e) Prior or post-facto notice and intimation of CoC meetings

Regulation 15(2A) of SEBI Listing Regulations clarifies that Regulation 17 which provides for the constitution of the Board of Directors shall not be applicable for a listed company undergoing CIRP under the IBC and the role and responsibilities of the Board of Directors shall be performed by IRP/ RP. Further, Regulation 15(2B) elucidates the non-applicability of provision for an Audit Committee under Regulation 18, a Nomination and Remuneration Committee under Regulation 19, a Stakeholders Responsibility Committee under Regulation 20, and a Risk Management Committee under Regulation 21 for the listed company undergoing CIRP and cast the role and responsibilities provided in aforesaid regulations on IRP/RP.

Quarterly, Half-yearly, Annual and Event based Compliances

RP has to comply with Regulation 33 of SEBI Listing Regulations which provides for reporting of financial results and auditor's report within 60 days of the end of the fiscal year, or unaudited quarterly results must be submitted within 45 days of the end of each quarter. Further, corporate governance reports must be submitted within 21 days of the end of each quarter under Regulation 27(2) and shareholding patterns must be submitted within 21 days after the end of each quarter. A compliance certificate and a certificate from a practicing company secretary must be submitted within a month of the end of each half-financial year and must be signed by the share transfer agent and compliance officer. In accordance with Regulation 24A, an Annual Secretarial Compliance Report must be submitted within 60 days of the end of the fiscal year with regard to compliance with SEBI Regulations, deviations, and actions taken thereunder. This list is not exhaustive. Event based compliance requirements also to be adhered to as per SEBI Regulations.

2. Further, RP is mandated to disclose certain information related to resolution plans such as:

(a) A summary of the invitation to submit resolution plans required by section 25(2)(h) of the Code in the form outlined in regulation 36A(5) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations);

(b) The number of resolution plans that he has received;

(c) The filing of approved resolution plan by the CoC with the AA

3. Post approval of the resolution plan, RP has to fulfill the following requirements as provided under the Regulation 30 of the SEBI Listing Regulations:

(a) The AA's approval or rejection, as appropriate, of the resolution plan;

(b) Specific features and details of the resolution plan as approved by the AA under the Code, not involving commercial secrets, including details such as:

i. Pre and post net worth of the company, details of the company's assets post CIRP along with the details of securities continuing to be imposed on the company's assets;

ii. Details of funds infused in the company, other significant liabilities placed on the company and additional liability on the incoming investors due to the transaction, source of such funding, etc.

iii. Detailed pre and post shareholding pattern assuming 100% conversion of convertible securities, the effect on the investor, including updated P/E and return on net worth (RONW) ratios;

iv. The names of the new promoters, important managerial personnel, if any, and their prior work history. If the promoters are corporations, information on the company's history and the names of the natural persons in charge;

v. A brief of the company's business plan. Any more pertinent information that doesn't include trade secrets.

vi. Proposed actions the incoming investor/acquirer would take to accomplish the MPS; Quarterly disclosure of the status of accomplishing the MPS. Specifics of any delisting plans, if any that were approved in the resolution plan.

RELAXATIONS FOR RESOLUTION PLANS

(a) Non-applicability of open offer: According to Regulation 3 of SEBI Takeover Regulations, the Regulator mandates that anyone acquiring shares in a listed firm that will increase its ownership to 25% or more must make an open offer. SEBI Takeover Amendments were amended in 2017, exempting from the requirements of regulations 3 and 4 of the Takeover Regulations regarding making an open offer for acquisitions made in accordance with a resolution plan under the IBC. This allows the resolution applicants significant flexibility to structure their resolution plans to acquire the listed CD undergoing CIRP.

(b) Public shareholding can be below 25%: Proviso to regulation 3(2)[13] of SEBI Takeover Regulations forbids an acquirer from acquiring or entering into an agreement to acquire shares or voting rights that would increase the aggregate shareholding resulting from the acquisition above the maximum permitted non-public shareholding, which is 75%. In 2018, SEBI Takeover Regulations were modified specifying that an acquisition of shares by an acquirer made in accordance with a resolution plan under section 31 of the IBC would be exempt from the requirement under regulation 3(2) of the Takeover Regulations. Now, a resolution plan may now stipulate that a resolution applicant seeking to acquire a publicly traded company that is subject to CIRP may acquire more than 75% of the company's share capital, bringing the public shareholders' shareholding down to below 25%. However, it further mandates to restore 25% public shareholding. In this regard, sub rule 5 of Rule 19A of Securities Contracts (Regulation) Rules, 1957[14] states that when a listed company's public shareholding falls below

25% due to the implementation of the resolution plan approved under section 31, the company must restore the public shareholding to 25% within a maximum of three years from the date of the fall, in the manner prescribed by the SEBI. With the caveat that, if public shareholding falls below 10%, it must be increased to at least 10% within a maximum of 12[15] months from the date of such decline. Furthermore, as a result of the resolution plan's adoption, every listed firm must continue to hold at least 5%[16] of its shares in the public.

(c) **Exemption for preferential issue of specified securities:** Preferential issue refers to the issuance of certain securities by a listed issuer to a particular individual or group of individuals on a private placement basis excluding the offering of certain securities through a qualified institutions placement, a public offering, a right offering, a bonus offering, an employee stock option plan, or the issuance of sweat equity shares etc. SEBI has also made it clear that these firms will not be required to follow the preferential issue rules for Specified Securities (Equity as well as convertible securities) apart from the lock-in restrictions set forth under the ICDR Regulations[17] for the issuance of securities, for the resolution plan approved under the IBC.

(d) **Related party transactions:** Regulation 23[18] of SEBI Listing Regulations excludes the prior approval of the Audit Committee of the listed company for all related party transactions and subsequent material modifications for the resolution plan approved under section 31 of the IBC provided that the event is revealed to the recognised stock exchanges within one day of the approval of the resolution plan.

(e) **Corporate governance requirements:** Since the shareholder's approval become redundant under IBC, Regulation 24(5)[19] and 24(6)[20] of SEBI Listing Regulations allows disposal of a majority shareholding to less than or equal to 50% in significant subsidiary or cessation of exercise of control over a subsidiary; and transfer or leasing of more than 20% of the assets of a significant subsidiary on an aggregate basis for a given fiscal year, respectively, without the shareholder approval requirements, for a resolution plan approved under the IBC. However, it is mandated that both these events should be disclosed to the recognised stock exchanges within one day of the resolution plan being approved.

(f) **Conditions for re-classification of any person as promoter/public:** Provisions of the Regulation 31A of SEBI Listing Regulations relating to promoter reclassification such as the prohibition on promoters having post-reclassification special rights will not apply if reclassification is contemplated under an IBC resolution plan and the promoter and promoter group being reclassified as public shareholders do not remain in control of the company. There could be due to section 29A of the IBC which controls any participation by the former promoters in an approved resolution plan.

(g) **Delisting of Shares:** The SEBI delisting procedures include minimum shareholder participation and approval requirements, in combination with the high exit prices found through the reverse book-building process. The SEBI amended the Delisting Regulations[21] in 2018 to exempt the delisting requirements for resolution plan approved under the IBC with conditions that a precise process has complied to successfully delist equity shares and the plan provides current public shareholders with an exit option at a price the current public owners an option to sell their shares priced outlined in the resolution plan. If it is proposed that the current promoters' shareholders be given the chance to leave the company under the resolution plan for an amount, then the delisting should take place at a price that is not less than the price at which such promoters or other shareholders, either directly or indirectly, are given the opportunity to leave the company. SEBI Delisting Regulations also mandate that within one day of the resolution plan's approval, the stock exchanges must be informed of the decision to delist an insolvent firm along with the justification for the exit price. However, it may be noted that after paying off debts in the order of priority as outlined in the IBC, the exit to shareholders should be at a price that is not less than the liquidation value as determined in accordance with section 35 of the CIRP Regulations. It is appropriate to say that SEBI's exemption of the delisting procedure for the resolution plan under IBC granted relief and flexibility to the resolution applicants by exploring more avenues for planning the resolution of the distressed CD.

(h) **Allowing delisting exemption subject to any mandatory offer to public shareholders:** In the event that listed companies are subject to insolvency proceedings, the SEBI has recommended a framework to protect the interests of public equity owners (minorities). In the discussion paper,[22] SEBI has suggested that after the CIRP is complete, public equity shareholders should have the opportunity to purchase shares of the newly constituted firm at the price offered to the successful resolution applicant (SRA). SEBI has suggested that public equity investors be offered the option to purchase a minimum of 5% and a maximum of 25% of the new firm. The offer that must be made to existing public shareholders will be 25%, and the minimum acceptance will be 5%, if a new acquirer's shareholding increases to 100% as a result of the CIRP. The resulting entity will be permitted to delist if there is no interest even for 5% of the shares. The proposal of the SEBI provides an opportunity for minority shareholders to participate in the resolution process of the listed companies on the same pricing terms as available to the resolution applicant up to 25% and restricts the exemption of delisting regulations currently provided to SRA. Family members of promoter group companies, trusts run by promoters, associate companies, key managerial personnel, and directors will not be eligible for the offer to buy shares of the resulting entity.

The SEBI proposal seeks to create rights for public equity shareholders in the post-resolution entity. Equity and debt are the two sources of finance for firms. It is the general principle of corporate law that equity shareholders are at the bottom of the pile, and they take risks. Hence, also known as 'Risk Capital'. The Bankruptcy Law Reforms Committee (BLRC)[23] which conceptualized the Code noted in its report that 'The limited liability company is a contract between equity and debt. As long as debt obligations are met, equity owners have complete control, and creditors have no say in how the business is run. When default takes place, control is supposed to transfer to the creditors; equity owners have no say'. It further while emphasising the importance of sound bankruptcy process noted that 'The equity value of the enterprise would be wiped out and the existing shareholders would lose control'. In addition to this UNCITRAL Legislative Guide on Insolvency Law[24] also noted that-

> Reorganisation, however, does not imply that all of the stakeholders must be wholly protected or that they should be restored to the financial or commercial position that would have obtained had the event of insolvency not occurred .....Management may be terminated and changed, the interests of equity holders may be reduced to nothing, employees may be retrenched and the source of a market for suppliers may disappear.

The proposal aims to restrict resolution choices including merger and demerger by removing the right to delist, in effect. The limitations would disincentive potential resolution applicants. A resolution applicant saves the distressed CD by creating a resolution plan. Making it necessary for the resolution applicant to provide the existing public equity shareholders (i.e., non-promoter public shareholders) with a minimum public shareholding percentage of 25% may act as a deterrent to the resolution applicant. As a result, the proposal may lead to less resolutions, which would be against the objective of the Code.

It may be noted that for the listed entities post-resolution, in June 2021[25] Ministry of Finance, in order to facilitate the resolution of distressed assets, notified that every listed business must continue to hold at least 5% of its shares in the public as a result of implementing the resolution plan that was approved in accordance with section 31 of the Code. Amendments were made in Rule 19A of the Securities Contracts (Regulation) Rules, 1957 against the standard norm of minimum public shareholding of 25%. This 5% has been further mandated to increase to 10% in twelve months and 25% in three years.

The trading of shares of publicly traded firms that are undergoing CIRP is not prohibited by the laws in effect at this time. As a result, this proposal may further boost speculative trading in the stocks of listed businesses that are undergoing CIRP, as investors may rush to buy shares at a discount in anticipation of an unexpected profit following the resolution plan's successful approval. Additionally, the promoters of the CD could sell a significant portion of their shares to retail investors or transfer them to some proxies through a sale. Currently, the resolution applicant has the option of delisting the CD, and even if it chooses to retain it on the stock exchange, it must maintain a 5% public shareholding. The proposal wants to raise this to 25% while eliminating the delisting option. This creates an imbalance as the resolution applicant carries out the necessary research, assumes risks, acquires credit at interest, and waits for the resolution plan to be approved. It goes against established standards to offer equity owners at the same rate. Further, delisting is a cumbersome process. Particularly when the rights of equity holders are determined as per the waterfall mechanism provided under section 53 of the Code, the priority of claims of creditors over equity makes the reverse book-building process unwarranted.

Section 30(2) of the Code provides for consideration of dues as per the waterfall mechanism under section 53, in which the equity shareholders come at last rank below FC, workmen, employees, Government, and operational creditors (OCs). Explanation to section 30(2) clarifies that 'if any approval of shareholders is required under the Companies Act, 2013 (18 of 2013) or any other law for the time being in force for the implementation of actions under the resolution plan, such approval shall be deemed to have been given and it shall not be a contravention of that Act or law'. Moreover, section 31 of the Code mandates that the resolution plan approved by the AA shall be binding on all the stakeholders including creditors and stakeholders.

A resolution plan has unlimited possibilities, including merger, demerger, amalgamation, and capital reductions, for this NOC from the stock exchanges is not necessitated. Schemes of arrangement that are in accordance with a resolution plan that has been approved by the NCLT and that have been disclosed to recognized stock exchanges within one day of the resolution plan's approval are exempt from the procedures and requirements outlined for similar transactions in regulations 37 of the SEBI Listing Regulations. The IBC is comprehensive legislation for insolvency and reorganisation. Hon'ble SC[26] held that the IBC is an exhaustive code on the subject matter of insolvency in relation to corporate entities and is complete in itself. Hence, creating rights for equity in lieu of minimum public shareholding above the other creditors like OCs, workmen, and government dues. Creating such rights above the present limit of 5% would disturb the waterfall mechanism under the Code, and restricts the alternatives to prospective resolution applicants by a mandatory offer to the public before opting to delist. This does not go in sync with the Code's prime objective i.e., resolution. Further, the proposal has also not been deliberated about the scenario where the successful resolution applicant failed to implement the plan. To promote the continued status of the listing, if the new management voluntarily opts to delist the securities of the CD, then a cooling-off period of three years as applied in other cases may be made applicable.

CONTINUE TRADING AND LISTING OF SHARES DURING LIQUIDATION

When all the possible efforts to revive the CD fail, the liquidation process is initiated against the CD. Under the Code, there is no direct commencement of the liquidation process. Liquidation happens when resolution fails. Thus, when every attempt has been made to resolve the CD as a going concern fails, liquidation is the last resort. As contemplated by the BLRC, when the resolution process is over and neither creditors nor debtors can come to an agreement to keep the entity operating, the entity enters liquidation. However, there is no explicit provision under the Code for the trading of shares during liquidation. While section 334 of the Companies Act, 2013[27] and corresponding section 536 of the erstwhile Companies Act, 1956 prohibit any transfer of shares after the commencement of the winding-up process unless ordered by Tribunal.

International Practice: The UK Insolvency Act, 1986[28] provision is akin to the Indian Companies Act which provides that unless the court specifically decrees differently, any disposal of the company's assets, transfer of shares, or change in the status of the company's members made after the winding upstart is void. Under Singapore Insolvency Restructuring and Dissolution Act 2018, section 130[29] prohibits dispositions of property made after the start of the winding-up process, including any transfers of stock in the firm that is being wound up. Any disposition of the company's assets, including items in motion, transfers of shares, or changes to the status of the company's members made after the Court started the winding-up process, are invalid unless the Court orders otherwise. In accordance with section 130,[30] the Court said that a company's position had to remain unchanged while the petition for winding up was being processed. One advantage of this is that the liquidator would have less work to do in order to assess the company's affairs, and it would be possible to examine these dispositions to make sure that no one would be adversely affected by the company's winding up, especially its creditor. In Hong Kong, when the company is insolvent and a winding-up petition is filed, the stock exchange suspends the trading of the shares. In Australia, shares of a company cannot be transferred or shareholders' status cannot be changed during liquidation without the liquidator's written consent or the court's approval.[31] The transfer of shares or changing the status of shareholders must be in the best interest of the company's creditors and must not violate shareholders' rights under the Corporations Act in order for the liquidator or court to approve.

Looking at the practice in India, it is observed that in standard operating procedure floated by NSE for the delisting of equity shares,[32] it is mentioned that corporations intended to be delisted forcibly are on the list of suspended companies that have been suspended for more than six months. The reason for suspension of trading may be on account of non-compliance with the SEBI Listing Regulations, or the initiation of liquidation proceedings against the company. It may be noted that delisting is the process of permanently removing a company's equity shares from the trading platform of a recognized stock exchange, either voluntarily or involuntarily. As a result, shares that have been delisted will no longer be traded on the stock exchanges. The SEBI, a market regulator, controls the process of delisting securities for any company. As per Regulation 24 of the SEBI Delisting Regulations, a corporation that has been compulsorily delisted from the exchanges must wait ten years before applying for relisting.

As per the IBBI data published on its website for CIRPs of the CD ending with order of liquidation as on June 30, 2022,[33] it is observed that 1703 companies have been ordered for liquidation, out of which 7 are LLP. Thus, the liquidation of 1696 companies has been commenced, and based on Company Identification Number (CIN), it is observed that of these 1696 CDs, 159 CDs are listed companies. NSE and BSE are suspending the trading and later on, delisting the securities of the CDs for which the liquidation process has commenced. However, it has been observed that there is a substantial time gap between the date of liquidation and the date of suspension of trading. For example, shares of Easun Reyrolle Limited (LCD dated February 17, 2022) and Punj Lloyd Ltd. (LCD dated May 27, 2022) were trading till October 6, 2022. Similarly, Neueon Towers Limited (LCD dated October 14, 2021) and Nitin Fire Protection Industries Limited (LCD dated January 18, 2022) continued trading[34] till January 5, 2022 and February 10, 2022 respectively. The trading of shares of listed CD namely Rainbow Denim Limited (LCD commenced on April 12, 2022), Sri Adhikari Brothers Television Ltd. (LCD dated December 16, 2021), and Gujarat Metallic Coal & Coke Ltd (LCD dated November 3, 2021) are still being continued despite the order of liquidation. In a nutshell, it would be appropriate to state that due to a lack of explicit provision, the suspending and thereafter delisting of shares during the liquidation is not being uniformly followed. Indian and foreign jurisdictions prohibit the trading of shares during winding-up process. Since there is no prospect for the revival of the CD post liquidation and it would end up with the dissolution of the company, it is in the interest of stakeholders that explicit provision may be made to deal with suspension of a trading post liquidation order and their rights pursuant to liquidation order.

CONCLUSION

The effective insolvency framework caters to the interest of all stakeholders and strives for a balance between their respective rights and interests. The association of the public at large in the insolvency of publicly listed companies necessitates transparency in the process. A plethora of compliances for distressed CDs needs to be contextualised for resolving the CDs in a time-bound manner. It cannot be denied that the value of the stock during insolvency floats at a negligible amount, if it is not zero. To ensure the efficacy of the insolvency structure with respect to serving shareholders**,** the legitimate expectations of the shareholders particularly timely and adequate information of the public listed CD under CIRP needs to be fulfilled.

From the foregoing discussion, it goes without saying that SEBI, the regulator of the capital and securities market has provided commendable support for restructuring insolvent companies under the Code. Non-applicability of pre-clearance requirements to the resolution plan approved under section 31 of the Code, waivers for strict norms of public shareholdings, a mechanism to continue listing, trading, and facility of delisting aided not only the RP to focus on revival and complete the process in a time-bound manner, but also the prospective resolution applicant with the freedom to acquire. The convenience of unrestricted possibilities enhances the desired outcome of revival. Further, there are some teething problems concerning the continued listing and trading of securities during CIRP and liquidation, which could be clarified for the smooth restructuring of the publicly listed companies. Need to mention that the active participation of the stock exchanges NSE and BSE by providing guidelines from time to time regarding disclosure requirements and the manner of its compliance, has assisted the IRP/RP to perform their duties.

Listing status is a valuable intangible asset of the company, which enables expansion plans through capital procurement from the public at large. Thus, preservation of listing status can benefit the creditors by yielding more value and the shareholders, even if the creditors are not fully satisfied. Trading of shares during CIRP provides an exit mechanism to small investors and at the same time these retail investors have the option to maintain status quo. Since a delisting exemption should not be put forth with conditions, suspension of trading would not only restrict the shareholder's opportunity to sell but may invariably result in nil value in case of resolution with delisting. The shareholders should be free to take a call and all the avenues must be available to deal with his securities at the time of distressed position of the CD. Necessity is to ensure full disclosures and information symmetry so that all material information necessary for making an informed decision is disseminated to the public at large. For an example: It is observed that NSE has issued press-release[35] about 'Manner of dealing with companies undergoing Corporate Insolvency' wherein it is stated that the securities must be identified and tagged by the exchange in a way that makes it clear to members and market participants that it is currently the subject of IBC proceedings. In line with US practice of adding a ticker 'Q', it will be in the interest of shareholders if listed securities code on NSE and BSE may also incorporate such mechanism to aware the investors about securities are under insolvency proceedings and trading in such shares can be risky and speculative investments. This can particularly help the investors in Tier 2 and Tier 3 cities in India, where updates of insolvency proceedings are not adequately known.

Further, a study of performance of the listed resolved entities post-implementation of the resolution plan, in terms of market cap, operations, earnings and employment illustrates the tangible outcome of the IBC socially and economically. Saving feasible and viable units, generating contribution to GDP, preserving value and employment, overcoming losses, and expanding indicates the potential of the IBC. An added observation that emerges out of this study is that resolution of a company under IBC encompasses a broader scope, with far-reaching objectives at the macroeconomic level. Such objectives include preserving viable entities, appraising the extant configuration of the CD with engaged resources against the cost of creating a new arrangement, safeguarding existing employment opportunities, contributing to the economy through sustained operations, exploring prospects for the expansion of new projects, and generating synergies via mergers, among others. Regrettably, these aspects are frequently overlooked by evaluators while assessing the efficacy of the IBC. It seems that the terms 'resolution' and 'recovery' have become entangled, causing confusion and misplaced expectations. IBC is not just a tool for recovering non-performing assets, but a long-term structural reform with far-reaching implications for our economy. The impact of reorganisation reaps over the years. The true essence of the IBC resides in the ongoing success and sustenance of these businesses.

[1] Circular No. IP/002/2018, IBBI, 3 January, 2018.

[2] Ins. by Act No. 26 of 2018, sec. 13 (ii) (w.e.f. 6 June, 2018).

[3] SEBI Discussion Paper (2018),"Compliance with SEBI Regulations by Listed Entities undergoing Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code, 2016", 28 May.

[4] Framework for protection of interest of public equity shareholders in case of listed companies undergoing Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code (IBC), Reports for Public Comments, SEBI, 10 November, 2022.

[5] Supra Note 3.

[6] Investor Publications, "Investor Publications Bankruptcy: What Happens When Public Companies Go Bankrupt", US Securities and Exchange Commission.

[7] Investor Bulletin, "Bankruptcy for a Public Company", US Securities and Exchange Commission.

[8] Rules 5.1.1 and 5.1.2 of Listing Rules (Suspending Listing).

[9] Part III Suspension of Trading, Chapter 13 Trading Halt, Suspension and Delisting, Mainboard Rules, SGX Rulebooks.

[10] Rule 6.01 "Chapter 6 Trading Halt, Suspension, Cancellation and Withdrawal of Listing", General, Main Board Listing Rules.

[11] Rule 13.24, "Chapter 13 Continuing Obligations", Equity Securities, Main Board Listing Rules.

[12] Section 437F, "Effect of administration on company's members", Corporations Act 2001 (Australia).

[13] Regulation 3(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (Takeover Regulations).

[14] Inserted by the Securities Contract (Regulation) (Amendment) Rules, 2018, w.e.f. 24.27.2018.

[15] Substituted for "eighteen" by the Securities Contracts (Regulation) (Amendment) Rules, 2021, w.e.f. 18 June, 2021.

[16] Inserted by the Securities Contracts (Regulation) (Amendment) Rules, 2021, w.e.f. 18 June, 2021 vide Notification No. G.S.R. 423(E) dated 18.06.2021.

[17] Chapter V of the SEBI (Issuer of Capital and Disclosure) Requirements, 2018 (ICDR Regulations), Regulation 158.

[18] Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2021 w.e.f. 7 September, 2021.

[19] Inserted by SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2018, w.e.f. 31 May, 2018.

[20] *Ibid*.

[21] Regulation 3 of Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021.

[22] Supra Note 4.

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

[24] Legislative Guide on Insolvency Law, United Nations Commission on International Trade Law, para 25.

[25] Ministry of Finance (Department of Economic Affairs) vide Notification No. G.S.R. 423(E), 18 June, 2021.

[26] In the matter of *Innoventive Industries Ltd. vs. ICICI Bank & Anr.* Civil Appeal Nos.8337-8338 of 2017, 31 August, 2017.

[27] Section 334, "Transfers, etc., after commencement of winding up to be void", The Companies Act, 2013 states that "In the case of a winding up by the Tribunal, any disposition of the property including actionable claims, of the company and any transfer of shares in the company or alteration in the status of its members , made after the commencement of the winding up shall, unless the Tribunal otherwise orders, be void."

[28] Section 127, "Avoidance of property dispositions, etc", The UK Insolvency Act, 1986 states that "In a winding up by the court, any disposition of the company's property, and any transfer of shares, or alteration in the status of the company's members, made after the commencement of the winding up is, unless the court otherwise orders, void."

[29] Section 130, "Avoidance of dispositions of property and certain attachments, etc.", Insolvency, Restructuring and Dissolution Act 2018 states that "Any disposition of the property of the company, including things in action, and any transfer of shares or alteration in the status of the members of the company, made after the commencement of the winding up by the Court is, unless the Court otherwise orders, void."

[30] Allen and Overy (2022), "High Court suggests that it should lean in favour of not granting approval for the transfer of shares where the shares are of an insolvent company", 7 October.

[31] Information Sheet 43 (INFO 43), Australian Securities and Investments Commission.

[32] SOP For Delisting of Equity Shares, National Stock Exchange of India.

[33] Corporate Insolvency Resolution Processes Ending with Order of Liquidation: as on 30 June, 2022, IBBI.

[34] For status of continued trading, money control website is used.

[35] Press release, "Manner of dealing with companies undergoing Corporate Insolvency", NSE, 9 July, 2021.

2 ANALYSING THE INSOLVENCY RESOLUTION MECHANISM FOR THE REAL ESTATE SECTOR IN INDIA: NEED FOR A 'CONCRETE' FRAMEWORK?

- Alankrita Pathak and Jay Shah

EXECUTIVE SUMMARY

The unique circumstances surrounding insolvency engagements involving real estate companies are complex and dynamic from others, particularly due to the intricate group structure of the corporate debtor (CD), the committee of creditors (CoC), which is made up of thousands of homebuyers, and the interaction of other statutory regulations like the Real Estate Regulatory Authority (RERA) and other state authorities. So, one of the primary reasons why the authors feel the need to advocate for a separate framework is because the real estate sector is one of the most capital-heavy industries', if it falters, the economy can get greatly affected. It is clearly visible that the Insolvency and Bankruptcy Code, 2016 (IBC/Code) still does not offer a workable answer or a comprehensive strategy for protecting homebuyers. The paper aims to analyse the same and for that purpose, the paper is divided into seven parts. It first lays out the current context with regards to insolvency, pandemic and India. Next part is a descriptive one providing a brief overview of the process under the IBC. The paper then moves on to discuss the application of the same in the real-estate sector and problems that arise therein. A background of the relevant legislations of other nations is thereafter provided which forms a basis for drawing inferences in the later part of the paper. It then presents a workable suggested model for the sector, the application and importance of which is highlighted through the Evergrande case study.

Keywords: Real Estate, Insolvency, Evergrande, Homebuyers, Time-value.

INTRODUCTION

On March 25, 2022, Supertech, one of the biggest real estate developers in the New Delhi-NCR region, was declared insolvent, shocking the industry. The order was given as a result of a request made by the Union Bank of India and a group of 100 homebuyers to the National Company Law Tribunal (NCLT).[1]

The large-scale real estate developer had neglected to pay Union Bank ₹ 4.3 billion it owed for the creation of the firm's Eco Village II project in Greater Noida. Out of the 38041 apartments that were built as part of the project, 27111 were delivered to customers at a total cost of ₹ 11 billion.

The homeowners were in a pickle because they were required to pay a pre-equated monthly instalment before receiving the apartments and were under pressure to do so because they had borrowed money. If they didn't, they risked facing severe penalties. It becomes important to mention that as of June of 2022, the Government reported that 1999 corporate insolvency resolution cases were active under the insolvency statute. The IBC, which allows for resolution through a market-driven procedure, governs how CDs are resolved.

Hon'ble Minister Inderjit Singh stated in a written response to the Lok Sabha on Monday said that the timeframe of the corporate insolvency resolution process (CIRP) is dependent on a number of variables, including the nature of the organization, economic cycles, market attitudes, and marketing activity. *'Only 436 of the 1999 CIRPs that are still active as of June 30, 2022, are in the real estate* *industry. There has been a widespread downturn in the distressed asset market during the COVID-19 pandemic'*, added the Minister.[2]

The pandemic has been described as an event having a more negative impact than the financial breakdown of the Great Recession in 2007–2009 due to enterprises, corporations, and firms experiencing unprecedented problems.[3] A number of economic, political, and social upheavals have undoubtedly been brought on by the coronavirus pandemic.

Federal governments have made considerable adjustments to legislation and policy in an effort to combat the virus's onslaught. India in particular has been among the nations most severely impacted by the outbreak. The Indian Government concentrated on minimizing the negative economic impact through fiscal stimulus, monetary policy, and special programs geared towards a certain demographic or industry after treating the urgent health issues brought on by the pandemic.[4] Such initiatives have only received a tepid reaction from the relevant parties due to the significant amount of uncertainty associated with it.

The role of IBC in enabling credit distribution, restoring lender trust, giving debtors a practical escape path, and gauging an economy's general financial health is crucial.[5] As businesses experience many challenges across all fronts during a recession, it takes heightened relevance and calls for a workable and long-lasting resolution structure. The Code has successfully countered the growing threat of non-performing assets (NPAs) and enhanced credit discipline within firms, proving to be a transformative move for the Indian economic system. The COVID-19, however, has abruptly stopped the motors of the world economy. The pandemic has affected India in a similar manner to other countries. After the shutdown in 2020, the first quarter (Q1) of 2021 saw a historic 23.9% decline in GDP.[6] The already troubled real estate market has been put under a lot of strain since the arrival of the global pandemic COVID-19. A quick glance at the facts reveals that they do not support the success of Code, especially when it comes to the real estate industry.

Despite the fact that significant firms in the real estate industry have been involved in insolvency procedures, most recently the Supertech Group, the path under the Code has not been the most successful in this area.[7] While there is a good chance that an insolvency will be resolved, compared to cases where the CIRP procedure has been successfully completed, more businesses have been forced into liquidation and ultimately died as a result of failing to follow the legal deadlines.

THE EXISTING INSOLVENCY FRAMEWORK IN INDIA

The IBC aimed to incorporate the failings of the earlier numerous and fragmented resolution frameworks with the best practices adopted internationally and used by leading jurisdictions. This was further explained in the Report of the Bankruptcy Law Reforms Committee (BLRC).[8] This committee was established to conduct a thorough review of the proposed insolvency legislation, which would ultimately become the IBC.

In order to make the contemporary analysis in the following sections of the article easier to understand, this section tries to analyse the legislative framework of the IBC. The Insolvency and Bankruptcy Board of India (IBBI) was founded under the Code, and it acts as both a regulator and a conduit for important information.

Sections 7 and 9 of the Code, respectively, gives the power to financial creditors (FCs) and operational creditors (OCs) of a CD to initiate the CIRP.

As is clear, creditors are mainly classified into two categories: FCs[9] and OCs[10]. The purpose of this divide was to separate the rights of OCs from FCs. Debt to OCs refers to a demand for the supply of goods and services in exchange for the payment of government dues, as opposed to debt to FCs, which is distributed against the consideration for the time value of money.

Distinction between a FC and OC has been drawn by the BLRC in para 5.2.1 of its final report.[11] It states:

> Here, the Code differentiates between financial creditors and operational creditors. Financial creditors are those whose relationship with the entity is a pure financial contract, such as a loan or debt security. Operational creditors are those whose liabilities from the entity comes from a transaction on operations...The Code also provides for cases where a creditor has both a solely financial transaction as well as an operational transaction with the entity. In such a case, the creditor can be considered a financial creditor to the extent of the financial debt and an operational creditor to the extent of the operational debt.[12]

It is clearly evident that the law makers have chalked out distinct definitions of FC and OC and that they are not to be interpreted as inclusive or exclusive of each other.

Since they are members of the creditor's committee and have voting rights, FCs are given a higher priority than OCs, who are not. The fundamental problem is that because the statute's provisions safeguard the rights and interests of FCs, some categories of OCs are subject to prejudice. This is supported by the fact that the relevant class is not permitted to make any proposals at the creditors' meeting when the application is submitted by OCs.[13]

Now, coming back to the process, the Code permits any FCs, OCs, or even the CD itself to file an application for launching the CIRP following a default by the CD. The application for the CIRP must also specify the chosen insolvency profession, who acts as an interim resolution professional (IRP).[14] Within the resolution process of IBC, one of the most important entities among all that becomes important to mention is that of the resolution applicant. The resolution applicant is the 'white knight' who comes to the aid of a corporate entity undergoing the insolvency process and makes an attempt at saving/reviving the company. Section 5(25) of the IBC defines a resolution applicant as '*any person who submits a resolution plan to the resolution professional.*'[15]

According to section 7, the NCLT has 14 days to determine the existence of a default after receiving an application. If the NCLT is convinced that a default exists and that there aren't any disciplinary procedures pending against the suggested IRP, it is obligated to admit the application, unless incomplete. This was the settled position of law which was even reiterated by the Supreme Court in the landmark case of *Innoventive Industries Ltd. v. ICICI Bank*.[16]

After confirming that the two criteria are fulfilled, the NCLT admits the application, and the insolvency resolution process against the CD officially commences. The issuance of a moratorium as soon as the bankruptcy resolution process begins is a crucial component of the insolvency resolution procedure under the IBC. The moratorium protects the CD from individual creditors' lawsuits and forbids the CD from being the target of any new lawsuits or continuation of existing lawsuits, including the execution of any order, judgement, or decree in any court of law, tribunal, or arbitration panel. This clause serves as an inducement for the CD since it wants the bankruptcy resolution process to be a 'quiet period' free of litigation.[17]

The IRP assumes control of the CD through an order issued by the NCLT after the resolution process begins and the moratorium is put in place. The instance the IRP is appointed, the Board of Directors' authority is suspended. The IRP now has full authority over all Board decisions. The primary duty of the resolution professional (RP) is to assemble the CoC.[18] The CoC has the option of appointing a fresh RP or the same IRP as the RP at its initial meeting.

The resolution plan is then filed to the NCLT, which has the necessary jurisdiction, and can be accepted or rejected, subject to the fulfilment of certain prerequisite conditions, after being accepted by the CoC by a vote of 66% by value.[19] If the resolution plan is not filed within the time frames stated in the

Code, or if it is not compliant with mandatory legislative criteria, the NCLT may reject it. The NCLT must approve an order before the CD can begin the liquidation procedure if the plan is rejected.

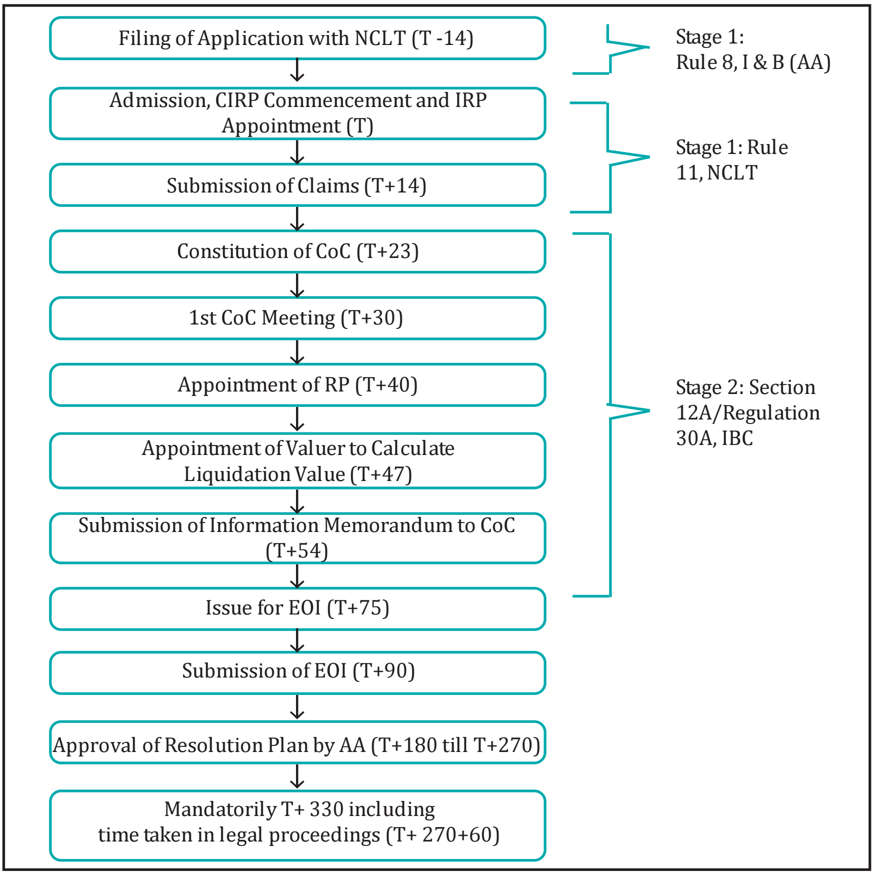


Fig 1: CIRP under IBC

The waterfall mechanism

The priority in which the financial offerings by the resolution applicant shall be distributed to the secured creditors during the insolvency proceedings is determined by the inter-se hierarchy of creditors, which stipulates the arrangement. When distributing proceeds to a class of recipients who rank similarly, section 53 of the IBC states that ‘*Each of the debts will be paid in full, or in equal proportion within the same class of beneficiaries, if the proceeds are inadequate to meet the debts in full.’* [20]

As a result, the IBC plans on allocating liquidation proceeds to the same class of stakeholders on an equal footing, or *pari passu.* As a matter of fact, the waterfall mechanism generally arranges the stakeholders’ names in a sequential order to denote who will receive payments from the liquidation first. Secured creditors receive preference over unsecured creditors under the IBC mechanism. According to the mechanism, these secured FCs must be compensated in full for their admitted claim before any proceeds from the sale are given to any other unsecured creditors if a company is being liquidated. As per section 52(1),[21] a secured creditor can either;

a) waive off its security interest that lies in the liquidation estate and agree to receiving proceeds from the waterfall mechanism described u/s 53; or

b) acquire security interest as per the present provision.[22]

Stakeholders have criticized the Code in a number of instances for giving OCs a lower priority than FCs. As is clear from a simple reading of the section, the OCs fall under the 'remaining debt and dues' which is much lower than the well specified position of FCs. At this point, the Supreme Court of India's ruling in the case of *Swiss Ribbons (P) Ltd v. Union of India*,[23] must be considered, which emphasizes the need for distinguishing between operational debts and financial debts, which are secured and unsecured, respectively, by stating '*Paying off financial debts injects capital into the economy in so far as banks and financial institutions are able to further lend such money to other entrepreneurs for their businesses with the money that has been paid back.*'[24]

LIQUIDATION PROCESS- PRIORITY WATERFALL OF CLAIMS

- Insolvency resolution process and liquidation cost
- Secured creditor and workmen dues (Up to 24 months)
- Other employee dues (Upto 12 months)
- Financial debts of unsecured creditors
- Government dues (Upto 2 years); and unpaid secured creditors
- Any remaining debt and dues
- Preference shareholders, if any
- Equity shareholders or partners, as the case may be

Fig 2: Waterfall mechanism under Section 53 of IBC

It is crucial to note that the Hon'ble Court rejected the argument that the distinction between various classes of creditors violates Article 14 of the Indian Constitution and is valid as long as the goal of the Code is not affected and there is a legitimate interest that needs to be safeguarded in that regard. The Court upheld the Code's waterfall mechanism by dismissing the challenge to section 53 of the Code.

INSOLVENCY IN THE REAL ESTATE SECTOR: A BACKGROUND

One of the few sectors in India that has, at most times, experienced exponential growth over the past 20 years is real estate. But because of some stagnation and weak sales and pricing performance, it has lost some of its appeal. The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 was passed by the Government in response to this problem, reclassifying real estate purchasers as FCs rather than other creditors who would otherwise have no rights or benefits.[25] Whether this modification has improved homebuyers' circumstances is still up for debate.

Homebuyers were in an unfavorable situation when it came to insolvency proceedings under the IBC, since they were not regarded as FCs or OCs.

This issue was evident in a number of cases, including the *Chitra Sharma case*,[26] where she represented 32000 affected buyers in a Supreme Court appeal challenging Jaypee Infratech Ltd.'s bankruptcy and stated in her statement that under the IBC, flat buyers did not fall under the category of secured creditors and as a result, they could only receive their money back if there was any left over after paying the secured creditors and OCs.

Both starting the CIRP against a defaulting builder or real estate developer and joining the CoC were not permitted to homebuyers. Additionally, they were not provided an assurance that they would get liquidation value under the resolution plan. Homebuyers could only turn to the courts for the necessary reliefs. This demonstrates that, prior to the bankruptcy law, homebuyers were not protected when real estate developers went bankrupt.

Through its decision in *Kridhan Infrastructure*,[27] the Hon'ble Apex Court was able to bring two notions that normally conflict during bankruptcy resolution processes together. On the one hand, the notion that liquidation ought to be the final resort is well-established. On the other hand, the goal of the Code is incompatible with an endless delay in resolving corporate insolvency. The Supreme Court ruled that it is crucial to resolve CDs and that, in the interest of the people, liquidating a debtor must be the very last resort. The fundamental goal of the law would be defeated if the CIRP were to veer into an endless delay.

Since the July, 2022 *IDBI Trusteeship Services Limited v. Abhinav Mukherji*[28] judgement of the National Company Law Appellate Tribunal (NCLAT), which confirmed the power of homebuyers to challenge lending institutions from qualifying as FCs (on a case-by-case basis), the power struggle between buyers and lenders for dominant control over the CIRP of real estate developers has only gotten worse.

When the NCLAT, in *PNB Housing Finance Limited v. J.S.S. Buildcon Pvt. Ltd*.[29] (2020), did not identify the lending institutions as FCs of real estate developers in transactions where the Housing Finance Companies (HFCs) had extended loans to the homebuyers and the said homebuyers had in turn defaulted in repaying the loan to HFCs that was secured by mortgages of the under-construction homes, the lending institutions—particularly HFCs.

In several situations, the HFCs logically followed the guidelines of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), and took legal action against defaulting homebuyers. This time, however, homebuyers complained to the High Court of Delhi (*Ashish Tiwari & Ors. v. Union of India & Ors.*[30]) that lending organisations had given out loans without verifying the legitimacy of developers and had even 'worked in concert with the developers'.[31]

To the displeasure of the lending institutions, the High Court stopped the lending institutions from taking action against homebuyers while the aforementioned matter is still pending consideration in an order dated January 31, 2022. As a result, certain lending institutions in the present neither qualify for a seat on the CoC nor are permitted to bring legal action against homebuyers to recover loan principal.

In *Union Bank of India v. Rajasthan Real Estate Regulatory Authority & Ors.*,[32] the Supreme Court expanded the assault by allowing homebuyers to file lawsuits against lending institutions before the authorities established by the Real Estate (Regulation and Development) Act, 2016, in the event that those authorities brought SARFAESI related proceedings against the homebuyers.

Even before the COVID -19 epidemic swept the globe, the real estate industry was in a precarious situation. In its first incarnation, the Code found it difficult to meet the demands of the specific sector. Despite the fact that they are important stakeholders, Indian real estate corporations sometimes operate without consulting the allottees.[33] The Code is one such piece of law that has, nevertheless, taken the initiative to address the demands of the sector. Since its start, the Code has not only expanded the scope of the legislation but also fortified it. The judiciary has frequently examined various Code sections through the prism of the goals and objectives stated in the preamble of the Code.

When the Reserve Bank of India (RBI) identified a list of the top 12 defaulters in the nation, including one of the top real estate companies, Jaypee Infratech Limited, that were declared to be in default of an amount approximately of ₹ 8000 crore to its lenders, the debate pertaining to the rights of homebuyers in insolvency proceedings was first brought to the forefront (the dirty dozen).[34]

In the case of Jaypee Infratech Ltd., IDBI Bank Limited[35] brought a lawsuit against Jaypee, at the Allahabad Bench of the NCLT. It is interesting to see that Jaypee and its management did not object to this petition. As a result, the NCLT granted the petition, and a moratorium order was made. The decree of the moratorium caused a clamor among the homeowners of Jaypee, highlighting the significance of homebuyers under a CIRP. In a number of writ petitions, the homebuyers petitioned the Supreme Court for safeguarding their legal rights. In that case, the Supreme Court created workable solutions in the public interest through its interim orders, in which it instructed the IRP to move forward with the CIRP and appointed a representative to represent homebuyers at meetings of the CoC and work on their behalf. Later, this was proposed as a Code amendment.

With effect from June 6, 2018, the owners of real estate, including those who purchase homes and commercial structures, were accorded the same standing as financial debtors. The amendment improved the position of the homebuyers by guaranteeing their ability to initiate CIRP, participate in the CoC, and obtain at least the liquidation value under the resolution plan, three important legal rights. By balancing the interests of all the stakeholders, the court's rulings in the cases of *Pioneer Urban Land Infrastructure Ltd.*[36] and *Manish Kumar*[37] have further refined and clarified the law pertaining to the real estate sector. The ruling in the *Pioneer Urban Land and Infrastructure Limited case* also acknowledged the rights of the homebuyers as FCs while also acknowledging the rights of the allottees to pursue other remedies, such as (i) the Real Estate (Regulation and Development) Act, 2016 and (ii) consumer protection laws, in order to obtain relief. The Hon'ble Supreme Court struck a delicate balance in its *Manish Kumar* decision by recognizing homebuyers' rights as FCs of real estate corporations while upholding the minimal threshold necessary for them to file an insolvency petition in order to protect the CD from baseless claims. In a well-reasoned decision, the Apex Court noted that allowing allottees from all projects to sue a real estate developer would make it more difficult for the applicants to fulfil their obligations during the bankruptcy resolution process.[38] This would have an impact on how quickly the insolvency resolution process moves overall. The goal of balancing the interests of all parties involved in the bankruptcy resolution process would be undermined by allowing a significant amount of subjectivity in decision-making for a specific allottee. The Supreme Court determined that it is both well-reasoned and constitutionally sound to require a minimum number of allottees and that these allottees come from the same project. The Supreme Court ruled that the allottees were distinguished from other FCs by their huge numbers, variety, and individuality in decision-making when addressing the issue of the Amendment's intelligible differentia. There could be hundreds or even thousands of allottees for a real estate project.[39]

The Code is intended to be helpful legislation aimed at helping struggling corporations get back on their feet, however this cannot be done if the deadlines set forth in the CIRP are not carefully followed. To prevent further diminution of the CD's assets, the resolution procedure's deadlines must be strictly followed. A number of legal examples highlight the crucial part that promptness plays in the insolvency resolution process.[40] The fact that the CoC, which also includes the allottees who can be distinguished from other FCs by their enormous numbers, variety, and individuality in decision-making, has the final say over the company's affairs is another significant factor for the failure of CIRP in the real estate sector.

The issue of time value of money

Time value of money refers to the real value of the money as compared to its absolute or nominal value. This principle denotes that a certain sum would be worth relatively less in future than in the present. Essentially indicating to the purchasing power of a certain amount in various time frames. This is due to several factors but the most prominent factor being inflation. The rising cost of commodities overall in an economy due to which the same amount cannot fetch the same amount of commodities over time.

The fundamental theoretical foundation for the 2018 amendment compares the sizeable investment apartment buyers make when purchasing houses to funds disbursed by FCs. Apartment owners pay substantial sums of money to developers only to be faced with delays and incomplete developments, according to the 2018 Report of the Insolvency Law Committee (ILC Report), which proposed the revision.[41] Although this issue merits regulatory consideration and may even be acknowledged during the developer's insolvency procedures, classifying apartment buyers as FCs runs the risk of exceeding the IBC's conceptual bounds.

While it's true that apartment buyers give the developer money, they don't do so in exchange for taking time worth of money into account. Essentially, opportunity cost or other projects in which the money could have been invested are represented by time value of money. For apartment buyers, this opportunity cost becomes less obvious; an early consideration is a better description of their payment to the developer. Because of this, the NCLAT ruled in *Nikhil Mehta and Sons v. AMR Infrastructure Ltd.*[42] that apartment buyers could only be regarded as FCs in certain situations, such as when they received guarantees from the real estate developer in exchange for their advances.

Consideration for the time value of money is one of the integral factors of financial debt. This includes returns such as interest payments. Hence not all transaction between homebuyer and real estate developer fall into financial debt especially as envisaged under IBC. The ILC report elucidated the findings of the NCLAT in the *Nikhil Mehta case*. The NCLAT ruled that the real estate developer's regular payments for the apartment buyers' expenses constituted the consideration for the item value of money. Additionally, when committed returns are involved, the transaction can be classified as strictly financial because the returns were used to encourage the first disbursement, which may not have been made only to guarantee the building of the apartment.

The transaction between apartment buyers and FCs would only be one for the purchase of a service in the absence of the element of committed returns (construction of an apartment). Although it might appear that this kind of transaction fits the definition of an OC, its structure differs from that of a normal OC. This is so because the company owes the raw material supplier money for the goods they provided, if the supplier is also a FC. The CD owes apartment buyers a service rather than money in this case (construction and delivery of an apartment). The Supreme Court held that apartment buyers could not be OCs on this justification.[43]

In *Kay Bouvet Engineering Ltd v. Overseas Infrastructure Alliance (India) Pvt Ltd*,[44] nevertheless, the NCLAT ruled that receivers of goods and services would be regarded as OCs. In this instance, a subcontractor kept money that was given to it for the building of a sugar mill. The NCLAT determined that the subcontractor was an OC when bankruptcy proceedings were initiated against it for the amounts paid. This situation seems similar to that of the apartment purchaser in that the CD owes a service (against advance payment) rather than money in both cases. It is probable that all customers who prepay may have to be regarded as FCs if one were to follow the Supreme Court's methodology, which defines cases in which payment flows to the CD in advance as financial debt. Other businesses, like interior design or even the customization of any equipment where payments are paid in advance, share similarities with the transaction between apartment buyers and real estate developers. The 2018 amendment and the Supreme Court's *Pioneer ruling* appear to have modified the definition of consideration for time value of money, a crucial component of financial debt, and as a result, loosened the definition of FCs.[45]

A PEEK INTO FOREIGN LEGISLATIONS

UK

In COVID-19, there was a change in strategy for the UK system. It changed from being a system that favored creditors to one that favored debtors. The moratorium was one of the areas where significant modifications were made.[46]

The system in moratorium is as follows:

Creditors are not permitted to initiate bankruptcy proceedings or take enforcement actions against debtors during the term for which the moratorium is in effect for obligations that have accumulated prior to the commencement of the term. Regarding pre-moratorium debts, this is referred to as a 'payment holiday' under the Act. The payment vacation provides creditors with 'breathing room' and gives them time to come up with a different resolution plan that will enable them to carry on as a going concern while still being under the watchful eye of a 'monitor' and functioning through their current management teams.[47]

The Act's provisions, which forbid the lender from beginning enforcement or insolvency proceedings while the moratorium is in effect, will apply to a borrower under a commercial real estate loan if the borrower is granted a moratorium. As a result, the lender is not in a position to appoint a receiver or to take any other steps that would ordinarily be permitted under the lender-borrower agreement.[48] However, the Act has given lenders a way to reassert the conventional agreement.

In commercial real estate finance agreements, any request by a borrower for debt relief or enforcement protection will often result in an event of default. Due to the acceleration of the loan, the lender is now empowered to demand fast payment of all outstanding debts. Therefore, if a debtor who is a borrower under a typical real estate loan agreement requests a moratorium, they run the risk of having their loan accelerated.[49] Despite the fact that the loan was made before the moratorium, the borrower is nevertheless required to pay the accelerated amount due to the special status that loans have under the Act.[50] The prohibitions on pursuing lawsuits or enforcing security are lifted after the monitor ends the moratorium, unless it has the funds to pay the accelerated amount (such as through the committed backing of a well-capitalized sponsor or another type of committed finance).

Circumstances in which the moratorium can be imposed

The moratorium method cannot be used to keep 'zombie' enterprises alive; rather, it can only be utilized when a company can be restored to going-concern status. The contractual arrangement made between a debtor and their lenders cannot be started by the debtor.[51] The monitor's involvement in the process is crucial in this case.

There is a higher likelihood that a company will be reinstated to going-concern status when it is in a short-term 'liquidity' situation (where it cannot pay its debts immediately but will, or at least expects to be able to pay them in full as its business position improves), as opposed to a 'credit' situation (where it will never be able to pay its debts in full because its business situation has fundamentally changed, either for peculiar reasons) (for example, some areas of traditional retail).[52] Therefore, in the co-working scenario, if the enterprise's income had been temporarily harmed by something like COVID-19 or if certain investments were required to provide additional income but might be funded by the debtor, the debtor's liquidity situation would be impacted.[53] When referring to a retail asset, the situation can be different because this asset class has recently seen a fundamental transformation in how commerce is performed.

Borrowers may be able to resolve their short-term financial issues throughout the allowed time. To make it possible to implement the plan, a well-thought-out asset management and operational strategy may be required, as well as a source of additional finance. There are lenders who focus on providing short-term financing.[54]

The debtor must engage into a legal standstill agreement with regard to the loan if it faces the possibility of being accelerated, unless it has committed sponsor support.

USA

The USA laws pertaining to insolvency provide for avoidance actions. The avoidance actions are limited but have the following provisions:

Avoidance actions

The Bankruptcy Code also outlines a variety of steps that the debtor or trustee can take to prevent a transfer of property from the bankruptcy estate before filing for bankruptcy. This enables the debtor to maximise the value of the bankruptcy estate and avoid its depletion, which can favour some creditors over others, prior to the start of the bankruptcy procedure. Chapter 5 of the Bankruptcy Code contains provisions for these safeguards.[55] The following are the most common trail of actions acts:

a) avoidance of preferential transfers, which allows an insolvent debtor to avoid and recover payments based on antecedent debt made to creditors within the 90 days prior to the debtor's filing for bankruptcy - up to one year for payments made to insiders of the debtor.

b) avoidance of fraudulent transfers, which allows the debtor to avoid and recover transfers of property that were in fact fraudulent or were made while the debtor was insolvent.

c) avoidance of unperfected security interests, which allows a debtor to get rid of property liens that hadn't been established under applicable non-bankruptcy law before the bankruptcy case was filed.[56]

China

In China, a creditor filing for insolvency need only demonstrate that the debtor is unable to pay the outstanding balance. The burden of proof shifts to the debtor once the creditor has established this. The court will quickly accept the insolvency application if the debtor is unable to show that it is not true that its 'assets are insufficient to pay off all debts' or that it 'clearly lacks the ability to pay off his debts'.

The appointment of the Administrator improves the effectiveness of the Chinese system. While the NCLT in India examines the CIRP, the Chinese system additionally chooses an Administrator, who has a number of responsibilities and guarantees that the insolvency procedure yields the greatest possible benefit.

In practice, the entire bankruptcy process is mainly controlled by the Administrator. The duties of the Administrator include:[57]

a) taking over the property, seals, account books, documents and other data of the debtor;
b) investigating the financial position of the debtor and preparing a report on such position;
c) deciding on matters of internal management of the debtor;
d) deciding on the debtor's daily expenses and other necessary expenditures;
e) deciding whether to continue or suspend a debtor's business (before the first creditors' meeting, when the debtor has not filed an application for self-management or the debtor's application has not been approved by the court);
f) managing and disposing of the debtor's property;
g) participating in litigation, arbitration or any other legal procedure on behalf of the debtor;
h) proposing that a creditors' meeting should be held; [58]

i) choosing whether or not to continue to perform a contract; [59]

j) exercising the right of revocation so as to recover a debtor's property; [60]

k) examining the claims declared; [61]

l) supervising a debtor while managing a property and business operations on his or her own (reorganisation); [62]

m) formulating a reorganisation plan and organizing the voting (except when managed by the debtor itself); and [63]

n) supervising the implementation of the reorganisation plan (reorganisation).[64]

The duties of the court are mainly aligned to the supervision of the insolvency proceedings, including:

a) the review of insolvency applications;

b) designating Administrators and determining their remuneration;

c) hearing the trial for bankruptcy revocation;

d) confirming the claims that have been declared;

e) approval of debtor-in-possession; [65]

f) executing an automatic freeze (revocation of violations, approval of freeze release); [66]

g) approving a reorganisation plan (including mandatory approval); and

h) ruling on the termination of the procedure.[67]

Japan

In the Japanese system, the government performs an additional role and offers bankruptcy-prone business choices.

Tax incentives may be provided to debtor enterprises that submit plans to increase profitability through business restructuring under the Industrial Competitiveness Enhancement Act (ICEA).

The ICEA also offers a turnaround Alternative Dispute Resolution (ADR) system for out-of-court settlement negotiations (Jigyo saisei ADR). Large businesses now choose turnaround ADR over civil rehabilitation processes in recent years. For listed firms, this tendency is noteworthy because official reorganisation procedures would result in de-listing, whereas informal restructuring would not.

Turnaround ADR focuses mostly on settling FCs' debts. It is theoretically feasible for foreign banks or other foreign financial organisations to be involved in the work-out, despite the fact that there isn't any precedent at the moment. In turnaround ADR, a mediator with expertise in business turnarounds can help facilitate settlements with FCs. All creditors included in the procedure must agree on the turnaround ADR. The court presiding over the matter must take the rescue plan created during the turnaround ADR procedure into consideration if unanimous creditor consent cannot be reached and the matter leads to civil rehabilitation or corporate reorganisation proceedings.

There are also some other programs for out-of-court workouts that are backed by the Government. For instance, the state-owned organisation known as the Regional Economy Vitalization Corporation of Japan (REVIC) (Chiiki Keizai kasseika shien kikou) encourages workouts by coordinating the procedures that apply to lenders and funding to debtors.

France

When debtors are still solvent but encounter challenges (financial or otherwise) that they are unable to overcome, safeguard proceedings are court-administered processes that they may choose to engage in.

A draught plan, which may include debt write-offs, debt for equity swaps, a partial sale of the business, or rescheduling of debts, must be presented by the debtor to the creditors during such proceedings after a customary consultation with them or, as appropriate, to classes of affected persons.[68] If the necessary thresholds are satisfied or a voluntary application is made, the safeguard plan will be approved (subject to court confirmation) either through individual consultation of the affected parties or through a class-based consultation. The surveillance period in safeguard procedures may not be longer than 12 months (compared to 18 months prior to the 2021 reform).

Insolvent corporations may begin reorganisation proceedings, which may last up to 18 months (the last six months being renewed as an exception, upon request of the public prosecutor).[69]

With a few exceptions, the adoption procedure for a reorganisation plan is largely similar to the procedure used in safeguard procedures, most notably the ability for creditors to submit an alternative plan to the debtor's plan during a class-based consultation.

Under reorganisation proceedings, a court may order:

a) the continuation of the business through a reorganisation plan that has been approved by affected parties under the same conditions as for the safeguard plan (i.e., a vote by affected parties divided into classes or through the standard consultation);

b) the sale of all or part of the debtor's assets or business as a going concern through a sale plan if no plan is viable; or

c) if the latter fails, the conversion into liquidation proceedings.[70]

When a firm is insolvent and it is clear that it cannot be saved or reorganized, liquidation proceedings are initiated. Its goal will be to shut down the company's operations and sell off its assets in order to pay off the creditors as much as feasible. A judicial liquidator is chosen in this situation.[71]

There is no maximum time limit, although in reality, liquidation proceedings frequently go on for years. When a full or partial sale of the firm is conceivable, the judgement initiating the liquidation proceedings may, in exceptional circumstances, allow for the continuation of the company for a period of three months (extendable once at the public prosecutor's office).

Germany

Public auctions are used for immovable property in Germany. It's called a 'Land Charge' (Grundschuld). This is a lien on real estate. The property owner is subject to a claim from a land charge holder for foreclosure (Zwangsvollstreckung). Public auction (Zwangsversteigerung) or judicial receivership will be used to complete the foreclosure process (Zwangsverwaltung). The proceeds of a public auction or judicial receivership of the relevant property are used to pay off secured debts. Alternately, if the charge holder agrees to discharge the charge and if the proceeds will be shared as planned, which commonly occurs, an insolvency Administrator may sell the property free of encumbrances.[72]

THE WAY FORWARD

Currently as provided in the problem statement that even after the categorization of the homebuyers as FCs they still face certain problem when the prerequisites for becoming FCs are not met by homebuyers. This brings the homebuyers to deadlock as the advance paid by them not only loses value to inflation but also the delay in project and further insolvency of the company means them losing their lifetime of savings in the worst case.

In this regard, the foreign legislations have been analysed to find a solution which does not only help homebuyers but also the real estate companies as a whole.

The authors observed that the UK system turned to debtor friendly system post COVID-19. The UK system which brings payment holiday can be implemented in India to assure that the real estate company gets enough time to create maximum yield for assets. There is another tool known as company voluntary agreements wherein the company and creditors can form a mutual agreement. The UK system provides for standardize guidelines for issuing of moratorium which is similar to that of India. The system of accelerated payment of loans also adds to the pressure on real estate companies and can push them further in insolvency. Hence a real estate company should be allowed to avail short term finances from recognized lenders in event of liquidity crisis.

The avoidance action from the USA system is of relevance as it provides the debtor security from creditor misappropriation against moratorium wherein the creditor gets more space to administer judicious disposal of assets if required. Similar to the code of USA, in India avoidance actions should bind real estate companies. The NCLT or any authorized person should supervise the company in order to ensure that fixed assets are not disposed by insolvent debtor 90 days prior to filing bankruptcy in order to avoid litigation relating to recovery proceedings. It should be overlooked that the assets are not disposed fraudulently through benami transaction, related party transactions for an unfair value. The debtor should not be allowed to depreciate asset or diminish value of asset in order to reduce payment burden. Hence there is a balance in moratorium protection and the interest of creditors.

The Chinese system tackled the Evergrande crisis, the notable element of its system in the Administrator. After the declaration of insolvency there are typically three parties involved in the insolvency. The third counterpart apart from court and creditors is the Administrator. The same should be in India. The CoC has creditors which may not have the best experience in dealing with insolvency. Moreover, the NCLT has limited scope and technical expertise to generate maximum yield of the assets of the dying company. The duties of the same shall be as enumerated under the Chinese system whereby the major duties should entail performance of contract, right over debtor's properties and managing and disposing the property for the maximum value.

The next Japanese system provides for a more advance solution. It opens the scope of ADR in insolvency. The out-of-court method provides more scope to create a more agreeable rescue plan which can be formalized on basis of consent of involved parties thereby ensuring a greater say of creditors and also saving parties from long periods of litigation which is itself detrimental to interest of all parties.

Then comes the French system of safeguard proceedings which is similar to an ADR system but with a greater involvement of court. this method is also relevant as it consists of standard procedure and creation of draft. This is similar to the NCLT approval required in the Indian system. The reorganisation plan is similar to safeguard proceeding with the basic difference being of a judicial Liquidator.

Finally, the German system has the provision for public auction which can also be adopted as method to ensure the assets go to the highest valuing owner and maximum yield can be generated for the creditors in this case the homebuyers.

AN ENVISIONED FRAMEWORK

Considering how important real estate sector is not only to the economy but also to individuals it is pertinent that a procedure which is utmost judicious and expeditious is adopted. In the Evergrande crisis, the authors saw how real estate companies play a major role in the economy of the country and to prevent any such incident taking place in India, several aspects of foreign legislature must be adopted to develop a system which is not only comprehensive but favors both the creditor and the debtor.

So, a new system in India can look as follows:

The homebuyer in almost all cases provides advance money for the property. The same money should be invested by the real estate company. Thus, a real estate company must appoint a financial expert who can guide the company regarding investment. The same should be done in safe methods like redeemable debentures or redeemable bonds if not shares of a company.

Against the sum received the real estate company must issues a bank guarantee which shall be mentioned in the contract. The contract made by homebuyer and company shall have a clause of making company voluntary agreement in case of default by the real estate company in delivery of the property. This ensures greater surety to the homebuyer that incase of delay and insolvency their savings are not depreciated. Moreover, this changes the nature of the security and make homebuyer FC as in case of insolvency, the company is liable to the bank, and this makes the sum received by them a financial debt. This is beneficial considering that it provides returns to company. A systematic investment of the sum and withdrawal of same as and when required ensures that inflation does not lead to the company being burdened by increasing cost of raw material. In case of insolvency, it also ensures that the homebuyer receive a sum according to time value of money. Advance is provided so that homebuyers can safeguard themselves from the effect of inflation and pay a portion of the sum owed at a rate which is lower in absolute terms. In cases of completion of project, the companies should set-off a certain percentage of the gain with the final payment which reduces payment burden on the homebuyer and creates a surplus for both the company and the homebuyer as a certain sum can be retained by the company.

Now in cases of insolvency this clarifies that the advance would be a financial debt due to which it would be given priority in the waterfall mechanism. The company voluntary agreement would ensure that the homebuyers have greater say in cases the company is moving towards insolvency and have a more informed decision-making power as they have an estimate of how the company would treat insolvency.

For purposes of insolvency the company would get a payment holiday and the moratorium which can provide it breathing space and ensure that the company can reorganize its resources effectively to create maximum yield.

The company voluntary agreement should firstly encourage parties to go for arbitration. The arbitration process would involve forming of draft which can be submitted in Court and avail tax incentives and other monetary incentives like revival funding by the Government if the plan satisfies the Court that the company meets all its liabilities and can becomes a profitable going concern. To maintain the separation of powers, the final approval would rest with the government to look into the plan and approve the scheme. An alternative dispute settlement would allow both companies to save on litigation cost and creditors to receive their advance in the most expeditious and amicable manner.

To supervise insolvency the board of directors must be provided certain power to be part of insolvency and valuation procedure. But the actions of the directors should be tested against the principles enumerated in avoidance actions. During the moratorium the company should be given a leeway to acquire short term finance against pledge of asset or unsecured loan which ever can be acquired, but only in cases of absolute need of short-term finance. The financial agency which is hired by the real estate company should be consulted to create a financial plan for the company regarding acquiring short term finances. Considering the responsibility provided to the directors, the NCLT should appoint a monitor to look after the action of the directors.

Apart from the CoC and the directors, another person should be appointed who would act as an Administrator. The Administrator would supervise the overall process and then ensure that the company is not doing anything detrimental to the interest of the homebuyers. The Administrator would have the decision-making power to adjudge if the company can be revived as a going concern. The Administrator would have to submit its report periodically to the court and the court would have the power to sanction various orders and penalties.

Finally, if the company cannot be revived then there should be an option of public auction of the company. Wherein the company or the project goes to the highest bidder. The acquirer can call for fresh allotments of property. Again, the auction bid should be used to pay debts and to continue the plan. But the plan must first require clearance from NCLT, that the real estate project can be revived and only on the approval of NCLT should auctioning be allowed.

This new process has various levels and is more comprehensive which would ensure that the real estate sector is treated differently, and the new procedure makes sure that the rights of homebuyers are protected while the real estate company is also not at a detriment.

Another legal position which requires to be altered is that individual project wise insolvency be recognized. If a company does not have funds to complete a particular project than the aforementioned procedure to be implemented for a standalone project. This would ensure that funds of one project are not transmuted to another project which can lead to both projects becoming insolvent. But at the same time the monitor would ensure that the directors do not commit anything detrimental to the interest of the homebuyers and the Administrator would have to ensure that a project wise insolvency is not availed to get out of a low profitable project.

Appendix: The Evergrande Precedent: A Case Study

Background

With approximately 200000 people, the Evergrande Group ranks as the second-largest real estate corporation in China in terms of total sales. Its primary line of business entails purchasing big parcels of land, turning them into residences, eateries, and other uses, and then offering them for sale to potential customers. The business is financed by a significant amount of debt from banks and investors as well as short-term loans given by suppliers and real estate buyers.

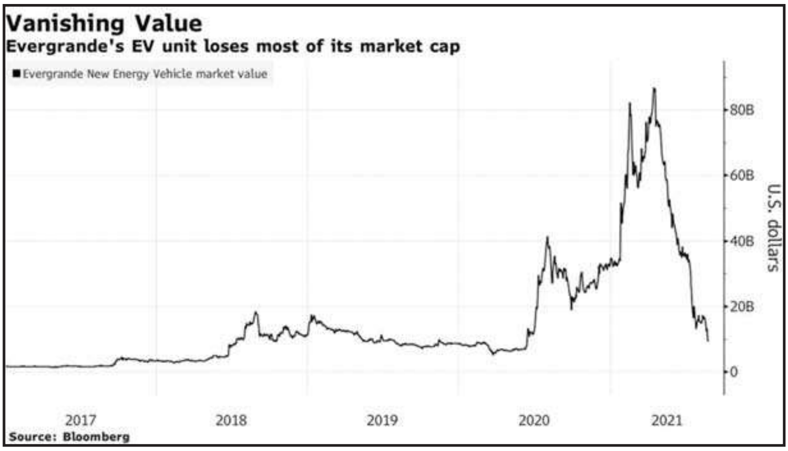
Its overall obligations exceed $300 billion, and over the next year, it will have to pay $37 billion in interest and debt maturities. Given the company's poor financial situation, rating agencies like Fitch and S&P downgraded the company's bonds, which have since traded for significantly less than 50 cents on the dollar.

In addition, the corporation has yet to pay several suppliers after promising to provide developed properties to nearly 1.5 million customers of real estate. With promises of strong returns, the company's wealth management team has amassed nearly $6 billion from its own employees. Public outrage resulted from it defaulting on these products and offering to exchange them for parking spaces and other real estate.

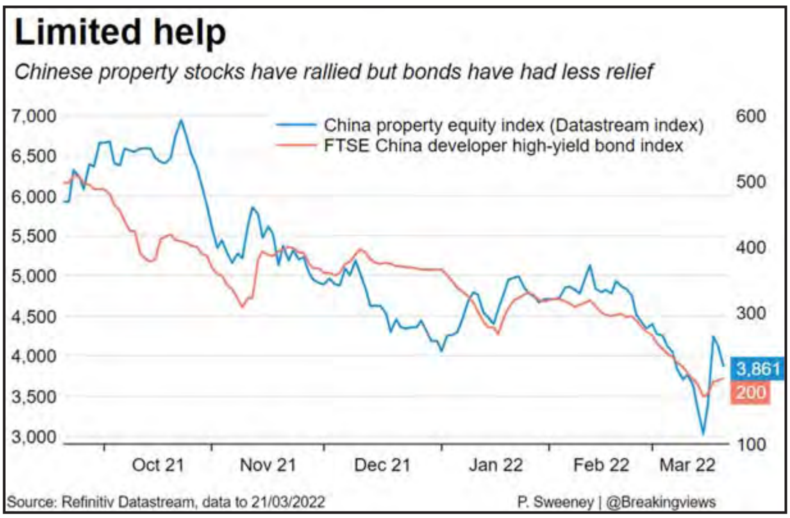
Cause of bankruptcy

The Chinese government's new regulations for real estate developers, in the opinion of observers, are the crisis' most direct cause. The Chinese government established guidelines in August, 2020 (commonly known as the 'three red lines') that set borrowing limits for real estate developers based on their financial standing as determined by three debt criteria. Due to the new regulations, Evergrande is essentially prohibited from adding any new debt on its balance sheet. Evergrande's business took a significant damage as a result because it relied heavily on borrowing to function. Thus, in order to pay off its debt, the corporation was compelled to sell its land and other assets at a significant loss. It is claimed that this asset fire sale ultimately caused Evergrande to become insolvent.

Some believe that the Chinese government's new regulations represent an effort to burst the nation's real estate bubble and facilitate an economic 'soft landing' Through the mainly state-controlled financial sector, Chinese authorities have always encouraged firms to incur enormous debt in order to construct new assets. Due to the uncontrolled development of real estate as a result, the sector now accounts for roughly a third of China's GDP. In Chinese 'ghost cities' there are reportedly millions of properties that are in very little demand from purchasers.



Evergrande's issues are critical for a number of reasons. First of all, many people purchased real estate from Evergrande even before construction started. If it fails, they can lose the money they have paid in deposits. There are furthermore the businesses that transact with Evergrande. Construction and design companies, as well as suppliers of materials, are at risk of suffering significant losses that could drive them into bankruptcy. Thirdly, if Evergrande defaults, banks and other lenders would be compelled to reduce their lending. This might have an effect on China's financial system.



This could result in a credit crunch, in which businesses find it difficult to obtain loans at reasonable rates. The second-largest economy in the world would suffer greatly from a credit crunch because businesses that cannot borrow find it impossible to expand and, in some cases, are unable to continue operations. Foreign investors can become uneasy as a result and think twice about investing in China.

Recommendations

In the Evergrande crisis, the authors saw how taking loan led to world's largest insolvency and led to disruption of rights of homebuyers. If an Evergrande like crisis were to occur in India, it would have the same outcome as in India the status of homebuyers remains unclear. This would mean a company which has taken debts can go insolvent and the advance payments by the homebuyers would not be reimbursed.

In the mechanism opined, the new system would ensure that the possibility of such occurrence is minimized. This is because they would need to appoint a specialized financial advisor prior to ach project who would evaluate if the company had the capability to pay off the advances or meet any exigency arising out of the project. Secondly the company voluntary agreement and bank guarantee ensure that the advances paid by homebuyers are safeguarded. Next the appointment of monitor would ensure that the company during the proceeding is not committing any breach of law or duty and an overall Administrator would ensure that the whole process brings the maximum yield. Further the investment made by the company would, in ordinary cases, yield a positive gain and ensure the company has relatively a softer landing in case of insolvency. The option of arbitration can be opted by the bank and the real estate company which would provide a greater stand to the bank to safeguard its interest, and as a bank debt is a financial debt it is given priority in the waterfall mechanism.

An Evergrande scale crisis in India could mean huge public displacement, erosion of wealth in an economy where the wealth distribution is not equitable and have other cascading effects which transgress into other sectors. Hence the recommended mechanism provides a better procedure and has more levels of safeguards to ensure that the rights of homebuyers and the economy of a country do not face severe repercussions.

[1] "Real estate developer Supertech declared bankrupt by NCLT", *Times of India*, 25 March 2022.

[2] "Total 1,999 insolvency cases were going on as of June 2022, says govt", *Business Standard*, 9 August 2022.

[3] Gopinath G. (2022), "The Great Lockdown: Worst Economic Downturn Since the Great Depression", IMF, 14 April.

[4] Jha A. K. and Jha R. (2020), "India's Response to COVID-19 Crisis", The Indian Economic Journal, Vol.68(3), pp.341–351.

[5] Rajoria K. (2018), "Insolvency and bankruptcy code of India: the past, the present and the future", International Business Law Journal, 61.

[6] "COVID-19 Blow: India's GDP Shrinks a Record 23.9% in First Quarter of FY'21", *The Wire*, 31 August 2020.

[7] Arora M. and Esa P. (2020), "Treating Homebuyers Within The Ambit Of 'Financial Creditors' Under Insolvency Bankruptcy Code, 2016 and Critical View On The Recent Amendments", SSRN 3791345.

[8] The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design, 2015.

[9] Section 5(7), IBC.

[10] Section 5(20), IBC.

[11] Supra Note 8.

[12] *Ibid.*, p.77.

[13] Gaur G.S. and Srivastava S.R. (2022), "Turning a blind eye to the dues of the operational creditor", Mondaq, 26 May.

[14] Section 16(1), IBC.

[15] Section 5(25), IBC.

[16] AIR 2017 SC 4084.

[17] Section 14, IBC.

[18] Saxena D., "Appointment of Resolution Professional by COC", *India Filings*.

[19] Section 30(4), IBC.

[20] Section 53, IBC.

[21] Section 52(1), IBC.

[22] *Ibid.*

[23] 4 SCC 17.

[24] *Ibid.*

[25] Section 25A, IBC.

[26] 143 SCL 680 (SC).
[27] 6 SCC 9.
[28] SCC Online NCLAT 267.
[29] CA(AT)(Ins) No. 103/2020, 2020 SCC Online NCLAT 546.
[30] W.P.(C) 10223/2021 & CM APPL. 31512/2021.
[31] *Ibid.*
[32] Special Leave Petition (Civil) No. 1861-1871/2021, 2022 Live Law (SC) 171.
[33] “Realty Revival: Revival of Real Estate Sector via IBC”, 24 May 2021.
[34] Mishra A. K. and Pandey S. (2020), “It Takes a Village to Raise a Child!’-The Development of Corporate Insolvency Law in India for Real Estate Companies”, NLUD J. Legal Stud. 2 (2020): 23.
[35] *IDBI Bank v. Jaypee Infratech Ltd.*, 2022, Item no.301, (IB)-77/ALD/2017.
[36] Writ Petition (C) no. 43 of 2019.
[37] Writ Petition (C) No. 26 of 2020.
[38] *Ibid.*
[39] *Ibid.*
[40] Johorey P. (2020), “Evaluating India’s Covid-19 Insolvency Ordinance: Blanket Protections & Executive Wariness”, Oxford Business Law Blog, August 7.
[41] Report of the Insolvency Law Committee, March, 2018.
[42] 2017 SCC OnLine NCLAT 859.
[43] *Ibid.*
[44] Civil Appeal no. 1137 of 2019.
[45] *Ibid.*
[46] Pal P. S. et al. (2021), “Real Estate Debt and the UK Corporate Insolvency and Governance Act 2020 – The Moratorium”, Greenberg Traurig, 8 February.
[47] Corporate Insolvency and Governance Act, 2020.
[48] “The UK Corporate Insolvency and Governance Act 2020: A move to a more debtor-friendly restructuring regime?”, July, 2020.
[49] Lester P. (2020), “The new moratorium procedure under the Corporate Insolvency and Governance Act”, 17 July.
[50] Terry J. et al., “Restructuring and Insolvency in the UK (England & Wales): Overview”.
[51] *Ibid.*
[52] McMaster K. et al. (2022), “The Insolvency Review: United Kingdom - England & Wales”, 25 October.
[53] Supra note 50.
[54] Supra Note 46.
[55] “Sungard AS Emerges from High-Speed Chapter 11 Less Than 40 Hours after Filing”, Reorg Research, 3 May 2019.
[56] Bernstein D. S. et al. (2022), “The Insolvency Review: USA”, The Law Reviews, 25 October.
[57] Yimin R. and Yun Z. (2022), “The Insolvency Review: China”, The Law Reviews, 25 October.
[58] Enterprise Bankruptcy Law, 2006, Article 25.
[59] Enterprise Bankruptcy Law, 2006, Article 18.
[60] Enterprise Bankruptcy Law, 2006, Article 31 to 39.
[61] Enterprise Bankruptcy Law, 2006, Article 57.
[62] Enterprise Bankruptcy Law, 2006, Article 73.
[63] Enterprise Bankruptcy Law, 2006, Article 80.
[64] Enterprise Bankruptcy Law, 2006, Article 90.
[65] Supra Note 57.
[66] *Ibid.*
[67] *Ibid.*
[68] Golshani S. and Hojabr A. (2022), “The Insolvency Review: France”, The Law Reviews, 25 October.
[69] *Ibid.*
[70] *Ibid.*
[71] *Ibid.*
[72]Streit G. and Bürk F., “Restructuring and Insolvency in Germany: Overview”.

3 ARTIFICIAL INTELLIGENCE BASED RISK ASSESSMENT OF MICRO, SMALL & MEDIUM ENTERPRISES IN INDIA

-Anil Kumar, Dr. Suneel Sharma and Dr. Mehregan Mahdavi

EXECUTIVE SUMMARY

Micro, Small & Medium enterprises (MSMEs) are identified as growth engines for the Indian economy. They are regarded as one of the crucial contributors in making *'Atmanirbhar Bharat'* (Self-reliant India). However, this sector in particular has been plagued with some of the age-old challenges in terms of technology adoption, skills upgradation, including owner's or manager's financial understanding, and the timely availability of credit. Therefore, considering the complexities of challenges, Artificial Intelligence (AI) /Machine Learning (ML) based applications will be an appropriate fit for new age risk assessments which ultimately will be win-win situations for both lending agencies and MSMEs. The aim of this study is an attempt to identify the most crucial factor/s impacting the performance of MSMEs. With this study, lending agencies will be able to provide adequate credit appraisal, and MSMEs on the other side would be in a position to bargain correctly for the right credit requirements at competitive interest rates. AI/ML based models in the form of classification analysis have been applied for risk assessment, and both financial and non-financial variables have been measured. This research paper has utilized the online or email based questionnaire survey for data collection work. Approximately 250 respondents have been approached who are engaged with various lending agencies, government bodies, and representatives (including founder or owner) of MSME firms. It has been found that, last three to five years performance of an MSME firm is the most crucial factor for assessing their risk bearing ability, and the probability of being in default or bankruptcy of an MSME firm. Other than this, availability of collateral is the next best important factors which most of the lending agencies assess, for the credit decision process. It has also been observed that lending agencies have gradually started the usage of advanced technology of AI/ML based tools for overall risk assessment, and in formulating the risk management framework for emerging challenges raised by newly established MSMEs or startups. The outcomes of this study may be beneficial for government bodies, regulators, lending agencies, MSME owners, researchers, and academicians among others.

Keywords: Artificial Intelligence, Machine Learning, Risk Assessment, Credit Assessment Models, Micro, Small & Medium Enterprises, Bankruptcy

INTRODUCTION

It has been well understood that development of MSMEs is extremely crucial for the inclusive growth of India. They are very strong connectors between urban rich and rural poor, to the poorest people of the country. The Government of India has implemented various schemes for the overall growth of MSMEs, and to increase their global competitiveness. With effect from July 1, 2020, the Government has also revised the definition of micro enterprises [investment in plant and machinery or equipment should not be more than ₹ 1 crore (₹ 10 million) and its annual turnover should not be more than ₹ 5 crore (₹ 50 million)], small enterprises [investment in plant and machinery or equipment should not be more than ₹ 10 crore (₹ 100 million) and its annual turnover should not be more than ₹ 50 crore (₹ 500 million)], and medium enterprises [investment in plant and machinery or equipment should not be more than ₹ 50 crore (₹ 500 million) and its annual turnover should not be more than ₹ 250 crore (₹ 2.50 billion)], so that maximum benefits can be utilized by this sector. Also, the Government has created the Credit Guarantee Trust Fund for Micro and Small Enterprises to provide collateral-free loans up to ₹ 1 crore (₹ 10 million) to individual micro and small business units. Under the ZED scheme, which is zero defect and zero effect, the Government is providing up to 80% of subsidies to micro and small business enterprises.

However, despite all these supportive schemes implemented by the Indian Government, the MSMEs still suffer from their age-old challenges like – technology upgradation and adoption at the firm's level, capital adequacy, and talent management. Though these problems are often repetitive in nature, these constraints still exist, creating unresolved hurdles for the MSMEs. Therefore, the purpose of this research study is to have the AI/ML based risk assessment of MSMEs from both the ends – supply side (like banks/NBFCs/ any other lending agencies), and the demand side (from MSMEs). Lending agencies like Banks/NBFCs/ any other lenders do an overall assessment of these MSMEs to get an adequate credit appraisal process, and to find if the firm is having a tendency for becoming bankrupt or insolvent in future. AI/ML based tools have an advantage (over traditional based methods of risk assessment) as they can be applied to measure a specific performance, and all the features can be included while assessing risks involved in the business. There is a very strong relationships among credit allocation, risk management and loan portfolio by which any lending agency's success can be measured, and their objectives will be fulfilled by keeping default rates at very minimum level (Ssekiziyivu et al., 2017). It is the expertise of any loan sanctioning officers to have eagle's view on credit allocation, and loan portfolio management for any MSME firms to avoid them for any insolvency issues in future. Most of the credit officers follows two aspects for the credit risk assessments of an MSME firm – a) an appropriate risk management tools must be in place to help in recovery in case of default, and b) lending agencies must be in a position to mitigate or mange the following risks – credit risk, liquidity risk, market risk, reputation risk, etc. which threatens the survival and success for any organization. It has been identified that very small or micro level units want to keep themselves away from any financial loan because of lack of understanding towards various schemes or benefits from these credit assistance, and also they do not possess sufficient collaterals other than the complete set of financial documents. Global and geo-political risks are other aspects which have greater impact now on these MSMEs. They are interconnected and not restricted to a particular geography now. According to World Economic Forum 2019 data, it is reported that extreme weather event, climate change factors, cyber theft, data fraud, large scale labor migration are some of the challenges which every economy is facing and MSME firms are not untouched to these challenges, which ultimately will impact their performances (Asgary et al., 2020). High structural unemployment rate and underemployment will have huge impact for success of any economy, particularly for the developing countries. Failure of national or regional or global governance because of geo-political crises will have a greater impact on MSME's sustainability. It has been estimated that 43% of total MSMEs closure worldwide have never re-opened, and 29% of them closed within their two years of operation. The reason being is that MSME do not have any adequate risk management in place, they are resource constraints, and they do not comply fully with the standards by covering with insurance and business continuity plan. Hence it is the role of the respective government bodies who should take a step forward to safeguard these MSMEs against all such adversaries. Transparency in the lending process, keeping updates for the various schemes and benefits from government schemes, and timely awareness for contemporary loans are extremely crucial for MSME firms or newly emerging startups (Koisova et al., 2017). It is high time that benefits from each and every government scheme must be passed to the end consumer or borrowers. MSMEs are generally considered as more risky, and tend to be highly sensitive to face any form of economic shocks. Therefore, it is the proper risk management plan which could help MSMEs to thrive their businesses in case of any unwanted or uncontrolled fluctuations in the market. MSMEs are the backbone for most of the Asian economies including India, all the regional / national / global level government authorities must provide adequate backup to these entities in case of any crises. It is forecasted that information asymmetry is one of the major hurdles for MSMEs and lending agencies as well for accurate credit appraisal process (Naoyuki Yoshino, 2018). Asian economies including India are largely bank finance dominated, and it is estimated that approximately 70% of Indian entities are directly dependent on bank loans for their short as well as long term capital requirements.

LITERATURE REVIEW AND MOTIVATION OF STUDY

It has been observed that MSMEs (small and micro businesses specifically) do not maintain adequate financial documents, they don't possess satisfactory collateral for obtaining required credit, and sometimes they fail to produce their exact projections for their future growth and development prospects, and due to these reasons, their loan application gets rejected. Also, banks and other lending agencies perceive them as a high risk for default, in turn facilitates credit to them even at a very higher interest rate which may also could be one of the reasons for MSMEs to become bankrupt or insolvent in future. Hence to get into deep dive further on these aspects, the entire literature reviews and motivation for this study revolves around two broad aspects described below.

Factors impacting the performance of MSMEs in India

MSMEs in India (including other emerging economies) are leading a pivotal role in employment generation. These units are contributing a major share in overall country's economic growth. Risk assessment is one of the factors which determines the firm stability, and their future prospects to sustain in national as well as international markets (Þigienë et al., 2019). Risk management frameworks need to evolve continuously to make them more competent. Some of the advanced technologies like AI, ML, big data elements to be applied for commercial risk assessments of MSMEs. Researchers (Barukèiæ et al., 2021) and other financial institutions are analyzing both financial (financial ratios) and non-financial (business sector, age, governance/management etc.) based variables for risk assessment of these MSMEs (Kou et al., 2021). It has been observed that transactional data can also significantly improve the bankruptcy prediction for these firms as it is also reliable and done in a timely manner. MSMEs in India have their own set of challenges, and sustaining in the market with very limited choices that are associated with their one or few quality product/s, market availability, and their nature of business (Mukherjee, 2018). Most of the earlier studies have adopted four methods to assess credit scoring for MSME firms, these are – Evaluation index weighting methods, Outranking methods, Parametric and Non-Parametric statistical techniques. It has been observed that because of limitations in available data related to list of customers served by MSME firms, competitors (both global and Indian markets), and industry analogue data leads to poor credit scoring and appraisal for MSME enterprises (Li et al., 2021). Trustworthiness of any MSME firms is the most crucial factor for obtaining funds for them, whether it is from a lending agency or from any investor's point of view. Also trustworthiness is adversely related to lending rates, if there is high trust of any MSME firms in their respective working areas, they may have all chances to obtain credit at a relatively lesser rate of interest. Normally lending agencies look for the following qualitative parameters like purpose of loan, loan size and pattern, mode of repayment, availability of guarantor, owner's attitude and credibility etc. and quantitative parameters like asset liability ratio, profit margins of a firm, operating environment, and contribution in GDP etc. to facilitate credit to any MSME firms. Trade credit or trade advance is another tool by which lending agencies try to influence MSME firms for their growth and in profit generation. Performance of any MSME firms are largely governed by four broad aspects which are – profitability of a firm, liquidity status, solvency measurements, and how agile or innovative the firm is (Kanapickiene & Spicas, 2019). Lending agencies must adopt a balanced approach while dealing with MSME firms regarding trade advance, as this could be one reason for a firm which may default if they get a higher credit or advances against their absorbing capacity. Enterprises are the collective form of resources, they are expanding in a rapid way, and brings new set of challenges, therefore lending agencies must adopt a digital inclusion platform for their adequate credit risk assessment, so that both the supplier and receiver must have appropriate risk mitigation plan in case of any market surprises (Yang & Zhang, 2020). Eradicating poverty, including extreme poverty, is one of the global challenges and listed under the United Nation's Sustainable Development Goal 2030, and this can be addressed only by adopting inclusive approach, and without any social inequality. It can also be seen that MSMEs try to avoid approaches for banking institutions because of cumbersome loan process, and high demand of collaterals availability, even for small ticket size loan. Social responsibility disclosure, C-emission disclosure etc. are a new set of challenges for MSME firms, which lending agencies and investors are keenly looking for, at various enterprise levels. High inflation rate, skilled and trained manpower availability, global crises, foreign exchange fluctuations, are some of the emerging challenges which MSMEs are facing at this stage. Peer to peer lending (P2P lending) is the another aspect where MSMEs have challenges particularly in terms of class imbalance issues (Anahita Namvar, 2017). Imbalance problems arise when agencies find difficulty in separating the good borrowers from bad borrowers and often ignore the less prevalent class. P2P lending now is getting more popular because of the emergence of fintech particularly in India. However, this leads to a new set of challenges in terms of credit risk exposure, therefore lending agencies have to come up with robust model of risk mitigation plan to protect their customers as well as lenders themselves (Giudici et al., 2019). Authors have highlighted here the topographic coefficients of the borrowers as explanatory variables to support their inferences. The objective behind P2P lending is a many to many approach with a faster disbursal of loans and speedy decisions on risk assessments of a firm. This also provides a strong association between lenders and borrowers. However the only concern here is the cost of credit, and the risk management framework of fintech in facilitating the credit to MSMEs which is also one of the biggest worries for the regulators. There is no any doubt that banks are the most regulated sectors worldwide and consider almost all factors at level while facilitating the credit to MSMEs – (a) at micro level they usually focus on organizational level perspectives, (b) at meso level, usually it is industrial effect on lending practice, and (c) at macro level it is more on national/global level factors like inflation rate, unemployment, exchange rate etc. (Win, 2018).

MSMEs (specifically small and micro business units) have traditional roots and tends to evolve at their own pace and structure

Both male and female-owned firms have similar kinds of challenges, however it has been observed that female-owned (especially micro and small business units) units have higher discrimination, and probably the lending agencies find them as a higher risk for defaults. It is estimated that women led enterprises are largely concentrated on retail, services and food supply sectors which restrict their expansion opportunities to other wider sectors and in turn hesitate to infuse higher capital in their respective businesses (Chaudhuri et al., 2018). Also, these enterprises lack in formal financing facilities because of their less interest towards them. 5Cs are still popular among lending agencies for risk assessments, especially owner's or manager's character is of foremost importance for judging them, particularly for micro and small business enterprises. This could lead to biases if the relationship (or any other factors for the matter) between firms and lending agencies are not in the same boat (Boushnak et al., 2018). For the MSME lending process, banks / financial institutions are largely dependent on their experienced employees to consider all factors (both qualitative and quantitative) while deciding their credit appraisal process. Most of the MSME firms which are newly born (or even aged one) devoid of certain critical documents, so that they can obtain loan at a better rate of interest, where experienced employees (working with various lending agencies) play a crucial role to facilitate credit to these MSMEs. They build a solid framework for the entire lending process, to safeguard from any future credit risks. Few researchers broadly highlighted the four lending processes comprising – financial statement based lending, asset based lending, credit scoring based, and relationship based lending methods (Boushnak et al., 2018). By assessing these, a bank official develops trust so that in future any given MSME firms will not default, and will engage in quality investments in turn earning higher return on assets. Following these methods of evaluation, MSME firm also provide ratings to the respective financial institutions, and appreciates their officials as they consider all the facts while facilitating the credit to them at an affordable rate of interest. There is an urgent need for the setting up of information infrastructure system among lenders, borrowers and guarantors for easiness of the entire lending process. This would be extremely helpful for newly established MSME firms and even for promising startups in India. Guarantors can play a critical role in case any unstructured MSME fails, and when lender is not in position to recover their credit from these sick or struggling units. Therefore, such enterprises must be backed by various regional or national level government authorities and trade associations. MSMEs which do not have a complete set of documents, lending agencies must have a way to analyze their alternative source data to fulfill their eligibility for credit. These alternative data will be in the form of mobile usage, electronic mode of transactions, mobility trajectory, and information in social media for their credit worthiness are some of them for their credit risk assessment (Lu, 2019). It is general perception that the lending agencies consider only the conventional data for their assessment and finalizing the credit scoring. However, in this digital era, gradually financial institutions have now started tracking this source of data for understanding of MSME's overall credit behavior. Any kind of little or extra information always gives more comfort and brings higher trust for any MSME firm in front of lending agency's assessment. Lending agencies are also using AI and robotics methods to obtain the necessary data for understanding of any industry trends, so that they can take a right call before facilitating credit to any unique set of entities or corporations (T. Dhanabalan, 2018). It is observed that entrepreneurs and entrepreneurial tasks are extremely demanding, and requires right mindset in the form of psychological capital for their success and to sustain in a competitive market. Social networking and relational capital are the two important aspects for unstructured or newly born MSMEs to provide adequate credibility to the financing institutions (Baluku et al., 2018). These are actually intangible assets but have a greater impact on performance of any MSMEs. It is seen that a strong mindset of an MSME's owner with a winning attitude always helps in achieving them a desired success despite having all challenges existing in the business. Further it can be stated that the extent and degree of risks varies at various levels of enterprise – (a) at micro level there is challenge of status quo and they tend to remain stagnant, (b) at small level business, there is always a higher competition to thrive and sustain, and (c) at medium level business, they often have a bigger market risk and highly dependent on national or industrial level policies (Grondys et al., 2021). Also, a good quality company generally gives a signal whether the market is responding correctly or not, and then these high quality companies utilize their risk management tools as per the situations, and performs accordingly (Kustina, 2018). Capital allocation and duration of the company are interrelated, often it can be found that the long duration company usually utilize bank credit to expand their business in a much efficient way, and relatively less dependent on their savings which is extremely opposite for the newly born entity which largely incurs their capital requirement from their personal savings (Belas et al., 2018). Manager's (loan manager) decision about capital structuring largely depends on firm size, their risk bearing ability, business areas and extent of operation, team size etc. which largely impacts on performance of any MSMEs. Earlier researchers also tried to come up with various theories for risk assessment strategies adopted by various lending agencies like commercial loan theory, the shiftability theory, credit risk theory, and liability management theory (Taiwo JN; Ucheaga, 2017). Commercial loan theory is also known as real bills doctrine, and often lend only for short term basis. This is mainly to meet the short term capital requirements of MSMEs, and of self liquidating in nature. Then, it was realised that these short term funding will not able to serve the purpose of various lending agencies if any forceful liquidation of assets are required, so the objective of shiftability theory come up which suggest that it is mere shifting of the assets to the other institution so that lending agencies can manage their cash reserves effectively. The objective of credit risk theory is to apply all safety mechanisms by the lending agencies to protect their credit risk exposure in the form of insurance or mortgage or involving any third party or guarantor. And, liability management theory holds that and as the name suggest lending agency can always exercise the short term debt instrument to manage their credit risk. After having detailed reviews of the existing literatures, and referred for this study below two hypotheses can be drawn.

H1: Lending agencies in India considers all listed factors (financial, non-financial and other alternatives) for risk assessment of MSMEs (for their credit appraisal or scoring).

H2: MSMEs are readily adopting innovative processes (including digital platforms) to improve their performance for competing at global and national level.

METHODOLOGY

In this research study, the authors have used classification analysis for risk assessment of MSMEs, and attempted to examine the most crucial factor/s (by analyzing the responses for both financial and non-financial variables) which are impacting the successes or failures of these MSMEs, and also to assess them whether they will be able to compete globally (also in the domestic market) or not, considering various kinds of risk. These units were also assessed internally for their adequate risk-taking ability, and not to become default or bankrupt or insolvent in future. Most of the researchers believed that Logistic Regression based methods are widely used in credit risk analysis of classification based study like this in particular, because of their efficiency, reliability and ease of use in estimation analysis. Because of time constraints and for further validation, the authors will use logistic regression as a future research work to validate the findings identified in this research paper. This study involves dependent variable (which is having two levels of classification – risk bearing ability and bankruptcy prediction of an MSME firm), therefore Logistic Regression analysis seems to be most apt for this study. Primary interaction with various MSME agencies leads to following output which also supports the work of author (Kanapickiene & Spicas, 2019):

a. Profitability ratio, liquidity ratio analysis are widely used in credit risk assessment

b. Assets availability, turnover, rate of interest on assets are considerably used for credit assessment for MSME firms

c. Tangible assets ratio, involvement in capital market are least used among financial variables for credit risk assessment

These above listed analysis also highlights that a lending agency take all measurements to bifurcate a good credit from a bad credit. Some of the authors have also followed the cross sectional research design to predict the default rates however, this largely helps in generalizing the data of the sample to a bigger population (Ssekiziyivu et al., 2017). However, few of the authors raised the challenges of adoption of AI based tools by the lending agencies, and they stressed that this could be at all three levels – technological, organizational, and environmental (TOE) framework (Luisa Kruse, 2019). At technology level, it is informed that there is a scarcity of trained data and not in sufficient quantity to run the AI model. The available historic data is vague and not the authenticated one, therefore will not provide a concrete assessment for further implementation at various lending agencies. At organizational level, it is the acceptance of AI based model for risk assessment from the organization and giving a green signal to implement this, also some of the organizations have insufficient AI expertise to run the model or train the data. At environmental level, it is the peer pressure and lacking of customer's and community support for the further implementation of AI model for the risk assessment as they fear that there could be higher cases of rejection rather than acceptance of loan applications by MSMEs.

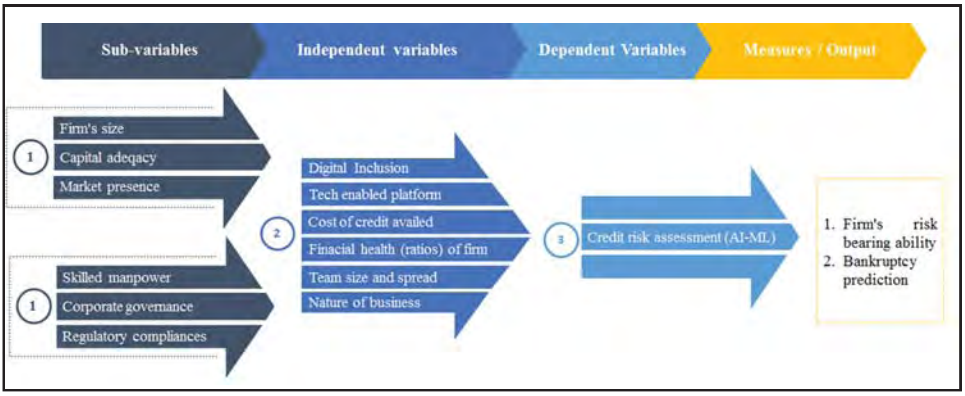


Fig. 1 – Factors impacting the performance of MSMEs in India

The purpose of this research study is mainly to predict the MSMEs for bankruptcy or probability of being default in future and the other level of dependent variable is to assess whether the MSME can bear the risk even if they get additional capital investment for the expansion of their respective business. Few independent variables and sub-variables which can be categorized further under financial, non-financial and other alternative data information by which lending agencies can assess the risk bearing capacity of an MSME firm to sustain in the market.

DATA SOURCES, COLLECTION AND ANALYSIS

For primary data collection, in-depth interviews and expert interviews have been followed, along with focus group discussions. Secondary data has been obtained from the public domain of various banking and non-banking institutions, regulators, and relevant stakeholders. The authors have approached approximately 250 respondents for primary data collection, and analysis. Both qualitative and quantitative data are collected, and analysis has been done with the different software to validate or reject the hypotheses. Convenience sampling methods have been applied, sample respondents have been purposefully selected based on their experiences, and past achievements to predict the loan behavior of any MSME firms. Respondents were requested to highlight their insights, for the series of question for the credit risk assessment of any MSME firm, and also to understand their overall experience while sanctioning loans to any micro, small, and medium size businesses. For reliability and validity of the analysis tools or questionnaire, a content validity test on pilot basis has also been conducted.

Basically, the surveyed questionnaire had two parts – one for officials representing the various lending agencies – supplier side (comprises of public and leading private sector banks, non-banking finance corporations, small finance banks etc.) and second part of questionnaire was for the owner / founder / top level officials representing MSME firms – receiver side. Out of the total respondents from the lending agencies, approximately 40% of total respondents have more than 15 years of work experience in financing sector, and approximately 30% of total respondents having more than five years and up to ten years of work experience with various lending agencies. MSME respondents are largely from four main sectors – Retail, Trade, Manufacturing and Foods and Beverage industry.

Most of the respondents representing the lending agencies informed that it is the last three or five years performance of an MSME firm which helps in deciding to facilitate credit in terms of business loan. Below illustration (Fig. 2) suggest that approximate 41% of total respondents feel that the duration and firm's performance or longevity influence the lenders to allocate the credit at their interest.

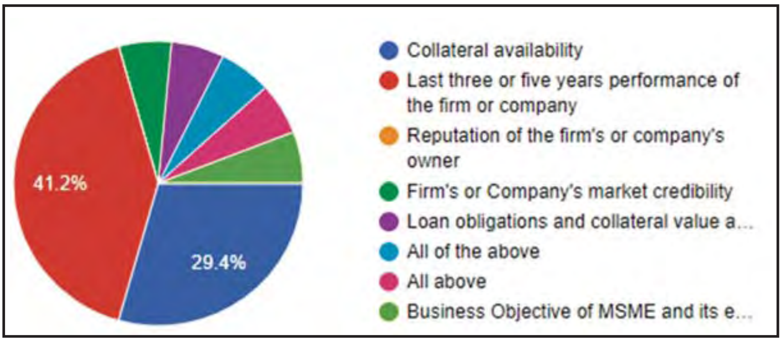


Fig. 2 – Factors for facilitating credit to MSME firm (response from supplier side)

The surprising part is when the authors asked the same question to the MSME representative, there also approximate 56% of the respondents felt that it is the last three to five years' firm performance which creates higher trust in front of lending agencies to facilitate credit to them at affordable rate of interest. Below illustration (Fig. 3) correctly support this. However, it is also informed that collateral availability is the next important factor (from supplier end), and owner's or company's reputation is the next best factor (from receiver end).

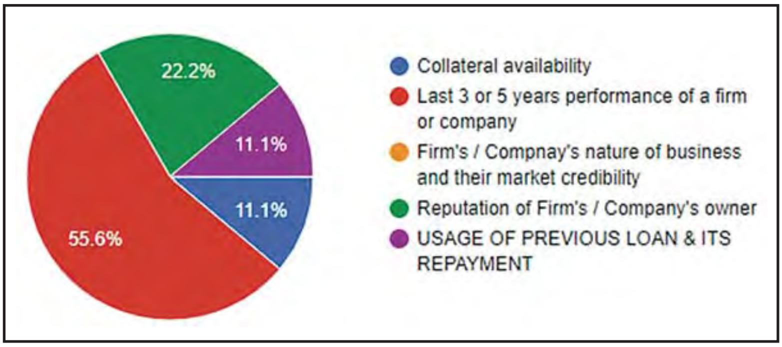


Fig. 3 – Factors for facilitating credit to MSME firm (response from receiver side)

When the authors surveyed the respondents for what would be the main reasons for an MSME firm to default or becoming bankrupt in future, both the sides concluded that it is the attitude or mindset of a firm's owner or top-level officials who intent to default other than the factors like market conditions or market responses for the varied nature of the business responsible for making them bankrupt. Few respondents also suggested that it is the high rate of interest for making MSME defunct or default. Below illustrations (Fig. 4 and Fig. 5) clearly depicts this.

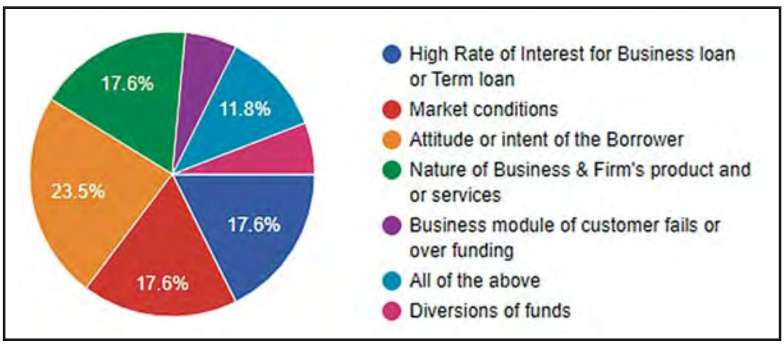


Fig. 4 – Factors responsible for MSME firm to default or bankrupt (response from supplier side)

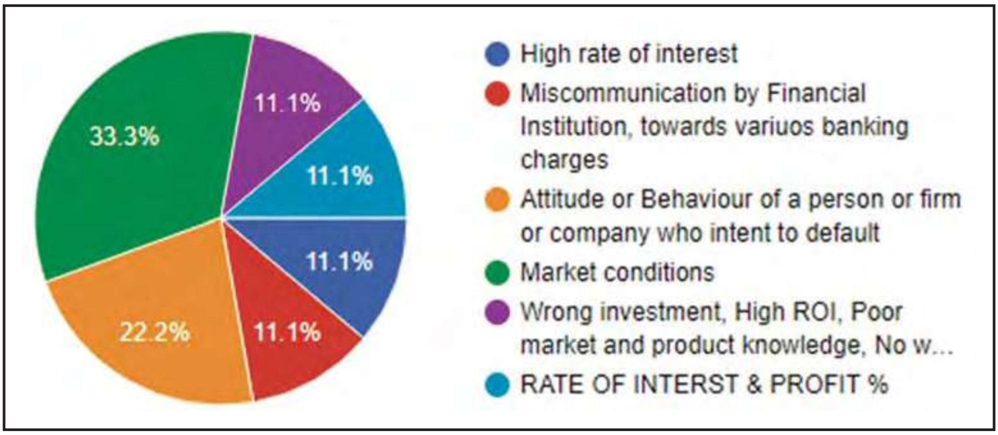


Fig. 5 – Factors responsible for MSME firm to default or bankrupt (response from receiver side)

After asking the respondents about - what are the strategies or processes usually the lending agency follows while sanctioning or rejecting the loan applications? Then it was good to arrive at approximately 29% of the financial institutions in India take help of advanced technology based tools (AI/ML based) for assessing the loan applications, for facilitating credit to MSME firms. However, here we can have ample scope for further strengthening it by bringing more number of lending agencies under digital platforms. This also shows that the lending agency checks all conventional data plus the other available alternative data while approving the loan and for risk assessment of an MSME firm. Therefore, Fig. 6 supports the hypothesis (H1) and it is valid that lending agencies consider all factors and are not just dependent on their financials for facilitating credit to MSMEs.

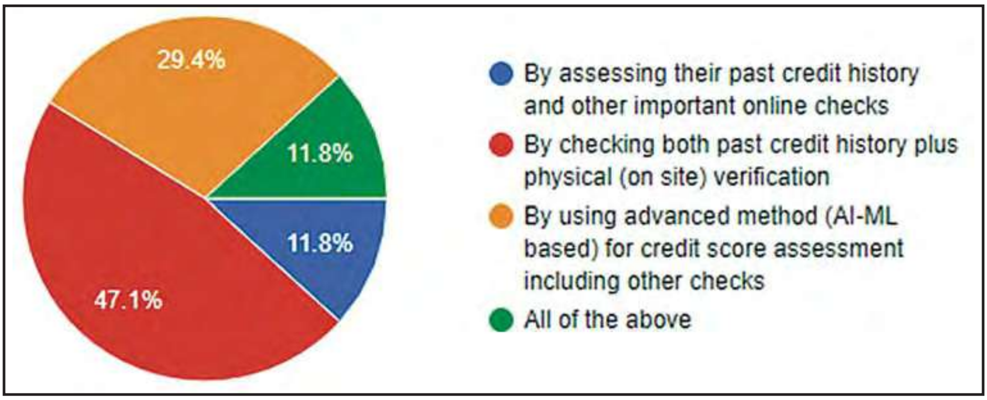


Fig. 6 – Factors for assessing MSMEs of their risk bearing ability (response from supplier side)

MSME representative feels that it is the government policies and/or market conditions which mainly help them for their success or failure, and not just the constant upgradation of infrastructure, team size etc. (including the hiring of trained or skilled manpower). They further insisted that it is the market response and how it behaves, all these decide for their success or failures and to sustain globally. So in one sense this finding does not support our hypothesis (H2) and this will be rejected, however this would be further tested or validated through other methods of analysis. Below illustration (Fig. 7) provides the detail.

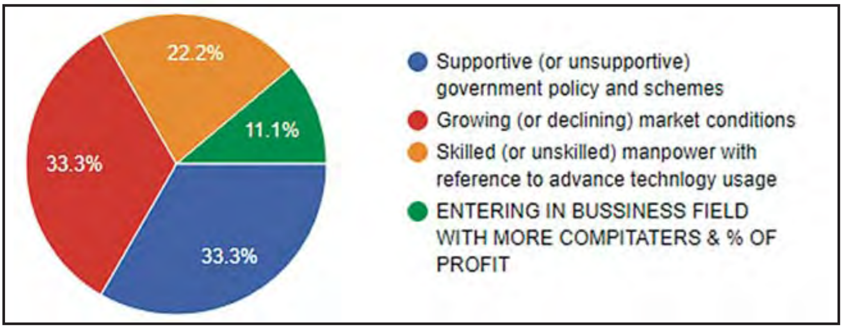


Fig. 7 – Factors for probability of success or failure of MSMEs (response from receiver side)

CONCLUSION AND FUTURE RESEARCH

We have approximate 6.3 crores of MSMEs in India, which contributes around 30% of GDP, and shares almost 50% of total exports. Therefore, inclusive growth and development of each unit of MSMEs are desperately required. MSME firms are instrumental in providing the economic balance, creating job opportunities, and will fuel India to achieve the USD 5 trillion economy by 2025. The biggest challenge is that around 40% of total MSMEs in India do not have any financial access or very limited financial access which also supports our finding for this research study. Out of total respondents we surveyed, only 50-56% of them had taken bank loan during recent past from the formal financial channels. And, even those who had taken loan, they took at a very high rate of interest which practically makes them difficult for their sustainable growth. Some of the government schemes like Pradhan Mantri Mudra Yojana, Udyog Aadhar, MSME Samadhaan, ZED scheme, Make in India have produced considerable outcomes. Government's recent flagship schemes like Merchandise Exports from India Scheme to realize the dream of *Atamnirbhar Bharat* (Self-reliant India) and Make in India, also launching of production linked incentives for various manufacturing products would be a great boost for the MSMEs. They have to bounce back (post-COVID) within a short period, and there are no options left for a country like India with a huge population size of 1.4 billion. Digitisation and financial inclusion could be one way to resolve these challenges for inequality of MSMEs particularly in terms of accessing formal finance that too at an affordable rate of interest. It is the need of the hour to bring most of MSME firms on a common platform, to have interconnectedness globally and in national or regional level markets.

It has been observed from the secondary literatures that many of the Indian MSMEs have not even taken the full benefits from the digitisation initiatives launched by Indian government like Udyam registration portal, CHAMPIONS portal, and raising and accelerating MSME performance scheme etc. Therefore, these firms are not serious about their sustainable growth, having an approach of traditional routes to grow which makes them adopt a very lethargy style of work, and not able to compete globally. They still rely on various government incentives, and look for relaxations in goods and service tax for their growth, which also supports our finding (please refer Fig. 7) in this research paper. Now-a-days customers are more inclined to tailored financing products specific to day to day requirements. Therefore, lending agencies must have innovative financial products to deal with these kinds of requirements. And here AI/Ml based tools will be having greater role to play in assessing various customer needs and in the same way helping the lending agencies to come up with high profitable financial products. New age borrowers are getting smarter, and exploring all sorts of benefits from a single investment, hence banking institutions (both public and private) must have a dedicated product team to identify these challenges even for the overseas client specific on behalf of the MSMEs borrower/s to fulfill their needs. Financial inclusion is also one of the key aspects under the UN Sustainable Development Goals for the financial sector. Referring to the information published in various grey literatures, most of the MSME owners in India are from rural and semi urban parts, deprived of their financial access to the formal channels, and are running the business with limited understanding of finance. This could also be one of the reasons for taking wrong financial decisions, and ultimately falling into the trap of bad loans which results in the victim of bankruptcy. Our findings also support the same (please refer to Fig. 4 and 5 in this research paper). Therefore, training and complete guidance programs must be initiated from various stakeholders like trade associations, local / regional level government authorities, and from various lending agencies to keep them updated for all the benefits by accessing formal financial channels. Future research work could also be recommended to undertake various other AI/ML based methods to validate these findings.This research paper used a self-administered questionnaire which may be one of the limitations for the data collection, collation and analysis. Therefore, other mode of surveys, and the data collection methods can also be explored to further validate these outcomes.

BIBLIOGRAPHY

(1) Namvar A. et al. (2017), "Credit risk prediction in an imbalanced social lending environment".

(2) Asgary A. et al. (2020), "Small and Medium Enterprises and Global Risks: Evidence from Manufacturing SMEs in Turkey", International Journal of Disaster Risk Science, 11(1), pp.59-73.

(3) Baluku M. M. et al. (2018), "Psychological capital and entrepreneurial outcomes: the moderating role of social competences of owners of micro-enterprises in East Africa", Journal of Global Entrepreneurship Research, 8(1).

(4) Barukèiæ I. et al. (2021), "Credit of small and medium sized scientific and technological enterprises based on BP neural network Evaluation research", MATEC Web of Conferences, 336.

(5) Belas J. et al. (2018), "Impact of Selected Characteristics of Smes on the Capital Structure", Journal of Business Economics and Management, 19(4), pp.592-608.

(6) Boushnak E. et al. (2018), "Factors Influencing Credit Decision for Lending SMEs: A Case Study on National Bank of Egypt", OALib, 05(11), pp.1-17.

(7) Chaudhuri K. et al. (2018), "Gender, small firm ownership, and credit access: some insights from India", Small Business Economics, 54(4), pp.1165-1181.

(8) Giudici P. et al. (2019), "Network Based Scoring Models to Improve Credit Risk Management in Peer to Peer Lending Platforms", Front Artif Intell, 2, 3.

(9) GrondysK. et al. (2021), "Risk Assessment of the SME Sector Operations during the COVID-19 Pandemic", Int J Environ Res Public Health, 18(8).

(10) Kanapickiene R., and Spicas R. (2019), "Credit Risk Assessment Model for Small and Micro-Enterprises: The Case of Lithuania", Risks, 7(2).

(11) Koisova E. et al. (2017), "SMEs Financing as an Important Factor of Business Environment in Slovak Republic Regions", Montenegrin Journal of Economics, 13(2), pp.29-140.

(12) Kou G. et al. (2021), "Bankruptcy prediction for SMEs using transactional data and two-stage multiobjective feature selection", Decision Support Systems, 140.

(13) Kustina K. T. (2018), "MSMEs Credit Distribution and Non-Performing Loan towards Banking Companies Profit in Indonesia", International Journal of Social Sciences and Humanities (IJSSH).

(14) Li B. et al. (2021), "Strengthen credit scoring system of small and micro businesses with soft information: Analysis and comparison based on neural network models", Journal of Intelligent & Fuzzy Systems, 40(3), pp.4257-4274.

(15) Lu T. Z. et al. (2019), "The Value of Alternative Data in Credit Risk Prediction: Evidencefrom a Large Field Experiment. ICIS 2019 Proceedings", 10.

(16) Luisa Kruse N. W. and Beck R. (2019), "Artificial Intelligence for the Financial Services Industry:What Challenges Organizations to Succeed", Proceedings of the 52nd Hawaii International Conference on System Sciences, pp.6408-6417.

(17) Mukherjee S. (2018), "Challenges to Indian micro small scale and medium enterprises in the era of globalization", Journal of Global Entrepreneurship Research, 8(1).

(18) Naoyuki Yoshino F. T.-H. (2018), "The role of SMEs in Asia and their difficulties in accessing finance", Asian Development Bank Institute working paper (911).

(19) Ssekiziyivu B. et al. (2017), "Credit allocation, risk management and loan portfolio performance of MFIs—A case of Ugandan firms", Cogent Business & Management, 4(1).

(20) Dhanabalan T. and Sathish A. S. (2018), "Transforming Indian industries through artificial intelligence and robotics in Industry 4.0", International journal of mechanical Engineering and Technology (IJMET), 9(10), pp.835-845.

(21) Taiwo JN et al. (2017), "Credit Risk Management: Implications on Bank Performance and Lending".

(22) "Growth", Saudi Journal of Business and Management Studies, 2(5B), pp.584-590.

(23) Win S. (2018), "What are the possible future research directions for bank's credit risk assessment research? A systematic review of literature", International Economics and Economic Policy, 15(4), pp.743-759.

(24) Yang L. and Zhang Y. (2020), "Digital Financial Inclusion and Sustainable Growth of Small and Micro Enterprises-Evidence Based on China's New Third Board Market Listed Companies", Sustainability, 12(9).

(25) Þigienë G. et al. (2019), "Artificial Intelligence Based Commercial Risk Management Framework for SMEs", Sustainability, 11(16).

Annexure

List of referred research articles, highlighting the SMEs coverage across the various countries worldwide, in their risk assessments:

Sl.	Name of Author/s	Topic of the Article	Name of the Journal. Vol. No. Issue No. (Year & Citation)	Keywords	Country covered
1	Bing Lia, Binqing Xiaoa, and Yang Yangb	Strengthen credit scoring system of small and micro businesses with soft information: Analysis and comparison based on neural network models	Journal of Intelligent & Fuzzy Systems 40 (2021) 4257–4274, DOI:10.3233/ JIFS-200866	Credit scoring, small and micro businesses, soft information, back-propagation neural network, comparative analysis	China
2	Rasa Kanapickiene 1, and Renatas Spicas	Credit Risk Assessment Model for Small and Micro-Enterprises: The Case of Lithuania	Risks, 5 June 2019	Trade credit; small and micro-enterprises; financial non-financial variables; risk assessment; logistic regression	Lithuania
3	Bob Ssekiziyivu1, Rogers Mwesigwa1, Mayengo Joseph1 and Isaac Nkote Nabeta2	Credit allocation, risk management and loan portfolio performance of MFIs—A case of Ugandan firms			SMEs of Uganda
4	Ekhaa Boushnak, Mohamed A. Rageb, Aiman A. Ragab, Ahmed M. Sakr	Factors Influencing Credit Decision for Lending SMEs: A Case Study on National Bank of Egypt	Arab Academy for Science, Technology and Maritime Transport, Alexandria, Egypt		Egypt
5	Kausik Chaudhuri & Subash	Gender, small firm ownership, and credit	Small Bus Econ (2020) 54:1165–1181		India

Sl.	Name of Author/s	Topic of the Article	Name of the Journal. Vol. No. Issue No. (Year & Citation)	Keywords	Country covered
	Sasidharan & Rajesh Seethamma Natarajan Raj	access: some insights from India			
6	Ali Asgary1, Ali Ihsan Ozdemir2, Hale O¨ zyu¨rek3	Small and Medium Enterprises and Global Risks: Evidence from Manufacturing SMEs in Turkey	Int J Disaster Risk Sci (2020) 11:59–73	Global risks Risk assessment Risk matrix Small and medium enterprises Turkey	Turkey
7	EVA KOISOVA1, JOZEF HABANIK2, ZUZANA VIRGLEROVA3, ZOLTAN ROZSA4	SMEs Financing as an Important Factor of Business Environment in Slovak Republic Regions	Montenegrin Journal of Economics, Vol. 13, No. 2 (2017), 129-140	SMEs of EU Countries	
8	Naoyuki Yoshino and Farhad Taghizadeh-Hesary	The role of SMEs in Asia and their difficulties in accessing finance	ADBI Working Paper Series, December 2018	Asian countries	
10	T. Dhanabalan, A. Sathish	Transforming Indian industries through artificial intelligence and robotics in industry 4.0	International Journal of Mechanical Engineering and Technology (IJMET), Volume 9, Issue 10, October 2018, pp. 835–845	India	
11	Martin Mabunda Baluku1,3, Julius Fred Kikooma1, Edward Bantu2 and Kathleen Otto3	Psychological capital and entrepreneurial outcomes: the moderating role of social competences of owners of	Baluku et al. Journal of Global Entrepreneur-ship Research (2018) 8:26, Journal of Global	Commitment to entrepreneurship, Entrepreneurial outcomes, Performance, Psychological capital, Psychological	East African countries

Sl.	Name of Author/s	Topic of the Article	Name of the Journal. Vol. No. Issue No. (Year & Citation)	Keywords	Country covered
		microenterprises in East Africa	Entrepreneur-ship Research	resources, Satisfaction, Social, competence, Well-being	
12	Katarzyna Grondys 1, Oliwia´ Slusarczyk 1,2, Hafezali Iqbal Hussain 3,4, and Armenia Androniceanu	Risk Assessment of the SME Sector Operations during the COVID-19 Pandemic			Poland (EU countries)
13	Ketut Tanti Kustina a, I Gusti Ayu Agung Omika Dewi b, Gine Das Prena c, I Gusti Ayu Diah Utari	MSMEs Credit Distribution and Non-Performing Loan towards Banking Companies Profit in Indonesia	International Journal of Social Sciences and Humanities, Vol. 2 No. 1, April 2018, pages: 10~23		Indonesia
14	Jaroslav BELAS1, Beata GAVUROVA 2*, Peter TOTH3	Impact of selected characteristics of SMEs on the capital structure	Journal of Business Economics and Management, 2018 Volume 19 Issue 4: 592–608	Capital structure, SMEs, company indebtedness, credit risk, loan availability, company, prosperity, optimal capital structure, ordinal logistic	SMEs of Czech Republic
15	Liu Yang and Youtang Zhang	Digital Financial Inclusion and Sustainable Growth of Small and Micro Enterprises—Evidence Based on China's New Third Board Market Listed Companies	Sustainability 2020, 12, 3733; doi:10.3390/su12093733		China

4 AVOIDANCE APPLICATIONS AND THEIR POTENTIAL FOR UNLOCKING VALUE

- *Aparna Ravi and Aakash Sherwal*

EXECUTIVE SUMMARY

One significant way in which the Insolvency and Bankruptcy Code, 2016 (IBC/ Code) departed from the framework for insolvency and winding up under the Companies Act, 2013 was through the introduction of provisions for dealing with preferential, undervalued, fraudulent and extortionate credit transactions (PUFE), collectively termed as avoidance transactions. For the first time, the IBC mandated a critical review of the functioning, accounts and prior transactions of the corporate debtor (CD) by an Insolvency Professional (IP). Further, the IBC requires that a Resolution Professional (RP) or Liquidator take appropriate steps to report such transactions to the Adjudicating Authority (AA) with the objective of clawing back amounts arising from avoidance transactions for the benefit of the CD's stakeholders.

As of December, 2022, RPs and Liquidators had filed 847 avoidance applications under the IBC seeking to recover an aggregate amount of close to ₹ 2.8 trillion. However, despite the large number of applications filed and the enormous amount claimed in aggregate, orders have been passed in only 143 cases and recovery rates are very low. Through an analysis of case law on avoidance transactions under the IBC as well as policy discussions in this area, this research paper seeks to identify some of the challenges with pursuing avoidance applications and the areas where ambiguity on the scope of avoidance transactions remain. There have, to date, been few empirical studies on avoidance applications and this paper hopes to be a starting point for an analysis of implementation of the avoidance provisions in the IBC and how their potential for unlocking value can be better utilized.

Keywords: Avoidance Applications, Transaction Audit, Preferential Transactions, Asset Tracing, Fraudulent Transactions

INTRODUCTION

In February, 2020, in the insolvency proceedings of real estate developer, Jaypee Infratech Limited (JIL), the Supreme Court passed an order for the release of a mortgage and return of over 758 acres of land valued at over ₹ 4,000 crore to the CD. This case, *Anuj Jain v. Axis Bank Limited*,[1] was one of the first cases to demonstrate the enormous value that could be realized from the avoidance provisions in Chapters III and VI of Part II of the Code. Since the IBC came into effect, RPs and Liquidators have filed 847 avoidance applications under the IBC seeking to recover an aggregate amount of close to ₹ 2.8 trillion.[2] While this is a staggering number, the amount actually recovered through these applications is less than 0.3% of the amount claimed and orders have to date been passed in only 143 cases.[3] In a large majority of cases, avoidance applications are not concluded at the time of closure of the resolution or liquidation process. In fact, for the 611 resolution plans that have been approved by the tribunals to date, 133 applications in respect of avoidance transactions to the tune of ₹ 87,721 crore were pending before tribunals at the time the resolution plans were approved.[4] Why have the recoveries under avoidance transactions been so low despite the enormous number of claims being filed? And how critical are avoidance provisions within the larger scheme of the IBC? Through a qualitative analysis of the case law and policy initiatives in this area, this research paper aims to shed light on the evolving jurisprudence on avoidance applications and the various challenges and ambiguities that remain.

The paper first analyses the provisions on avoidance transactions under the IBC, the differences between various types of avoidance transactions and the exceptions in this regard. Relying on the existing literature on avoidance transactions in other jurisdictions, it then looks into the purpose behind avoidance provisions under insolvency legislation in general and the IBC in particular. It also discusses competing interests and disadvantages to avoidance provisions that need to be considered when making policy decision on avoidance provisions in insolvency legislation. It then analyses a sample of judgments passed by the National Law Company Tribunals (NCLTs), the Appellate Tribunal (NCLAT), the High Courts and the Supreme Court in avoidance applications to better understand the issues that have arisen in such cases, divergences across tribunals and areas where further clarifications are required. The paper also delves briefly on recent amendments to the provisions on avoidance transactions as well as additional reforms that have been suggested by the Insolvency Law Committee (ILC).

Based on the analysis of case law and practical issues with implementation of avoidance applications, this paper concludes by identifying some of the impediments to unlocking the full potential from the avoidance provisions in the IBC as well as suggesting areas for future research. There has, to date, been limited empirical research on avoidance transactions both from a legal and financial perspective and this paper hopes to be a starting point to fill this gap from a legal perspective.

AVOIDANCE TRANSACTIONS UNDER IBC

Avoidance transactions is the collective term used to refer to PUFE transactions under the IBC. If the CD has engaged in these types of transactions in the lead up to insolvency, the RP or Liquidator can apply to the AA to have these transactions reversed and the debtor company put back to the same position it would have been in, had the transaction not occurred at all. While there are overlapping goals and features across the various types of avoidance actions, there are important differences among them as well.

Preferential transactions involve the CD providing a benefit or 'preference' to a creditor in the lead up to its insolvency, which puts the creditor in a more favourable position vis-à-vis other creditors in case of the CD's insolvency. Under section 43 of the IBC, a transaction will be deemed a preference if (a) the CD has transferred its property or interest to a financial or operational creditor (OC) on account of an antecedent financial or operational debt and (b) the effect of such a transfer is to put that creditor in a more beneficial position than it would have been, in the event of a distribution of assets under section 53.[5] To constitute a preference, the transaction should have occurred during the relevant time, which is two years preceding the insolvency commencement date for transactions with related parties and one year preceding the insolvency commencement date for transactions with unrelated third parties.[6] Section 43 also provides two exceptions where such a transfer will not be deemed a preference – if the transfer occurred in the ordinary course of the CD's business and financial affairs or if the transfer involves creation of a security interest that is securing new value and such transfer is registered with an Information Utility (IU) within 30 days of acquisition of the property by the CD.[7]

An undervalued transaction under section 45 is a transaction outside the CD's ordinary course of business in which it has transferred one or more of its assets to a third party either as a gift or for a consideration that is significantly less than the value of the consideration provided by the CD. Undervalued transactions are also required to have taken place within the relevant time period of two years and one year for related and unrelated parties respectively.

The ingredients of an extortionate credit transaction under section 50 are stated in greater detail in the regulations and refer to financial or operational debt transactions that involved exorbitant payments by the CD. However, the explanation to section 50 clarifies that any debt extended by a financial services provider in compliance with applicable law will not be considered an extortionate credit transaction. To be avoided under the IBC, an extortionate credit transaction should have taken place during the two-year period preceding the insolvency commencement date.[8]

The final category of avoidance transactions are fraudulent trading or wrongful trading and transactions intended to defraud creditors under sections 66 and 49, respectively. Section 66 is a broad provision that targets any business of the CD that was carried on with the intent to 'defraud creditors of the CD or for any fraudulent purpose'.[9] In such an event, the AA has the power to order any persons who were knowingly contributing to the fraudulent activities to make contributions to the assets of the CD to reverse the harm done. Section 49 specifically refers to cases where an undervalued transaction was carried out with the purpose of keeping the assets of the CD outside the reach of its creditors or to adversely affect the right of creditors making a claim in the insolvency proceedings.

A critical difference between preferential transactions and other avoidance transactions is the deeming provision. If a particular transaction meets the ingredients of section 43, it will be deemed a preferential transaction even if the parties to the transaction did not intend or even anticipate it being one. By contrast, undervalued, fraudulent and extortionate credit transactions do not contain deeming provisions and the RP or Liquidator bringing such actions would have to demonstrate a fraudulent intent, such as an intent to keep the CD's assets out of reach of its creditors. A related difference is that more evidence would typically need to be produced to prove an undervalued, fraudulent or extortionate credit transaction (for example, valuation reports by third party experts in the case of an undervalued transaction or proof of fraudulent intent in the case of a transaction intended to defraud creditors) when compared to a preferential transaction. As will be seen later in the paper, these differences are often emphasized by the AA when passing orders in these applications as RPs and Liquidators tend to file applications that simultaneously refer to all these sections.

THE NEED FOR AVOIDANCE PROVISIONS

What purpose do avoidance provisions serve in the larger scheme of the IBC or any insolvency law legislation? The first and most obvious purpose stems from insolvency being a collective process. Unlike debt recovery or security enforcement laws that allow each creditor to pursue individual actions against the CD, the goal of insolvency resolution or liquidation is to ensure a fair distribution of the proceeds among different classes of creditors. Preferential provisions in particular seek to ensure that one creditor does not unjustly benefit at the expense of other creditors by penalizing creditors that try to enter into 'side deals' with the CD as it enters the zone of insolvency.

Second and equally important, avoidance provisions seek to maximize value in the resolution or liquidation process by returning value and assets to the CD. By identifying and seeking to reverse certain transactions, avoidance provisions have the potential to bring back significant value to the CD's estate for the benefit of all stakeholders. Taking the case of *JIL*, the value of the land recovered by the CD was immense. As Dr. Sahoo and Dr. Nair point out: '*If this value is retrieved fully, several firms would be rescued. If this value was not alienated, many would not have got into CIRP in the first place*'.[10]

Third, avoidance provisions attempt to change the behaviour of CDs and their promoters when encountering financial distress. The IBC is not a punitive legislation, with its goal being resolution or liquidation to maximize value for creditors and ease the exit process for the CD and its promoters.

At the same time, the IBC, like other insolvency legislations the world over, acknowledges the tendency of debtor companies and their promoters to resort to diversionary tactics as they enter the zone of insolvency. Transferring assets to related parties of the promoters for low or nil consideration, paying off certain creditors at the expense of others and entering into transactions that provide little commercial benefit for the CD are all too common during this period. Avoidance provisions seek to serve as a deterrent to such opportunistic behaviour.[11]

Finally, as a by-product, avoidance provisions serve to increase transparency. For the first time in Indian insolvency legislation, the IBC and the related regulations place an affirmative duty on the RP and Liquidator to investigate into the affairs of the CD and identify transactions to be avoided. As a consequence, RPs and Liquidators often engage transaction auditors and third-party specialists to undertake a detailed review of the CD's books, records and past transactions. In addition to identifying and pursuing avoidance actions, such an exercise helps clean up the books of the CD, allows for better asset tracing and provides a more accurate view of the affairs of the CD and any kinds of dealings that might be hidden beneath the surface.

Are there any disadvantages of avoidance provisions?

While avoidance provisions bring several benefits to insolvency and liquidation proceedings, the ability to have certain transactions 'avoided' also comes with its costs. Leaving aside transactions involving fraud, many avoidance transactions, particularly preferential transactions, would be perfectly legal if carried out, outside the zone of insolvency process. As a consequence, an insolvency legislation where transactions can be easily avoided could lead to uncertainty among contracting counterparties and make parties reluctant to enter into transactions in the first place.[12] For this reason, avoidance provisions, typically have built in protections for third parties who might have entered into transactions with the CD in good faith and without any idea that that the debtor might be entering the zone of insolvency. For example, section 44 of the IBC prevents the AA from passing an order in a preferential transaction that requires a party that received a benefit from a preferential transaction in good faith and for value to pay a sum to the RP or Liquidator.

Yet another concern with enforcing avoidance provisions relates to litigation costs. Pursuing avoidance actions brings in parties that may not otherwise be involved with the insolvency proceeding. In addition, as has been seen, certain types of avoidance actions could require detailed evidence gathering, leading to protracted litigation. While it is clearly a step forward that RPs and Liquidators are required to investigate into the affairs of the CD and initiate corrective action, these benefits do need to be balanced with the increased time and costs of such actions. It is against this backdrop that we turn to examining the evolving jurisprudence on avoidance transactions under the IBC.

EVOLVING JURISPRUDENCE ON AVOIDANCE TRANSACTIONS

Elements to establish preference

As mentioned above, one of the first cases to provide an in-depth analysis of avoidance transactions under the IBC was the Supreme Court's landmark decision in *Anuj Jain v. Axis Bank Limited*,[13] on the avoidance of the mortgages that the CD - JIL had created in favour of the lenders of its parent company, Jaiprakash Associated Limited (JAL). In *Anuj Jain*, the Supreme Court, in holding the creation of the mortgage to be a preferential transaction under section 43, also laid out the following sequence for RPs and Liquidators to determine whether a particular transaction constituted a preference:[14]

(i) Placing all the transactions of the corporate debtor in chronological order from the start of the insolvency to the two years prior, identifying the parties involved, and classifying them as related parties and others;

(ii) Separating the identified transactions into two subsets – related parties and non-related parties – further examining the non-related party transactions to only include those that occurred within a year of the insolvency's start date;

(iii) Examining the sub-sets to determine: (a) if the transaction involves the transfer of property or an interest in property owned by the corporate debtor, and (b) whether the beneficiary to such transaction is acting as the corporate debtor's creditor, surety, or guarantor. This third step would then lead to shortlisting transactions that appear to have involved a preference.

(iv) Scrutinizing the transactions shortlisted in (iii) to determine if the transfer was made on account of an antecedent financial or operational debt or other liability owed by the corporate debtor;

(v) Examining if the transfer in question would result in the creditor, guarantor, or surety being in a better position than it would have been in, in the event of an asset distribution in accordance with Section 53 of the Code; and

(vi) Finally, even if the answer to the question in (v) is yes, checking whether any of the exceptions in Section 43(3) would apply: (a) if the transfer is in the ordinary course of business or financial affairs of the corporate debtor or transferee, (b) the transfer is a security interest to secure new value, or (c) the transfer was registered within an information utility within 30 days of the corporate debtor receiving possession of such property.

Applying the above analytical framework to the facts in hand, the Supreme Court concluded that the mortgage created by JIL in favour of JAL's lenders did indeed constitute a preference and ordered that JAL's lenders release the mortgage and possession of the property be returned to JIL. The judgment in *Anuj Jain* itself provides two important takeaways. First, intention of the parties is not relevant in determining whether a particular transaction constitutes a preference. The deeming provisions in section 43 are such that any transaction that meets the strict requirements of section 43 would be a preferential transaction. In this context, it is also worth noting that the Supreme Court avoided the mortgages even though there was no debtor-creditor relationship between the CD, JIL, and the transferees/ beneficiaries of the mortgage, the lenders of JAL. The Court held that a debtor-creditor relationship between the CD and the transferee was not necessary as long as the transaction had the effect of putting a creditor of the CD in a more beneficial position. In this case, the ultimate beneficiary of the mortgages granted by the CD was JAL, which was an OC of the CD.

Second, the Court placed significant weight on the fact that JIL had provided the mortgage to JAL's lenders, at the expense of its own creditors at a time when JIL itself was under financial stress. The Court also rejected the respondent's contentions that deeming the mortgages as preferential transactions would impact a large number of transactions commonly undertaken by lenders when taking third party security from a borrower's subsidiaries. The Court stated that lenders were expected to conduct diligence on the financial condition of third party security providers and assess whether the transaction may be subject to legal challenge at a later date.[15] In other words, the Supreme Court placed the onus on lenders rather than borrowers to take steps to prevent preferential transactions by conducting sufficient diligence not just on the financial condition of borrowers, but also on third party security providers.

Standards of evidence

The decision in *Anuj Jain* sent ripples across the lender community, causing lenders to rethink how they structured security packages from group companies of the borrower. In addition, it provided a clear framework for RPs and Liquidators to analyse the past transactions of the CD and signalled to them the possibility of unlocking significant value in insolvency. However, it should be kept in mind that *Anuj Jain* dealt only with preferential transactions as the Supreme Court decided that it was not necessary to go into whether the transactions were also undervalued and fraudulent. Unlike preferential transactions that have a deeming provision, fraudulent and undervalued transactions require a demonstration of intent and the adjudicating authorities have been grappling with the level of evidence required for transactions under sections 45 and 66. Even for preferential transactions, as the framework laid out in *Anuj Jain* demonstrates, significant ground work needs to be carried out by the RP or Liquidator to establish that a preference was indeed given.

One specific issue that has arisen from the case law regarding evidence is the extent of reliance that can be placed on forensic reports and transaction audits conducted by third parties. In *Vijay Lulla v. Technovaa Plastic Industries Private Limited*,[16] the NCLT, Allahabad Bench, made clear that while a RP or Liquidator could be assisted by third party experts, the opinion and determination as to whether a particular transaction was to be avoided had to necessarily be made by the RP or Liquidator.[17] In this case, the NCLT dismissed the applications of the RP under sections 43, 45 and 66 for lack of evidence as well as undue reliance that the RP had placed on the forensic report. The NCLT also noted that the forensic report itself was full of disclaimers and did not make any definite observations on the kinds of questionable transactions that the erstwhile promoters and directors of the CD were required to repay.[18]

In *Bank of Maharashtra v. Visa Power Limited*,[19] the NCLT similarly pointed out that the transaction audit report on which the Liquidator had placed reliance did not present sufficient material to prove that the transactions in question were preferential, undervalued and fraudulent: *'It appears that the Liquidator made allegations against the Respondents that they did some fraudulent, under valued or preferential transactions only on the basis of observation of the Auditor in forensic report'.*[20] In contrast, the AA went on to point out that the transaction audit report itself stated that transactions in question could not be considered fraudulent solely on the basis of the report.

It is worth noting that AAs have adopted varied practices in relying on transaction audit reports. In contrast to *Vijay Lulla* and *Bank of Maharashtra*, the AA have, in other instances, allowed reliance on the transaction audit report in determining that the transactions in question should be avoided. This was the case in the decision of the NCLT, Principal Bench in *Suresh Kumar Jain v. Adriatic Sea Foods Pvt Ltd*,[21] which was upheld by the NCLAT.[22] The evidence in this was case admittedly more straightforward as it involved a sale of a plant by the CD at a price significantly lower than the price indicated in the conditional NOC for the sale granted by the mortgagee bank. However, neither the NCLT nor the NCLAT questioned the RP's reliance on the transaction audit report. In yet another similar example, the NCLAT in *Radico Trading Limited v. Tarun Batra & Ors.*,[23] did not raise any question on the RP relying on the transaction audit report in determining that CD had entered into an undervalued transaction. In this case, however, the transaction audit report was clear in stating that the transaction in question satisfied the requirements for undervalued transactions in section 46.

The use of and extent of reliance on transaction audit reports is an evolving area of jurisprudence and the practice in this regard has not been established. There have been rare cases in which the RP has been able to rely on the books and records of the CD to establish avoidance transactions. For example, in *Raksha Bullion v. Royal Refinery*,[24] NCLT relied on the ledgers of the CD to determine that the CD had fraudulently diverted funds to third parties. A similar approach was followed by the

NCLT, Chennai Bench in *GV. Ravikumar v. K. Kuppuswamy*,[25] where the AA held that, in the absence of any rebuttal by the respondents, the tribunal had to presume prima facie that the entries in the ledger account of the CD were true and such undervalued transactions were carried out.

However, in a majority of cases, it has been essential for RPs and Liquidators to appoint third party experts to investigate into the past transactions of the CD. Most avoidance transactions may not be unearthed by a mere surface level perusal of the books and records of the CD and the use of forensic and other expert techniques for asset tracing can serve to detect the kinds of questionable transactions that promoters of companies in the zone of insolvency might have engaged in. On the other hand, reports of third-party experts are often littered with numerous disclaimers and AAs have been reluctant to place undue reliance on them. At the very least, it appears that RPs and Liquidators should have satisfied themselves of the determination and use the transaction report to bolster their claims. This is, of course, hard to achieve in practice as obtaining information from promoters and erstwhile management continues to remain a challenge in most insolvency proceedings. Insolvency proceedings are also largely summary proceedings and the time to gather evidence is necessarily limited. While RPs and Liquidators may obtain more guidance in this area with time, it is likely that the level of evidence required will be a highly fact specific analysis.

Ordinary course exception

How does one ensure that bona fide transactions of the CD are not caught in the wide net of avoidance provisions? The ordinary course of business exception for preferential and undervalued transactions seeks to ensure that the CD is not prevented from carrying on its usual business and third parties are not deterred from entering into ordinary course dealings with a company in the zone of insolvency. The case law on avoidance transactions to date indicates that the AAs on several occasions have dismissed avoidance applications in reliance on the ordinary course exemption. In *Dipti Mehta, Resolution Professional, Parag Distellery Private Limited v. Shivani Amit Dahanukar & Ors.*,[26] the RP had alleged that a change in the business model of the CD from being the manufacturer and seller of liquor to carrying out bottling job works for liquor had resulted in a transfer of ₹ 43.85 crore to its holding company and constituted a preference. The AA, in reliance on the contentions of the former directors of the CD on industry practice, concluded that such a change in business model was part of the ordinary course of business and financial affairs of the CD. In the same case, the AA also refused to entertain the RP's contention that the sublease arrangement of the CD was null and void as it was prejudicial to creditor interests. Interestingly, the fact that the creditors of the CD had not approved the sublease and had raised concerns with the arrangement, did not factor into the AA's decision that the sublease was well within the commercial wisdom of the CD's erstwhile management and in the ordinary course of business.

In *Cura Healthcare Private Limited v. Deepak Mittal, Ex-director, Cura Healthcare Pvt Ltd.*,[27] in dismissing an avoidance application, the NCLT pointed out that a transaction could not be considered outside the ordinary course of business for the sole reason that it was carried out nine days prior to the initiation of corporate insolvency resolution process (CIRP). In expanding further on the ordinary course of business exception, the NCLT, in *Venkatasan Sankaranaraynan v. RNT Distributors Private Ltd & Anr.*,[28] sought to distinguish between priority and preference. In the case at hand, the CD had repaid certain advance amounts funded by the respondent in the course of its business operations, which the Liquidator contended was a preferential transaction. In concluding that the transactions did not constitute a preference, the AA relied on the fact that the parties had been doing bona fide business for several years and the transactions in question were clearly in the ordinary course of business. The tribunal also considered the financial condition of the CD and noted that the transactions in question were clearly carried out with the aim of keeping the CD as a going concern:

> There is a clear distinction between 'Preferential Transaction' and 'Priority Transaction'. Looking at the precarious financial condition of the Corporate Debtor, if some priority is given to the Respondent with an honest intention to keep the factory running, the same cannot be termed as a preferential transaction.[29]

These cases suggest that the AAs consider the overall context and intention of the transaction in question when analysing whether the ordinary course of business exception applies. While this is again a fact specific analysis, it brings in a subjective element that, to a certain extent, goes against the deeming provision in section 43.

A final issue that has been a bone of contention in deciphering the ordinary course exception is whether the transaction in question could be in the ordinary course of business of either the CD or the transferee or if it had to be in the ordinary course of business of both parties. The Supreme Court's judgment in *Anuj Jain* clarified this issue by stating that the transaction had to be in the ordinary course of business of both the CD and the transferee. In that case, the respondents had tried to argue that the transactions of mortgaging JIL's properties were in the ordinary course of business as far as JAL's lenders, i.e., the transferees, were concerned. The Supreme Court, however, clarified that it had to be in the ordinary course of business of the CD as well for the exception to apply. This is again an important issue for creditors to keep in mind as it significantly narrows down the scope of the ordinary course exception as far as transactions such as the creation of a mortgage (which are typically the subject matters of a preference) are concerned.

Time period for completion of avoidance applications

As we have seen from the analysis of the case law so far, the existence of avoidable transactions typically take time to detect. The process of evidence gathering, appointing a third party to conduct transaction audit all take time, particularly when faced with uncooperative promoters and erstwhile management. Further, once detected by a RP or Liquidator, prosecuting the avoidance transaction takes time as such applications cannot be decided in a summary manner.

The time and costs of evidence gathering and asset tracing for avoidance transactions stands in contrast to the time bound nature of the CIRP and liquidation processes. This is one of the reasons that, despite the helpful guidance provided and significant signalling value of *Anuj Jain*, large scale recoveries in avoidance transactions tend to be few and far between. In this context, a question that has arisen on several occasions is whether avoidance applications can continue to be pursued post approval of the resolution plan.

This issue first gained attention in the Delhi High Court's judgment in *Venus Recruiters Pvt Ltd. v. Union of India & Others,*[30] relating to avoidance applications filed during the CIRP of Bhushan Steel Limited. At the time of closure of the CIRP with the approval of Tata Steel Limited's resolution plan, the NCLT had not passed any orders on the avoidance application filed by the RP. However, a few months after Tata Steel had acquired control of Bhushan Steel, the NCLT issued notice to the counterparties (one of which was Venus Recruiters Pvt. Ltd.) in these avoidance applications, directing them to file responses. This led Venus Recruiters to file a writ petition in the Delhi High Court challenging the NCLT's jurisdiction to hear an avoidance application post-completion of the CIRP as well as the RP's authority to pursue the application.

The Delhi High Court ruled in favour of Venus Recruiters, holding that an avoidance application cannot continue once a resolution plan has been approved by the NCLT and the resolution applicant has taken over control of the CD. The High Court reasoned that the IBC's avoidance provisions were for the benefit of the insolvent company and its creditors, rather than for the resolution applicant or the new management of the CD. There was, therefore, no plausible reason for avoidance transactions to continue once a resolution plan was implemented as the intended beneficiaries could no longer benefit from these actions. Once the new management had taken over, it was up to them to pursue any contractual or civil remedies they may have against contractual counterparties, but remedies under the IBC were no longer available. Further, the High Court pointed out that the RP's role concluded on approval of a resolution plan and he could not continue to prosecute an avoidance application in his 'hat' as a former RP.

The judgment in *Venus Recruiters*, however, left open one possibility. Avoidance applications may continue to be prosecuted following completion of the CIRP if the resolution plan provides for this. This possibility is also supported by section 26 of the IBC, which states that filing of an avoidance application will not affect the CIRP. This provision suggests that avoidance applications can be pursued independently of the CIRP and vice versa. Following the judgment in *Venus Recruiters*, several resolution plans do stipulate that avoidance actions will continue to be pursued and that any recoveries from these actions will be distributed to creditors. Moreover, an amendment to the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 in June, 2022 now require the resolution plan to mandatorily include a statement on how avoidance applications will be dealt with.[31]

While it is now clear that avoidance applications may be pursued post conclusion of the CIRP if provided for in the resolution plan, the 'how' question remains. Who will continue to prosecute avoidance applications and who will bear the costs of litigation? The NCLAT, in its judgment in *63 Moons Technologies Limited & Ors v. Administrator of Dewan Housing Finance Limited*,[32] added to the 'how' question by considering who would be the beneficiaries of avoidance applications that were continued after approval of the resolution plan. In this case, the resolution plan for Dewan Housing Finance Limited provided that recoveries from fraudulent transaction applications under section 66, which were valued at a nominal value of ₹ 1, would flow to the resolution applicant. The NCLAT held that, it was a matter of law that the benefits of avoidance applications could only flow to the creditors of the CD and the resolution plan could not stipulate otherwise. In so holding, the NCLAT relied on the decision in *Venus Recruiters* as well as the UNCITRAL Legislative Guide on Insolvency Law (2004) and the Report of Bankruptcy Law Reform Committee, both of which suggested that the purpose of avoidance applications was to maximize value for creditors.

The NCLAT's decision in *63 Moons Technologies* has been appealed to the Supreme Court, which has stayed the NCLAT order for the present.[33] The creditors of Dewan Housing Finance Limited as well as the successful resolution applicant have challenged the NCLAT's finding that the committee of creditors (CoC) does not have the right to transfer the benefits of avoidance applications to the successful resolution applicant. Interestingly, it appears that the value claimed in the section 66 applications is in the order of ₹ 40,000 crore, while a nominal value of ₹ 1 has been accorded to the recoveries from these applications in the resolution plan.[34]

The Report of the ILC of May, 2022 takes note of some of the present lack of clarity on how avoidance transactions may be pursued and provides certain suggestions in this regard.[35] The ILC pointed out that if avoidance applications had to be closed upon closure of the CIRP, it could lead to two possible outcomes.[36] The AA may take the view that orders in avoidance applications must necessarily be passed before approval of the resolution plan, which could lead to delays in the CIRP. Alternatively, the avoidance applications may be made infructuous if not completed at the time of resolution plan approval. As both these outcomes would be undesirable, the ILC recommended a clarificatory amendment to section 26 of the IBC to clarify that avoidance applications may indeed be continued independently of the CIRP and following completion of the CIRP.[37]

The report of the ILC also considers the question of how avoidance applications are to be pursued following conclusion of the resolution plan and agrees that these details must be specified in the resolution plan. The ILC suggests an amendment to the IBC to require resolution plans to state the manner in which avoidance applications will be continued after approval of the plan, including who will pursue these proceedings, how the costs will be borne and the manner of distribution of recoveries.[38] Regarding the beneficiaries of avoidance applications, the ILC's report stops short of taking a view that is directly contrary to the NCLAT's judgment in *63 Moons Technologies*. However, similar to the recommendation of the 2020 report of the ILC, the ILC notes that the manner of distribution may take into account various factors and has suggested that the AA must have 'regard to the decision of the CoC regarding the manner of distribution of expected recoveries when giving final orders in proceedings for avoidance of transactions and improper trading'.[39]

While, in general, avoidance provisions are intended to benefit creditors, it is worth considering if there can never been any exceptions to this rule. If it is indeed the case that only creditors can be beneficiaries of avoidance applications, it leads to further questions on how or why they will be pursued post approval of a resolution plan. At this stage, the creditors have no nexus to the CD under its new management and it would be the resolution applicant that would have to pursue these applications. However, the resolution applicant would have no incentive to do so as it would not be a beneficiary of the recoveries. Indeed, in several cases, counsel for the resolution applicants have informed the tribunal that the resolution applicant has no interest in pursuing the avoidance applications.[40]

A possible solution to this incentive problem could be if creditors bear the costs of pursuing avoidance applications and have an agreement with the resolution applicant to take control of their prosecution on behalf of the resolution applicant. Ultimately though, pursuing avoidance applications is expensive in terms of time and costs. As there is an inherent uncertainty of recoveries and considering that creditors would have written off their unrecovered portion upon implementation of the resolution plan, there is a strong possibility that creditors themselves may often not be interested in pursuing avoidance applications after completion of the CIRP.

Given the potential for unlocking value and the significant time it takes to unearth avoidance transactions, it is reasonable to allow them to continue post completion of the CIRP. The extent to which they will be pursued, however, remains to be seen and might depend on the incentive structure as well as the availability of third-party funding to pursue these claims. At the same, it is important to keep in mind the costs of pursuing avoidance applications and their implications for contractual certainty. To provide for closure, it may also be worth considering a sunset period by which time avoidance applications must necessarily be closed to eliminate the possibility of orders in these transactions coming out of the woodwork several years after the CD has been taken over by the successful resolution applicant.

CONCLUSION

As we look at the landscape on avoidance applications to date, we have *Anuj Jain* and *63 Moons Technologies* at two ends of the spectrum. *Anuj Jain* demonstrated the potential of avoidance applications in returning value to the CD and ultimately its creditors, paving the way for transaction audits to be carried out and avoidance applications to be filed in a very large number of CIRPs and liquidations. Unfortunately, however, the number of applications that have been filed for high value claims has not translated into greater recoveries in avoidance transactions. This brings us to *63 Moons Technologies* where avoidance applications involving claims in the order of ₹ 40,000 crore have been valued at ₹ 1 in the resolution plan, suggesting that creditors have given up on any possibility of recovering this staggering amount.

There has been a growing realization of the potential of avoidance applications and various policy reforms in this area are being considered. Most of these reforms to date have focussed on allowing avoidance applications to continue post conclusion of the CIRP. This is a necessary clarification in light of the long time period that it might take to prosecute complex cases, which avoidance transactions are most likely to be. It is equally important that the manner in which avoidance applications will be pursued is detailed in resolution plans and that the AAs give the CoCs some flexibility in deciding the intended beneficiaries.

However, even if permitted, it is unlikely that avoidance applications will, in practice, be pursued vigorously once a resolution plan has been implemented as there are few incentives to do so and the costs involved are high. It is, therefore, important to also consider ways of streamlining the prosecution of avoidance applications with the aim of completing them within the CIRP and liquidation time periods. The case law suggests that there are ambiguities around the standards of evidence required as well as the reliance that may be placed on third party reports. Clarifications around the use of transaction audit reports and standards for their preparation could be very useful guidance for stakeholders. Similarly, if there are ways of expediting the process for gathering evidence and conducting transaction audits, these could also be considered. For example, lenders often have transaction audits undertaken for their borrowers when there are indications of financial distress. When such borrowers enter CIRP, lenders could be required to make any existing audit reports available to the RP, which could kickstart the process for identifying avoidance transactions.

Finally, it is equally critical to consider the costs of pursuing avoidance applications. While avoidance transactions should deter unscrupulous persons from entering into questionable transactions, they should not result in counterparties, including creditors, being reluctant to have any dealings with companies in the zone of insolvency. An empirical study of both the value that has been recovered from avoidance applications as well as the impact these have had on the creditor market would be very helpful to determine an appropriate balance. It is hoped that this paper provides a useful starting point for a holistic study of the impact of avoidance provisions in the IBC and their implementation.

[1] Civil Appeal Nos. 8512-8527 of 2019, decided on 26.02.2020.

[2] IBBI Quarterly Newsletter, October-December 2022, p. 17.

[3] *Ibid*., p. 17.

[4] *Ibid*., p. 15.

[5] Section 43(2) of IBC.

[6] Section 43(4) of IBC.

[7] Section 43(3) of IBC.

[8] Section 50 of IBC.

[9] Section 66(1) of IBC.

[10] Nair C. and Sahoo M. (2022), "Corporate Insolvency: Rethinking Irregular Transactions", *Business Standard*, October 25.

[11] Martínez A. (2018), "The Avoidance of Pre-Bankruptcy Transactions: An Economic and Comparative Approach", 93 Chi.-Kent L. Rev. 711, p. 714.

[12] *Ibid*., p. 716.

[13] Supra Note 1.

[14] *Ibid*., paras 28 and 28.1.

[15] *Ibid*., para 26.1.

[16] IA 618 of 2019 in CP (IB) 189/9/NCLT/AHM/2018, decided on 01.02.2021.

[17] *Ibid*., para 11.

[18] *Ibid*., paras 19 and 20.

[19] 2019 SCC Online NCLT 24522, decided on 25.07 2019.

[20] *Ibid*., para 15.

[21] I.A. No. 3175 of 2020 in (IB)-1731/(ND)/2019.

[22]*Adriatic Sea Foods Pvt Ltd. v. Suresh Kumar Jain, Resolution Professional* (2022 SCC Online NCLAT 281), decided on 16.03.2022.

[23]2022 SCC Online NCLAT 298, decided on March 22, 2022.

[24] 2021 SCC Online NCLT 2754.

[25] MANU/NC/1457/2021, decided on 09.06.2021.

[26] 2019 SCC Online NCLT 5754, decided on 02.21.2019.

[27] 2022 SCC Online NCLT 143, decided on 01.06.2022.

[28] 2019 SCC Online NCLT 12714, decided on 25.09.2019.

[29] *Ibid*., para 21.

[30] W.P.(C) 8705/2019 & CM APPL. 36026/2019, decided on 26.11.2020.

[31] Regulation 38(2)(d), Amendment was inserted vide notification Inserted by Notification No. IBBI/2022-23/GN/REG084, dated 14th June, 2022.

[32] Company Appeals (AT) (Insolvency) Nos. 454, 455 and 750 of 2021, decided on 27.01 2022.

[33] Civil Appeal No(s). 1632-1634/2022, order dated 11.04.2022.

[34] "DHFL Case: SC Stays NCLAT Order, To hear appeals of Piramal, Banks in May", *Money Control*, April 14, 2022.

[35] Report of the Insolvency Law Committee, May 2022.

[36] *Ibid.*, para 2.21.

[37] *Ibid.*, para 2.23. As discussed above, such an amendment was, following publication of the ILC's Report, been included in the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

[38] *Ibid.*, paras 2.28 and 2.29.

[39] *Ibid.*, para 2.29.

[40] Supra Note 16, para 23.

5 IMPACT OF SECTION 29A ON THE CIRP PROCESS AND ITS STAKEHOLDERS: A DETAILED ANALYSIS

- Archit Gupta and Aakriti Gupta

EXECUTIVE SUMMARY

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) was an attempt to shift the Indian recovery process from an independent creditor approach to a collective creditors approach to promote ease of doing business. However, once it was actually brought in the economic environment of the country, some practical difficulties arose. The Code lays stress on promoting entrepreneurship, availability of credit and balancing the interests of all the stakeholders by allowing reorganisation of the corporates by giving a new lease of life to failing and ailing business.

However, as the Code progressed, it was realized that there were consistent questions of Code becoming a tool for the defaulting promoters/ directors and other unscrupulous persons to reorganize/acquire the company with no liabilities and the same assets with a complete discharge of its previous financial and operational liability, giving rise to phoenixing. The same was noted and criticized in the matter of *M/s Synergies Dooray Automotive Limited* (August, 2017) in which a related party of the defaulter company acquired the company by giving a 94% haircut to the creditors.

To remedy this mischief, section 29A was introduced vide the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, w.e.f., November 23, 2017 and was further amended in the years 2018 and 2020. Section 29A declares certain people to be ineligible to be a resolution applicant. As per section 29A, a person who is an undischarged insolvent or is a willful defaulter or has not repaid any loan to the bank and financial institutions for a period of more than one year since the account has been classified as non-performing asset (NPA) or has been convicted for any offence punishable with imprisonment for more than two years or is disqualified to act as a director under the Companies Act, 2013 or is prohibited by the Securities and Exchange Board of India (SEBI) from accessing the securities market or is a promoter or in the management of company in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the Adjudicating Authority (AA) under this Code or has executed an enforceable guarantee in favor of a creditor in respect of a corporate debtor (CD) against which an application for insolvency resolution made by such creditor has been admitted under this Code.

Much has been discussed on section 29A. However, a detailed analysis on its impact on the corporate insolvency resolution process (CIRP) and upon its various stakeholders, is still something that needs a closer look. The aim of this research paper is to examine the legal and behavioral impact of section 29A on the CIRP and what can be done to remedy the situation.

Keywords: Due Diligence, Impact, Interpretation, Promoters, Resolution Professional, Stakeholders

INTRODUCTION

Success and failures are part of every business around the globe. In order to develop, ensure or cultivate more success than failure for a business, Governments all across the globe aims to provide an economic and legal framework that encourages development and safeguards entrepreneurial skills and spirit. One of the prominent ways to cultivate and nurture entrepreneurial skills is to provide businesses with ease of entry and ease of exit. This not only encourages people to set up new establishments but also helps to foster innovation and encourage competition in the market. The Indian economy's journey for ease of entry started with Liberalization Reforms in the year 1991, which are still continuing as it's a continuous and dynamic process. At the same time, in order to facilitate easy exit, the Indian economy has taken a significant foot forward by enacting the IBC.

The Code was an attempt to shift the Indian recovery process from an independent creditor approach to a collective creditors approach. The Code aims at rescuing and resolution of stressed businesses in a time bound manner by providing a framework that is driven by market forces and regulated by the Insolvency and Bankruptcy Board of India (IBBI). The Code lays stress on promoting entrepreneurship, availability of credit, and balancing the interests of all the stakeholders by allowing reorganisation of the corporates by giving a new lease of life to failing and ailing businesses. The Code was conceptualized by the Bankruptcy Law Reforms Committee (BLRC), under the leadership of Mr. T.K. Vishwanathan which submitted its report on November 4, 2015.

India in the past has also tried to revive its stressed business by enacting various legislations including the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) etc. However, these acts have failed to deliver their potential. There were many reasons for their failure and while conceptualization of the Code, the BLRC discussed and tried to address all issues that were faced in the past as well as tried to predict challenges that may occur in the future after enactment of the Code. However, once it was actually brought into the economic environment of the country, some practical difficulties arose.

It was for the first time that the promoters/ directors no longer continued to retain the possession of their company and were dispossessed of the control of the company literally overnight and the creditors were put firmly in control of the company. The promoters in the erstwhile SICA regime had still managed to retain the possession of the company and were able to strip the assets of the company till it ultimately went into liquidation. Even though the Code protected the assets of the company during the CIRP, the Code, as it was implemented in the original form, failed to address a similar situation that may arise at the end of the CIRP.

Therefore, as soon as the Code was implemented, the first concern that cropped up before the Government was the possibility of the Code becoming a tool for the defaulting promoters/ directors and other unscrupulous persons to reorganize/acquire the company with no liabilities and the same assets with a complete discharge of its previous financial and operational liability, giving rise to phoenixing. The same was noted and highly criticized in the matter of *M/s Synergies Dooray Automotive Limited* (August, 2017) in which a related party of the defaulter company acquired the company by giving a 94% haircut to the creditors. Once *M/s Synergies Dooray* was resolved, it was realised that the ability of the defaulting promoters/directors and other unscrupulous persons posed a big hurdle to the CIRP. Shri Injeti Srinivas, Former Secretary, Ministry of Corporate Affairs, while discussing the story behind the introduction of section 29A, stated that to prevent the history from repeating itself, the promoters had to be disabled from being the resolution applicants.[1]

Thus, to remedy this mischief, section 29A was introduced vide the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, w.e.f., November 23, 2017 and was further amended in the years 2018 and 2020. Section 29A declares certain people to be ineligible to be a resolution applicant during the CIRP. This section aims at disabling persons on whose miscount the company has landed into insolvency, to regain the assets of the company.

SECTION 29A

Section 29A of the Code provides that a person shall not be eligible to submit a resolution plan, if such person, or any other person acting jointly or in concert with such person –

(a) is an undischarged insolvent;

(b) is a wilful defaulter in accordance with the guidelines of the Reserve Bank of India (RBI) issued under the Banking Regulation Act, 1949;

(c) has an account, or an account of a CD under the management or control of such person or of whom such person is a promoter, classified as NPA by the RBI and at least a period of one year has lapsed from the date of such classification;

Provided that the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to NPA accounts before submission of resolution plan;

(d) has been convicted for any offence punishable with imprisonment for two years or more;

(e) is disqualified to act as a director under the Companies Act, 2013;

(f) is prohibited by the SEBI from accessing the securities markets;

(g) has been a promoter or in the management or control of a CD in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the AA under this Code;

(h) has executed an enforceable guarantee in favor of a creditor in respect of a CD against which an application for insolvency resolution made by such creditor has been admitted under this Code.

As per section 29A, a person who is an undischarged insolvent or is a wilful defaulter or has not repaid any loan to the bank and financial institutions for a period of more than one year since the account has been classified as NPA or has been convicted for any offence punishable with imprisonment for more than two years or is disqualified to act as a director under the Companies Act, 2013 or is prohibited by the SEBI from accessing the securities market or is a promoter or in the management of company in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the AA under this Code or has executed an enforceable guarantee in favor of a creditor in respect of a CD against which an application for insolvency resolution made by such creditor has been admitted under this Code, is not permitted to be a resolution applicant.

Much has been discussed on section 29A. However, a detailed analysis on its impact on the CIRP and upon its various stakeholder is still something that needs a closer look. The aim of this research paper is to examine the legal and behavioural impact of section 29A on the CIRP and what can be done to remedy the situation.

NEED OF SECTION 29A

The Code, as originally conceptualized by the BLRC, did not have any ineligibility criteria for a prospective resolution applicant. Therefore, any person could apply to be a resolution applicant and the rest was left to market forces and the commercial wisdom of the committee of creditors

(CoC) to accept or to reject the plan of a resolution applicant. However, soon it was realized that there was a need to define certain criteria for the eligibility of a resolution applicant to protect the interest of the CD and prevent certain people from gaining the control of the CD, in addition to ensuring transparency and therefore, ensuing confidence in the process.

Our journey to section 29A begins from a directive issued by the RBI in the month of June, 2017 whereby 12 biggest defaulters in the banking system were to be submitted in the CIRP, putting the Code to a critical test. The RBI formed an internal committee and identified 500 defaulters and reduced them to 12 largest loan defaulters - companies to which banks had a total exposure of at least ₹ 5000 crore, and where 60% had turned into bad loans as of March 31, 2016. These 'Big 12', which accounted for about 25% of the gross NPAs of the banking system, were submitted to CIRP.

The 'BIG 12'		
Sl.	**Name of the company**	**Debt (FY 2016) (₹ in crore)**
1.	Bhushan Steel Limited	38529.26
2.	Bhushan Power and Steel Limited	35684.00
3.	Essar Steel India Limited	31211.00
4.	Electrosteel Steels Limited	8807.85
5.	Monnet Ispat	11323.22
6.	Jyoti Structures	3801.97
7.	Alok Industries	19887.08
8.	Lanco Infratech	41843.47
9.	Jaypee Infratech	6768.79
10.	ABG Shipyard	6611.81
11.	Amtek Auto	12591.12
12.	Era Infra Engineering	9341.24

The banks/financial institutions were given a time of six months for resolution of the remaining 488 cases and if not resolved, these would also be submitted before the NCLT for resolution.

Before this decision was taken, a few resolutions under the Code were already concluded. One of the initial cases that were resolved under the new regime was that of *M/s Synergies Dooray Automotive Limited* (2017) wherein a related party of the CD had swept in and acquired the CD giving the financial creditors (FCs) a haircut of 94%.

Thus, it was felt that in order to protect the interest of the stakeholders and creditors, there was a need of a criteria to be provided in the Code which will debar the market players who are deemed to be unfit to resolve the company, i.e., to be a prospective resolution applicant. Further, it was felt if such protection is not provided, the Code will go into the same rabbit hole as SICA as discussed above. Accordingly, to protect all the CDs and stakeholders at large thereafter, section 29A was introduced.

Understanding the urgent need to bring the necessary amendment, section 29A was inserted by the way of an ordinance dated November 23, 2017. Subsequently, the same was introduced as Insolvency and Bankruptcy Code (Amendment) Bill, 2017 in the lower and upper House of the Parliament for necessary amendment in the Act and thereafter, the Insolvency and Bankruptcy Code (Amendment) Act, 2018 was passed. The statement of objects and reasons to the Insolvency and Bankruptcy Code (Amendment) Bill, 2017 states:

> Concerns have been raised that person who, with their misconduct contributed to defaults of companies or are otherwise undesirable, may misuse this situation due to lack of prohibition or restrictions to participate in the resolution or liquidation process, and gain or regain control of the corporate debtor. This may undermine the processes laid down in the Code as the unscrupulous person would be seen to be rewarded at the expense of creditors. In addition, in order to check that the undesirable persons who may have submitted their resolution plans in the absence of such a provision, responsibility is also being entrusted on the committee of creditors to give a reasonable period to repay overdue amounts and become eligible.

The Hon'ble Supreme Court in the matter of *Arun Kumar Jagatramka v. Jindal Steel and Power Ltd. & Anr*[2] noted the following with respect to section 29A:

> The enactment of the IBC has marked a quantum change in corporate governance and the rule of law. First and foremost, the IBC perceives good corporate governance, respect for and adherence to the rule of law as central to the resolution of corporate insolvencies. Second, the IBC perceives corporate insolvency not as an isolated problem faced by an individual business entities but places it in the context of a framework which is founded on public interest in facilitating economic growth by balancing diverse stakeholder interests. Third, the IBC attributes a primacy to the business decisions taken by creditors acting as a collective body, on the premise that the timely resolution of corporate insolvency is necessary to ensure the growth of credit markets and encourage investment. Fourth, in its diverse provisions, the IBC ensures that the interests of corporate enterprises are not conflated with the interests of their promoters; the economic value of corporate structures is broader in content than the partisan interests of their managements. These salutary objectives of the IBC can be achieved if the integrity of the resolution process is placed at the forefront. Primarily, the IBC is a legislation aimed at re-organization and resolution of insolvencies. Liquidation is a matter of last resort. These objectives can be achieved only through a purposive interpretation which requires courts, while infusing meaning and content to its provisions, to ensure that the problems which beset the earlier regime do not enter through the backdoor through disingenuous stratagems.

Therefore, in order to ensure the processes run under the Code are fair, and are conducted with integrity, transparency and to protect the interest of various stakeholders, section 29A was necessary and need of the hour.

LEGAL ISSUES PERTAINING TO SECTION 29A

As section 29A was introduced, there have been various legal issues with respect to its constitutional validity as well as its interpretation and scope of various debarments provided under the Code. The Courts and Tribunals at various stages have already answered a few of the questions arisen with respect to section 29A:

Constitutionality of section 29A

The constitutionality of section 29A of the Code was challenged before the Supreme Court in the celebrated judgement of *Swiss Ribbons Pvt Ltd and Anr v. Union of India.*[3] In this case, four major issues were raised before the Supreme Court of India vis-à-vis section 29A of the Code, as discussed below:-

(a) The section has been given a retrospective effect due to which the persons who were earlier eligible to submit a plan had been made ineligible with a retrospective effect, taking away their vested right to participate in the CIRP.

(b) The section should be restricted to malfeasance, i.e., only those persons should be made ineligible who have acted towards the CD in malafide. It was argued that section 29A violated Article 14 of the constitution because unequals are treated as equals.

(c) The section ousts the 'relatives' from acting as the resolution applicant which is excessive.

(d) Section 29A ousts indeterminable persons from acting as resolution applicants in the CIRP because the Explanation I, clause (ii) to section 29A(j) which defines the expression 'connected person' states that any person joining the CD post the commencement of the CIRP will be disqualified from acting as a resolution applicant.

After a detailed argument, the Hon'ble Supreme Court has held:-

Issue (a): Placing reliance upon the precedent of *Arcelor Mittal v. Satish Gupta*,[4] the Supreme Court held that section 29A does not take away the vested right of any person because the applicant has no vested right for consideration nor approval of its resolution plan. Therefore, no vested right has been taken away from the persons made ineligible by virtue of retrospective application of section 29A.

Issue (b): The Supreme Court held that the intention of section 29A was not to punish the erstwhile managers for malfeasance as the categories of ineligible people other than under section 29A(1)(c) have been made ineligible not on the ground of their malfeasance.

Issue (c): The Supreme Court while placing reliance on the judgement in the case of *Attorney General for India and Ors v. Amratlal Prajivandas and Ors.*,[5] and the doctrine of *noscitur a sociis*, held that the relative who has been declared ineligible needs to have a connection with the business activity of the resolution applicant. In the absence of showing that such person is 'connected' with the business of the activity of the resolution applicant, such person cannot possibly be disqualified under section 29A(j).

Issue (d): The Supreme Court held that the prima facie interpretation of Explanation I, clause (ii) to section 29A(j) is that any person who is in management or control of the business of the CD during the implementation of the resolution plan shall be deemed ineligible for the purpose of section 29A. Therefore, such a 'connected person' is not indeterminable as such.

Thus, section 29A was held to be constitutional.

Date on which eligibility is to be examined

Now that section 29A was introduced with the retrospective effect, the first question that arose was - what would be relevant date to determine the eligibility of a resolution applicant. The relevant date could be: (a) date of the admission of CIRP; (b) date of issuance of expression of interest (EoI); (c) date of submission of the resolution plan. The matter was clarified by the Hon'ble Supreme Court.

In *Numetal Ltd v. Satish Kumar Gupta*[6] it was held that the date of submission of 'EoI' should be treated as date of submission of resolution plan, as there is no provision of submission of EoI and it is a part of the resolution plan itself. The view was further affirmed in the matter of *Arcelormittal India P. Ltd v. Satish Kumar*.[7]

Interpretation of various debarments under section 29A

Interpretation of section 29A(h) of the Code

Section 29A(h) of the Code debars a person who has executed guarantee in favour of a creditor in respect of CD against which an application of CIRP has been made by 'such creditor' and such application has been admitted under this code.

In this regard, the Hon'ble Apex Court in the matter of *Bank of Baroda & Anr. v. MBL Infrastructures Ltd. & Ors*[8] held that 'such creditor' in section 29A(h) is to interpreted to mean similarly placed creditors after the application for insolvency application is admitted by the AA. As a result, what is required to earn a disqualification under the said provision is a mere existence of a personal guarantee that stands invoked by a single creditor, notwithstanding the application being filed by any other creditor seeking initiation of insolvency resolution process.

Interpretation of section 29A(c) of the Code

Section 29A(c) provides that persons who has an account or an account of a CD under the management or control of such person or of whom such person is a promoter, classified as NPA by the RBI and at least a period of one year has lapsed from the date of such classification, is not eligible to be a resolution applicant. Questions have been raised regarding whether the date on which classification is declared is relevant or the date with effect from such classification is made to be effective is relevant for the purpose of 29A(c).

The Hon'ble NCLAT in the matter of *Avantha Holdings Ltd. v. Mr. Abhilash Lal, RP for Jhabua Power Ltd*[9] held that the purpose of date of 'such classification' is the date on which the declaration that the person was an NPA was made by the bank. If one year period from the date of such classification has expired and NPA still continues, the resolution applicant is ineligible.

Interplay between section 29A and scheme of arrangement & compromise u/s 230-232 of the Companies Act, 2013

Contentions were raised related to non-applicability of section 29A with respect to scheme of arrangement & compromise submitted under sections 230-232 of the Companies Act, 2013. The Hon'ble Supreme Court in *Arun Kumar Jagatramka v. Jindal Steel and Power Ltd. & Anr*[10] held that prohibition placed by the parliament under section 29A and section 35(1)(f) of the Code must also attach itself to a scheme of compromise or arrangement under section 230 of the Act of 2013, when the company is undergoing liquidation under the auspices of the IBC.

Role and scope of CoC, Resolution Professional and the AA with reference to declaration of resolution applicant as ineligible

As per the Code, it is the duty of a resolution professional (RP) to check eligibility of a resolution applicant who has participated in the CIRP for resolution of the CD. Such eligibility has to be checked on the basis of the documents submitted by such resolution applicant. However, various questions have been raised with respect to the role and responsibilities of RP with respect to the eligibility verification under section 29A.

In *Sharavan Kumar Vishnoi v. Upma Jaiswal & Ors*,[11] the NCLAT New Delhi held that the RP is not to take a decision regarding the ineligibility of the resolution applicant. It has only to form its opinion because it is the duty of the RP to find out as to whether the resolution plan is in compliance of the provisions of the Code or not. The RP can give his opinion with regard to each plan before the CoC and it is for the CoC to take a decision as to whether the plan is to be approved or not.

In *Everest Organics Ltd. v. Leesa Lifesciences Pvt. Ltd.*,[12] the NCLAT Chennai held that the Code and the regulations empowers the CoC approving the resolution plan and also entrusts it that it shall not approve a resolution plan where the resolution applicant is ineligible under section 29A. Therefore, the CoC has the power to consider the eligibility/ineligibility of the resolution applicant whether they are eligible/ineligible under section 29A(e) of the Code, in accordance with the provisions of law.

IMPACT OF INTRODUCTION OF SECTION 29A

Now that section 29A had been introduced, new challenges emerged in the CIRP and the ultimate resolution of the CD. Section 29A left little to no scope for the former company management to reacquire the CD. Therefore, there was a behavioural change towards the CIRP as a whole and various stakeholders of the CIRP including the Insolvency Professionals (IPs) (the officers of the court for the CIRP). The aim of this section is to understand what were the challenges faced after the introduction of section 29A and how the same were dealt by the Government and the judiciary in terms of the following aspects: -

(a) Introduction of section 12A

(b) Increase in litigation by the promoters and other members of the management

(c) Impact on timeline of resolution process

(d) Impact on the cost of CIRP

(e) Impact on the goal of value maximization

(f) Attempt at backdoor entries

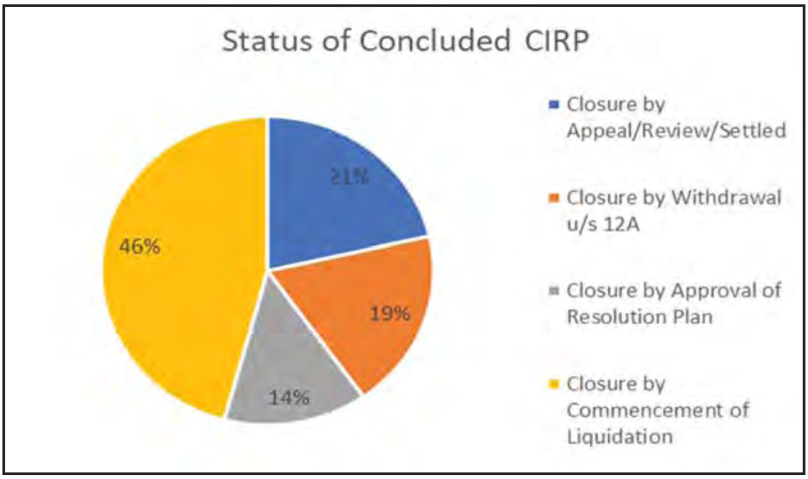
Introduction of section 12A

Once section 29A was introduced, a panic spread across the promoters as they were unable to re-acquire the CD. The promoters at the initial stage of the CIRP have started to enter in settlement with the creditors, convincing them to withdraw the CIRP applications even after the admission of such applications. In various cases it was noted that the CD itself has appealed against the CIRP admission orders on account of settlement with the creditors. While Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 permits withdrawal of the CIRP application at the pre-admission stage, there was no provision for the withdrawal of the CIRP application post admission. Thus, the creditors/CDs had started filling application for withdrawal under Rule 11 of National Company Law Tribunal Rules, 2016.[13]

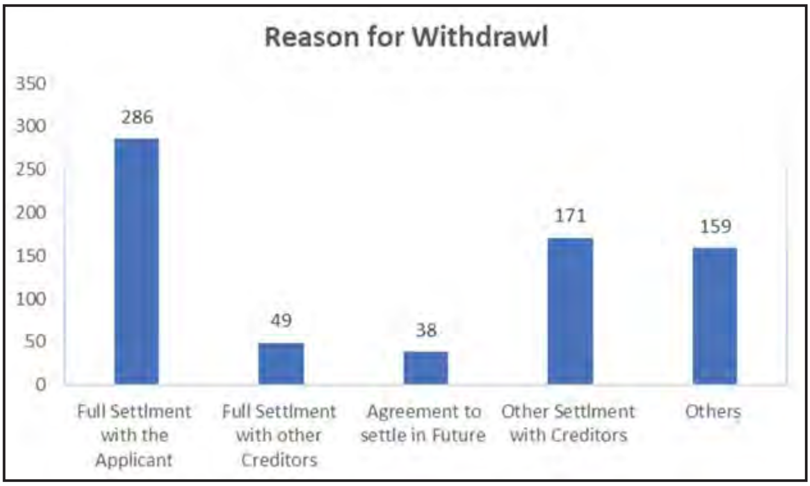
It was noted by Hon'ble Supreme Court in the matter of *Uttara Foods and Feeds Private Limited v. Mona Pharmacem*[14] that the NCLT/NCLAT does not hold any power under the Code to allow such withdrawals and Hon'ble Supreme Court used its residuary power under Article 142 of the Constitution to allow such withdrawal. However, at the same time, the Supreme Court noted that the Rules need to be amended by the competent authority so as to include such inherent powers.

This aspect was discussed and deliberated by the Insolvency Law Committee and in its report[15] recommended to amend the Code to provide for withdrawal of CIRP post admission. Accordingly, the necessary amendments were brought in by the legislature by way on insertion of section 12A in the code w.e.f. June 6, 2018.

As per the data provided by IBBI in its quarterly newsletter for the quarter ended September, 2022,[16] 3946 CIRPs have concluded. The details of concluded CIRPs as on September 30, 2022 are as follows:



It was therefore observed that 40% of the cases have been withdrawn/settled. In addition to the above, 53% of such withdrawals have taken place on account of settlement with the applicant creditors. The breakup of the same is discussed as below:



Above data imply that that the promoters prefer to settle the claims of the creditors at the initial stage of acceptance of the application. Such phenomenon is due to the risk of losing the control of the CD during CIRP due to disqualification provided under section 29A. Thus, it can be concluded that section 29A read with section 12A of the Code have led to settlement and quicker resolution and saving of resources of the stakeholders of the CIRP.

Litigation by promoters and other company and management of the CD

After initiation of the section 29A, there has been an increase in the trend of litigation by the promoters and their associates with the aim to delay the resolution of the CD and them losing control of the company. It has been seen that section 12A has been used by promoters and management who are disqualified under section 29A of the Code to provide competitive recovery terms to the creditors as compared to the resolution applicants. For instance, in the matter of *M/s Siva Industries and Holding Limited*, the promoters and shareholders of the CD had submitted competitive repayment plan of the outstanding dues to the lenders as compared to the resolution plan received by the CoC. The CoC ended up approving the settlement plan as submitted by the promoters and shareholder of the company.

Further, the promoters and shareholders have used section12A to overcome the disqualification u/s 29A of the Code. It has been seen in many cases that the promoters/management of the CD provide a lucrative repayment plan to the CoC (which may not be viable and feasible). If the CoC rejects the same, promoters file an application with AA seeking an approval of their plan on the ground of it being better than the resolution plan offered by the resolution applicant. This trend has been observed in the matter of, *inter alia, M/s Jhambua Power Limited*,[17] *Nimitaya Hotel and Resorts Limited*,[18] *Dewan Housing and Finance Limited*. This results in delay in CIRP and the resolution of the CD. In addition to the above, it has been noted that the directors and their associates file multiple applications against resolution plan and conduct of CoC as well the RP, which further results in delay in conclusion of CIRP.

Impact on timeline of resolution process

The 5th Report of the Insolvency Law Committee (May, 2022)[19] discussed the object of time bound reorganisation and insolvency resolution of the CDs. The Supreme Court in the case of *Surendra Trading Co. v. Juggilal Kamlapat Jute Mills Co. Ltd & Ors*[20] discussed in detail the nature of the timeline for the resolution of the CD. While the timeline was held to be directory in nature, the Apex Court also held that delay has to be explained before seeking an extension or exemption from the application of the strict timelines of the CIRP.

As per model timelines provided in the Regulation 40A of the IBBI (Insolvency Resolution Process For Corporate Persons) Regulations, 2016, the RP is required to issue a provisional list of resolution applicants by 85th day of the process and RP is required to issue request for resolution plan (RFRP) and other documents by 135th day. Therefore, there are approximately 50 days for the RP to do a due diligence for the eligibility of the resolution applicant as per section 29A. Even though the due diligence is supposed to be conducted on the basis of the documents submitted by the resolution applicant, yet certain expectations are attached to the role of an RP in terms of due diligence to be conducted by him.

Due diligence undertaken by a RP is an extensive exercise. RP is required to undertake search of documents and information available in public domain. In addition, RP is required to call for various documents from resolution applicant in order to ensure that the prospective resolution applicant is section 29A compliant.

Understandably, a prospective resolution applicant, if ineligible, would not disclose the same which makes it necessary for the RP to be extra cautious which adds to the time of the CIRP. Moreover, a rejected resolution applicant, more often than not, knocks the door of the NCLT after being rejected which adds to litigation and further delays the resolution of the CDs.

Impact on the goal of value maximization

The aim of the Code was value maximization of the assets of the CD through the process of CIRP. The same was also discussed in the 5th Report of the Insolvency Law Committee (May, 2022).[21] The NCLAT, in the case of *Binani Industries Ltd v. Bank of Baroda*,[22] observed that the objective of the IBC is to rescue a failing viable business. Resolution plan is for insolvency resolution of CD 'as a going concern'. The plan should maximize the value of assets of the CD, and should promote entrepreneurship, availability of credit and balance the interests of all the stakeholders. Resolution plan is not for the sale of the CD. It is not an auction. It is not recovery.[23] It is not liquidation. Similar were the observations of the Hon'ble Apex Court in the case of *Kridhan Infrastructure (P.) Ltd v. Venkatesan Sankaranarayan*.[24]

There might arise a situation where the promoters/ directors/ other non-eligible persons provide for a resolution plan which offers a better value to the creditors as compared to the resolution plan offered by a prospective resolution applicant. One may argue that in such a situation, the goal of value maximization might get side-lined because of section 29A. However, the Code itself provides for certain modes by which the goal of value maximization may be achieved in addition to ensuring that the CD does not go in the hands of unscrupulous buyers. These include:-

***Section 5(25)*[25]**

Prior to November 23, 2017, the Code did not make provision for submission of resolution plan by more than one person. Post the amendment w.e.f. November 23, 2017, the resolution plan can be submitted by more than one person as well and resultantly, joint ventures can also submit a resolution plan. Therefore, the CoC is in a position to get better resolution plans in terms of money.

***Immunity from prosecution of CD in relation to offence committed prior to CIRP - Section 32A*[26]**

As per section 32A of the Code, once a resolution plan is approved under section 31, the CD is no longer liable for an offence committed prior to the commencement of the CIRP if there is a change in the management of the CD. Therefore, it provides the prospective resolution applicants an incentive to gain the control of the CD.

Impact on the cost of CIRP

As per section 5(13) of the Code, 'insolvency resolution process costs' means -

(a) the amount of any interim finance and the costs incurred in raising such finance;

(b) the fees payable to any person acting as a RP;

(c) any costs incurred by the RP in running the business of the CD as a going concern;

(d) any costs incurred at the expense of the Government to facilitate the insolvency resolution process; and

(e) any other costs as may be specified by the Board;

It has been seen that generally RPs appoint another professional and third-party agency to undertake the due diligence of section 29A of the Code. This adds burden to the CIRP cost. In addition to the above, the delay tactics and extended timelines under the Code result in further additional cost in terms of legal expenses and fees of other professionals payable during CIRP. Additionally, there is indirect cost in form of loss of time value of value recovered by creditors from resolution process.

Attempt at backdoor entries

The persons ineligible to submit a plan must not be able to take a backdoor entry in the CD otherwise it would defeat the very purpose of the introduction of section 29A. A resolution applicant who is a person connected to the person who is ineligible under section 29A is also held to be ineligible under section 29A.

A connected person means -

(a) Any person who is the promoter or in the management or control of the resolution applicant.

(b) Any person who shall be the promoter or in management or control of the business of the CD during the implementation of the resolution plan.

(c) The holding company, subsidiary company, associate company or related party of a person referred to as (a) and (b).

Thus, if a resolution applicant associated with any 'connected person' who is ineligible under section 29A of the Code, will be ineligible as 'resolution applicant' and hence cannot submit a resolution plan. In such circumstances, the RP is therefore required to undertake a due diligence to determine whether any connected person to the resolution applicant is ineligible to be a resolution applicant under section 29A. This is more so because no resolution applicant will himself disclose that they are connected to a section 29A non-compliant person. In the case of *Arcelormittal India P Ltd v. Satish Kumar Gupta*[27] it was held that corporate veil can also be lifted to determine if resolution applicant is related.

Scope of section 29A

In addition to the above, the scope of section 29A has been extended to liquidation process as well by inserting proviso to section 35(1)(f) of the Code which states that a secured persons cannot sell the assets to ineligible persons. Therefore, even after the CIRP is over, the CD is accorded protection from the ineligible resolution applicant.

In the case of *State Bank of India v. Anuj Bajpai (Liquidator)*[28] the Apex Court held that secured creditors cannot sell assets under section 52(1)(b) of the Code to persons who are ineligible under section 29A of the Code. Further in such a case, the Liquidator can reject application of secured creditor to sell assets.

Compromise and arrangement scheme under section 230

In the landmark judgement of *Arun Kumar Jagatramka v. Jindal Steel and Power Ltd.*,[29] the Supreme Court held that a person who is ineligible under section 29A of the Code, would not be permitted to propose a compromise or arrangement under section 230 of the Companies Act, 2013. Prohibition placed by Parliament in section 29A and section 35(1)(f) of the Code must also be attached to a scheme of compromise or arrangement under section 230 of Companies Act, 2013 when company is undergoing liquidation under the Code.

Thus, the introduction of section 29A has impacted the CIRP in more than one way and its impact can be seen in not only the CIRP but also upon the liquidation process and the behaviour of the stakeholders of the CIRP.

SCOPE OF MSME AND EXEMPTION GRANTED TO THEM

A micro small and medium enterprise (MSME) is often said to be the backbone of the Indian economy. As per the report of the India Brand Equity Foundation, there are over 6.3 crore MSMEs in India contributing 33.4% towards India's manufacturing output.[30] According to the SIDBI - Trans Union CIBIL Report in FY21, the loan disbursals to MSMEs stood at ₹ 9.5 trillion, a 40% increase compared with ₹ 6.8 trillion in FY20.[31] Implementation of policies for the development and protection of MSMEs is part of part of the government agenda and vision and the Code is no exception. The Central Government vide the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 by the virtue of section 240A exempted the MSMEs from the application of section 29A(1)(c) and section 29A(1)(h) meaning thereby that for an MSME under CIRP, a promoter who is not a wilful defaulter or covered under any other specific disqualification as provided under section 29A can be a resolution applicant, and the MSME might not have to go into liquidation. The rationale behind the same being that a lot of resolution applicants might not be forthcoming for such MSMEs and it may ultimately lead to liquidation of the company.[32]

Before analyzing the impact of the exemption granted to MSMEs, it is important to discuss the meaning of an MSME.

What is an MSME?

MSMEs are enterprises that are involved in production, manufacturing, processing of goods or providing services. MSMEs are classified as per section 7 of the Micro, Small and Medium Enterprises Development Act, 2006. Criteria provided in section 7 for MSMEs is as follows:

Classification	Investment in Plant & Machinery	Annual Turnover
Micro	Not more than ₹ 1 crore	Not more than ₹ 5 crore
Small	Not more than ₹ 10 crore	Not more than ₹ 50 crore
Medium	Not more than ₹ 50 crore	Not more than ₹ 250 crore

Above mentioned criteria has been recently amended w.e.f. July 1, 2020. The said changes have been brought in due to the impact of the global pandemic on the Indian economy. It is no secret that the COVID-19 pandemic affected all the industries in a negative manner having a more negative impact on MSMEs which generally don't have much backing to be able to withstand the financial losses due to a pandemic.

Registration as an MSME

Any person who intends to establish an MSME may file an Udyam registration online in the Udyam registration portal, based on self-declaration with no requirement to upload the documents, papers, certificates or proof. On registration, an enterprise (referred to as 'Udyam') will be assigned a permanent identification no. to be known as 'Udyam Registration Number' and is assigned an e-certificate namely, 'Udyam Registration Certificate' shall be issued on completion of the process.

Exemption under section 29A

Section 240A of the Code exempts the MSMEs from the application of section 29A(c) and section 29A(h). It means that promoters/directors of an MSME can be a resolution applicant even if: (a) MSME has been classified as an NPA or (b) the promoters/directors have given guarantee in respect of MSME, which has been invoked by creditor but remains unpaid. The exemption, however, applies post the admission stage and not the admission stage itself. Thus, where the CD was in default, even though the CD is an MSME, the CIRP application filed by the FC under section 7 of the Code is required to be admitted.[33]

Jurisprudence for section 29A and section 240A

Whether section 240A gives complete exemption from applicability from section 29A for MSMEs?

Section 240A gives relaxation for MSMEs with respect to section 29A(h). All other disqualifications of section 29A would still be applicable for the MSME. This was reaffirmed in the matter of *Ravindernath Narayan Rao v. Marthanayagam Kathiresh, Dir M/s Mrutham Steel Rolling Mills Pvt Ltd.*[34] in which the resolution plan for an MSME CD was rejected because promoter was a 'wilful defaulter'.

Eligibility Criteria to be examined?

Due to change in the defamation and criteria for classification of MSME, various promoters and CDs which were ineligible for submitting a resolution plan became eligible for submitting a resolution plan. Taking advantage for the same, many promoters started presenting resolution plans to CoC or filling application with the AA claiming time or approval for submitting resolution plan. Therefore, there were questions before the AA regarding the eligibility of promoter or CD which came under the preview of the MSME post amendment to submit resolution plan for CIRPs pending as on date of amendment of MSME definition.

This was answered in the case of *POSCO India Pune Processing Centre (P.) Ltd v. Dhaval Jitendrakumar Mistry RP of Poggenamp Nagatsheth Powertronics (P.) Ltd.*,[35] the CD was not MSME when the CIRP launched but later became an MSME due to revised definition w.e.f. July 1, 2020. it was held that if CD was not an MSME on the date of initiation of CIRP under section 9 of IBC, he could not be treated as MSME subsequently and could not take the benefit of MSME in view of amendment in MSME classification norms.

Similarly in the case of *Digambar Anandrao Pingle, Shareholder of M/s Pingle Builders Pvt Ltd v. Shrikant Madanlal Zawar, RP of M/s Pingle Builders Pvt Ltd.*[36] it was held that the plan of the appellant was liable to be rejected even though the appellant stated that the CDs was an MSME at the time of submission of the plan and was therefore entitled to benefit of exemption under section 240A. However, the NCLAT noted that the CIRP had started on July 19, 2018 whereas the application for MSME was not made post the initiation of the CIRP. Moreover, the application for MSME was not made through the RP/ IRP and no consent was given to him. Such unauthorized application could not have been made.

The issue was again discussed in the case of *Anil Kumar Duggal Kaneriya v. CA Vineeta Maheshwari, RP, Kaneria Granite Ltd.*[37] wherein it was contended that an amendment was enforced during the CIRP which shall be applicable to decide the eligibility to submit the plan and that the promoters of the CD become eligible as the law was amended during the CIRP and the threshold for MSME has been increased. However, the contention of the appellant was rejected on the following grounds:-

(a) The CIRP in the present case commenced on April 26, 2019 whereas the amendment was brought into operation w.e.f. July 1, 2021, i.e., it was prospective in nature.[38]

(b) The CD was not registered as an MSME on the date of the admission of CIRP.

(c) The threshold for interfering in a commercial decision of the CoC is very high and the company had already been recommended for liquidation by a majority of 88.44%. No material irregularity to interfere under section 30(2).[39] Therefore, the NCLAT refused to interfere with the commercial wisdom of the CoC.

(d) The plan was submitted at a very belated stage of the CIRP.

However, this is not always the case and in certain cases, resolution applicants have been permitted to file a resolution plan. In the case of *C. Bharath Chandran v. Mr. Raju Palanilkiunnathil Kesavam, RP*,[40] the MSME certificate was received on June 16, 2021 whereas the CIRP was supposed to end on July 23, 2021. The promoters were given a week's time to submit a plan.

It is not the first time that MSMEs have been given an exemption. It has been noted that many jurisdictions across the globe have given different exemptions to MSMEs. Such exemptions include less complex resolution process, quick resolution procedure or tailor-made solution etc. The authors in this regard are in complete agreement that such an exemption was needed for the protection of MSMEs. However, the question that is posed is whether the scope of such exemption in its present form is enough to protect all the other sectors of the economy as well. For example - was the exemption to be extended to vulnerable industries, such as real estate and service industries, as well?

RESONSIBILITY OF RP FOR SECTION 29A

As per provisions of the Code, a resolution applicant is required to submit an affidavit, stating it is section 29A complaint along with the EoI for submitting a resolution plan. Along with this, a duty has been cast upon RP to carry due diligence based on the material on record in order to satisfy that the prospective resolution applicant complies with provisions of section 29A.

To conduct such due diligence, a RP either appoints a professional to assist in accessing the compliance with section 29A or undertakes such exercise itself. However, the role and responsibility of the RP has always been under dispute. The AA has time and again explained the scope of RP under the Code, which can be understood from the following case:

The Hon'ble Supreme Court in the landmark judgment of *Arcelormittal India P. Ltd v. Satish Kumar*[41] held that the RP will conduct due diligence of the applicants. He can ask for clarifications or additional information. He will prepare provisional list of eligible prospective applicants for submission to the CoC. Objections can be raised by the prospective resolution applicants within five days. Post that, the RP will prepare final list of prospective resolution applicants within ten days for submission to the CoC. The RP shall issue information memorandum, evaluation matrix and RFRP within five days of issue of provisional list. Minimum 30 days will be allowed to prospective resolution applicants to submit resolution plan. Non- refundable deposit shall not be asked. Detailed procedure as prescribed is required to be followed by RP.

Not only the RP, but the CoC too has the power to examine the section 29A eligibility of a resolution applicant under section 30(2) of the Code. If the resolution applicant is deemed to be ineligible, the CoC has the power to require the RP to invite fresh plans in case there are no other plans. Further, first proviso to section 30(4) states that the CoC shall not approve a resolution plan, submitted before November 23, 2017 where the resolution applicant is ineligible under section 29A of the Code and may, where no other resolution plan is available with it, require the RP to invite a fresh resolution plan.

Further, Hon'ble Apex Court has clarified that a RP is to confirm that a resolution plan does not contravene any of the provisions of law for the time being in force, including section 29A of the Code, only means that his prima facie opinion is to be given to the CoC that a law has or has not been contravened. Provisions of the law does not empower the RP to 'decide' whether the resolution plan does or does not contravene the provisions of law.

The Apex Court further noted that even though it is not necessary for the RP to give reasons while submitting a resolution plan to the CoC, it would be in the fitness of things if he appends the due diligence report carried out by him with respect to each of the resolution plans under consideration, and to state briefly as to why it does or does not conform to the law.

In addition to the above, conduct of RP has been challenged with AA as well as with IBBI with respect to examination made by RP. An interesting case in this regard is the matter of *Mr. Sumat Gupta, RP, M/s Vallabh Textiles Company Ltd v. M/s Aggarsain Spinners Ltd.*,[42] the RP had made an application against the resolution applicant, him being non-compliant of section 29A. The application of the resolution process was based on the information received from a third party after the approval of the resolution plan by the CoC. The resolution applicant raised the question: whether the RP is competent to adjudicate upon the eligibility of a successful resolution applicant under section 29A(f) of the Code when the plan has already been submitted to the CoC? The NCLT, Chandigarh had observed that the RP is the officer of the court and he is duty bound to report such information to the AA. In the same stroke of pen, the NCLT also observed that the RP has not acted diligently in accessing public information before submitting the resolution plan.

Therefore, another question that the authors raise is regarding the current tools available with the RPs for conducting due- diligence. No tools have been specified as such for the RPs and they are completely reliant upon the information available in the public domain or from other sources. Moreover, in majority of cases, the information is such that it is available more readily to the CoC members than the RP, as was the case in *Mr. Sumat Gupta, RP, M/s Vallabh Textiles Company Ltd v. M/s Aggarsain Spinners Ltd.*[43]

The tools available with the RP have been summarised as below:

Section 29(1)	Disqualification	Data available with RP	Challenges faced
(a)	an undischarged insolvent	Based on affidavit submitted by resolution applicant	No such public information to verify the same
(b)	Wilful defaulter in accordance with the guidelines of the RBI issued under the Banking Regulation Act, 1949 (10 of 1949)	Based on affidavit submitted by resolution applicant and data available at PSBs website	No Master data/ list available to verify data available
(c)	At the time of submission of the resolution plan has an account, or an account of a CD under the management or control of such person or of whom such person is a promoter, classified as NPA in accordance with the guidelines of the RBI issued under the Banking Regulation Act, 1949 (10 of 1949) or the guidelines of a financial sector regulator issued under any other law for the time being in force, and at least a period of one year has lapsed from the date of such classification till the date of commencement of the CIRP of the CD	Based on credit report submitted by resolution applicant	No detailed information available in public domain to reverify the same
(d)	convicted for any offence punishable with imprisonment – (i) for two years or more under any Act specified under the Twelfth Schedule; or (ii) for seven years or more under any law for the time being in force: Provided that this clause shall not apply to a person after the expiry of a period of two years from the date of his release from imprisonment	Based on the search undertaken for legal cases	No detailed information available in public domain to reverify the same
(e)	Disqualified to act as a director under the Companies Act, 2013	Based on data available with Registrar of Companies	—
(f)	Prohibited by the SEBI from trading in securities or accessing the securities markets	Based on SEBI Website and BSE/ NSE Website	It was noted that various powers have been passed to BSE and NSE to

Section 29(1)	Disqualification	Data available with RP	Challenges faced
			prohibit someone from accessing the market, such data is not available in public domain easily
(g)	a promoter or in the management or control of a CD in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the AA under this Code	Based on affidavit submit by resolution applicant and data available at NCLT/ NCLAT website	Resolution applicant can disassociate itself from the CD before expressing such interest
(h)	executed a guarantee in favour of a creditor in respect of a CD against which an application for insolvency resolution made by such creditor has been admitted under this Code and such guarantee has been invoked by the creditor and remains unpaid in full or part	Based on data provided by resolution applicant regarding bank guarantee submitted by RA	No detailed information available in public domain to reverify the same
(i)	subject to any disability, corresponding to clauses (a) to (h), under any law in a jurisdiction outside India	Based on data provided by resolution applicant	No Data available in public domain to verify such orders in other jurisdiction
(j)	connected person not eligible under clauses (a) to (i).	As mentioned above	As mentioned above

Therefore, there will always be limitation to the due diligence conducted by the RP. There is need to provide certain tools and training to the RP to ensure timely and efficient compliance.

Further certain tools and information that is not easily located in public domain can be gathered using the software provided by private companies. However, the cost involved to use such tools is always in contention. Therefore, in order to ensure efficient compliance, arrangement can be made with help of Insolvency Professional Agencies (IPAs) and such other institutes to make them available with RP at a reasonable cost. Such arrangements are generally entered with professional bodies and regulators such as ICAI, ICSI or Bar Council for the benefit of professional. IPAs can also look into the same, ensuring capacity building of IPs for the same.

WHAT CAN BE DONE FOR BETTER IMPLEMENTATION OF SECTION 29A

There has been much discussion around the current form of section 29A and jurisprudence developed under the Code. However, there have been criticism of section 29A and issues that has emerged out applicability of section 29A. The authors in this regard suggest certain solutions for the better implementation of section 29A.

Jurisdiction to RP to pass reasoned order

One of the major reasons for delay of the CIRP is that the NCLT has to go on a fact-finding mission in hundreds of interim applications (IAs) placed before it. Therefore, the authors suggest that the entire fact finding mission should be conducted by the RP and the NCLT on the basis of the observations of the RP, decide upon the IA before itself and save the time that will otherwise go into the fact finding mission. A procedure akin to section 148A of the Income Tax Act, 1961 can be adopted herein and the RP can further assist the NCLT in deciding the IAs before it.

Jurisdiction of NCLT to decide on certain disqualification under section 29A

Section 29A has provided for various disqualification under the Code which are guided by other laws of the country. Therefore, it has been observed that many times resolution applicants have been debarred by the SEBI from accessing securities market or declared as wilful defaulter. NCLTs have escaped from adjudicating on such disqualifications. Additionally, it has been observed that in some of the cases, resolution applicant when informed about their disqualification under section 29A under the Code, are able to cure the said disqualification after such information is being delivered to them. However, in such cases AA have not taken recognition of such removal by resolution applicant and have declared the applicant as disqualified under section 29A. This was noted in the matter of *Aggarsain Spinners Ltd. v. Shreeji Cotfab Ltd.*,[44] resolution applicant was debarred by BSE/NSE from dealing in securities market, therefore attracting disqualification under section 29A(c) of the Code. Resolution applicant was able to cure to said disqualification. However, since the disqualification was cured at later stage, the AA held resolution applicant to be disqualified under the Code. The same was upheld by the NCLAT.[45] However, the Supreme Court held that since the disqualification was subsequently cured, the resolution applicant was eligible under section 29A.

Complete reliance on commercial wisdom of the CoC

It is argued that reliance in regard to the eligibility of prospective resolution applicant can be placed upon the commercial wisdom of the CoC. Creditors in the CIRP are the ultimate stakeholders and they should have a say in whether they want to accept an economically and practically feasible resolution plan from an ineligible resolution applicant or reject the same. Further, if there is any information on bid-rigging or any such anti-competitive activity, the matter can always be forwarded to the Competition Commission of India.

This not only increases the creditor incentive to approach the NCLT but also decreases the burden of the NCLT and furthers the goal of value maximization.

Whether some relaxation should be given from section 29A

The Code has been criticized for large number of corporates facing liquidation under the present regime. As per data provided in IBBI's newsletter, out of 3946 CIRPs concluded under the Code, 46% of the CDs have faced liquidation. There have been various reasons for such high numbers of liquidation under the Code, which includes majority of CDs being non-operational as on date of admission of the CIRP. However, as per the information available, 425 CDs which were going concerns were liquidated. It has been argued that these companies could have been saved from liquidation if the promoters/directors were allowed to participate in the resolution process. Certain suggestions are being made about exemptions to section 29A. These include:

(a) Exemption under section 240A to certain companies under IBC, other than MSMEs.

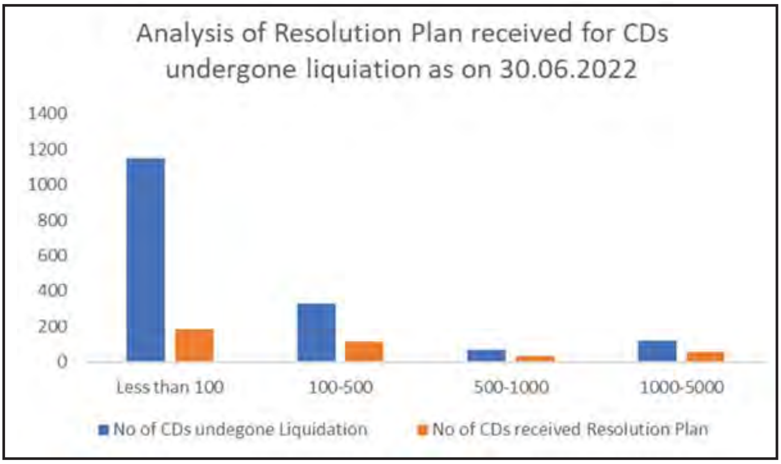
(b) Exemption under section 240A to certain industries such as service industry and real estate industry.

(c) Giving certain authority to AA/CoC to grant exemption for certain disqualification under different circumstances.

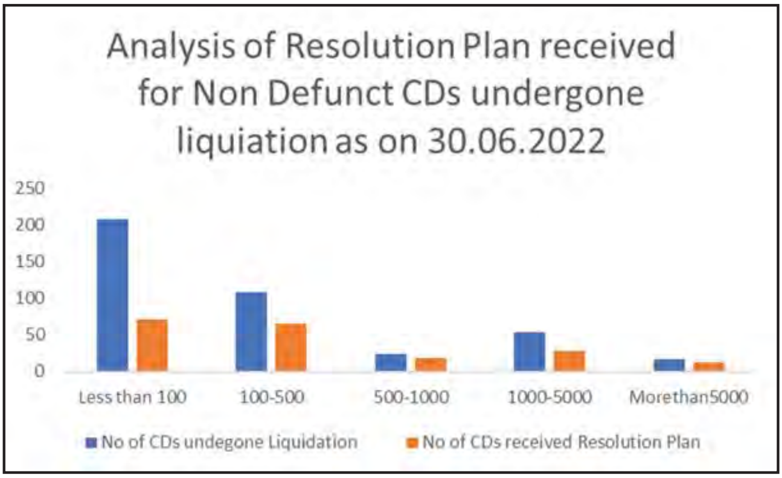
Viability of these suggestions have been discussed as below:

Exemption under section 240A to certain companies under IBC, other than MSMEs

As per data available for CIRP ending with order of liquidation as on June 30, 2022, there are 1703 CDs which have undergone liquidation. On further evaluation, it can be observed that 16% of the CDs having claims admitted less than ₹ 100 crore have received resolution plan as compared to 41% of the CDs having debt more than ₹ 100 crore. Data is presented as below:



Out of 1703 CDs undergone liquidation as on June 30, 2022, 412 CDs were not defunct i.e., that were going concern. 34% of the CDs having claims admitted less than ₹ 100 crore who have received resolution plan as compared to 62% of the CDs having debt more than ₹ 100 crore. Data is presented in the figure below:



Further, it can be observed that the value derived by creditors from resolution process for CDs is 177.60% of the liquidation value of the CD[46] as compared to 94% of value derived from liquidation process. Therefore, getting resolution under the CIRP is always favourable proceedings for the stakeholders as it ensures best economic use of the assets of the CDs as well as better value for past claims of creditors.

Therefore, to protect such companies from liquidation, there can be exemption provided to CDs who have debt size up to ₹ 100 crore.

Exemption under section 240A to certain industries

It has been observed that under certain industries there are limited number of resolution applicants other than promoters in the company, especially in case of real estate companies. In such circumstances, the promoters have even provided innovative solutions such as reverse CIRP such as in the case of *Flat Buyers Association, Winter Hills v. Umang Realtech Pvt Ltd through IRP & Ors.*[47]

This phenomenon is particularly noted in the companies which are dealing in service industry, the reason being that the companies don't have any assets which it can offer to a resolution applicant. Therefore, there have been demands from stakeholders to exempt applicability of section 29A to certain industries.

Giving certain authority to AA/CoC to grant exemption for certain disqualification under different circumstances

CIRP under the Code is a process that is run by stakeholders. Section 29A of the Code was inserted to protect the interest of such stakeholders. It has been argued that section 29A contains disqualifications which can be cured in shorter period or which are technical in nature. Therefore, certain powers can be granted to CoC to give exemptions to resolution applicants for being eligible for submitting resolution plans, or can be granted with some additional time to cure such disqualifications. However, some checks and balances may be placed or scope of such exemption can be limited. In addition, some stakeholders argue that AA may be given certain exemption to resolution applicants for disqualification under section 29A. The AA has already been given responsibility to ensure the principal of equity to the stakeholders while adjudicating a resolution plan. Therefore, certain exemption can be granted by AA under IBC to grant additional time to cure or remove disqualification under the Code. Hon'ble Supreme Court in the matter of *Arcelormittal India Private Limited v. Satish Kumar Gupta*[48] permitted ArcelorMittal and Numetal to remove their disqualification and present a resolution plan. Therefore, creating such enabling provisions may further the objective of introducing the Code. Similar was the case for *Aggarsain Spinners Ltd. v. Shreeji Cotfab Ltd.*[49] as discussed above.

CONCLUSION

Keeping in mind the aim of protection of the CDs from falling in the hands of defaulting promoters/ directors and other unscrupulous persons from acquiring the CDs, section 29A was introduced with a retrospective amendment. The decision of section 29A has been a successful one to a large extent as discussed above. But in a number of cases, it has also produced counter-productive results especially where the failure of the CD cannot be accorded to the office bearers of the CDs but the market forces of the economy. Therefore, certain medications need to be made to section 29A and to the Code in itself. As per the authors, certain exemptions, similar to those granted to MSMEs can be extended to certain industries, AA/ CoC can be given certain powers to exempt resolution applicants from the application of section 29A. Further, the RPs have to be better equipped to enable them to make proper inquiries into section 29A compliances, in addition to their formal training in this regard. While the Indian economy and legal landscape is on the right path, we still have a long way to go.

[1] Srinivas I. (2020), "The Story Behind Section 29A of IBC", Insolvency and Bankruptcy Regime in India: A Narrative, IBBI's Annual Publication 2020, p.97.

[2] (2021) ibclaw.in 46 SC.

[3] (2019) 4 SCC 17; *Chitra Sharma v. Union of India*, (2018) 18 SCC 575; *Jaiprakash Associates Ltd v. IDBI Bank*, (2019) 156 SCL 782.

[4] [2018] ibclaw.in 31 SC.

[5] (1994) 5 SC 54.

[6] [2018] 209 Comp Cas 181.
[7] (2019) 2 SCC 1.
[8] (2022) ibclaw.in 05 SC.
[9] (2022) ibclaw.in 476 NCLAT.
[10] Supra Note 2.
[11] (2022) ibclaw.in 271 NCLAT.
[12] (2022) ibclaw.in 13 NCLAT.
[13] Explanation to Rule 11 of National Company Law Tribunal Rules, 2016.
[14] [2017] ibclaw.in 10 SC.
[15] Report of the Insolvency Law Committee, March 2018.
[16] IBBI Quarterly Newsletter for the quarter July - September, 2022.
[17](2021) ibclaw.in 232 NCLT.
[18] (2022) ibclaw.in 474 NCLAT.
[19] Report of the Insolvency Law Committee, May 2022.
[20] (2017) 16 SCC 143.
[21] Supra Note 19.
[22] 99 taxmann.com 164 (NCLAT).
[23] *Swiss Ribbons v. Union of India*, (2019) 4 SCC 17; *Mobilox Innovations v. Kirusa Software*, (2018) 1 SCC 353; *Transmission Corporation of Andhra Pradesh v. Equipment Conductors*, 98 taxmann.com 375 (SC); *Reliance Asset Reconstruction v. Hotel Pooja International*, (2021) 7 SCC 352; *C Shivakumar Reddy v. Dena Bank*, (2020) 158 SCL 375; *Jignesh Shah v. UOI*, (2019) 10 SCC 750; *Babulal Vardharji Gurjar v. Veer Gurjar Aluminium Industries P Ltd*, (2020) 160 SCL 784; *Laxmi Pat Surana v. Union of India*, (2021) 8 SCC 481.
[24] [2020] 122 taxmann.com 88.
[25] The Insolvency and Bankruptcy Code (Amendment) Act, 2019 w.e.f. August 6, 2019.
[26] The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 w.e.f. December 28, 2019.
[27] (2019) 2 SCC 1.
[28] (2020) 160 SCL 44.
[29] [2021] 125 taxmann.com 244 (SC).
[30] The Report of Indian Brand Equity Foundation, August 2022.
[31] SIDBI Press Release dated July 28, 2021.
[32] *Swiss Ribbons v. Union of India*, (2019) 4 SCC 17.
[33] *One Capital Ltd v. Syglak Laboratories (P.) Ltd*, [2020] 115 taxmann.com 198 (NCLT).
[34] [2020] ibclaw.in 59 NCLT.
[35] 124 taxmann.com 401 (NCLT).
[36](2021) ibclaw.in 363 NCLAT; *Harkirat Singh Bedi v. OBC & Anr*, (2021) ibclaw.in 11 NCLAT.
[37] (2022) ibclaw.in 94 NCLAT, *Naushad Ahmed & Anr v. Mr. Sudershan Gupta, RP of VIL Ltd & Ors*, (2022) ibclaw.in 244 NCLAT.
[38] Reliance placed upon *SSL Srinivas Jute Twine Mills P. Ltd v. UoI*, (2006) 2 SCC 740; *DG of Trade & Anr v. Kanak Exporters & Anr*, (2016) 2 SCC 226.
[39] *K. Sashidhar v. IOB*, [2019] ibclaw.in 08 SC; *Ghanshyam Mishra & Sons Pvt Ltd v. Edelweiss Asset Reconstruction Co. Ltd*, (2021) ibclaw.in 54 SC.
[40] (2021) ibclaw.in 125 NCLT.
[41] [2018] ibclaw.in 31 SC.
[42] (2022) ibclaw.in 369 NCLT.
[43] (2022) ibclaw.in 369 NCLT.
[44] (2022) ibclaw.in 141 SC.
[45] (2022) ibclaw.in 702 NCLAT.
[46] Supra Note 16.
[47] [2020] ibclaw.in 166 NCLAT.
[48] [2018] ibclaw.in 31 SC.
[49] (2022) ibclaw.in 141 SC.

6 SECTORAL ANALYSIS OF EFFECTIVENESS OF IBC

- Ashish Vyas and Disha Choubisa

EXECUTIVE SUMMARY

The paper analysed sector wise status of selected 4946 corporate insolvency resolution process (CIRP) cases, recovery and reliefs sought in resolution plans. The average time in resolution of cases is 526 days, in which a few sector specific attributes were identified. The recovery for creditors was at 31% of admitted claims for resolved cases. Further, it was observed that recovery to creditors is 170% of liquidation value, which is an indicator that value of the assets had already eroded for those corporate debtors (CDs), which was one of the major contributors for higher haircut. Sector specific attributes were also analysed. Few general and specific reliefs allowed by the Adjudicating Authority (AA) were presented in the research paper.

Keywords: Sectoral Analysis, Realisation in IBC, Recoveries in IBC, Reliefs, Insolvency Professional, Liquidation Value vis-à-vis Recovery, Liquidation Value vis-à-vis Admitted Claims

INTRODUCTION

This paper provides a sectoral analysis of CIRP in India. The paper analyses sectoral effectiveness of the Insolvency and Bankruptcy Code, 2016 (IBC/Code). The paper summarises sector-wise outcome of CIRPs initiated by applicants. The outcome is derived based on current status of the CIRP cases, which were admitted. Overall, the outcome of CIRP cases is divided into concluded cases and yet to be concluded categories, which is further analysed by sector/ industry to which CD belongs. Average days taken in reaching current stage is analysed sector/ industry wise. The data is presented in tabular form with appropriate notes.

The paper covers analysis of resolution plans and sector-wise/industry-wise recoveries by stakeholders. The research has also studied a few resolution plans to examine, industry specific reliefs sought in resolution plan by prospective resolution applicants. This study was conducted to identify the need for industry specific regulations or law on the permissible reliefs for good and timely resolution of CD.

The CIRP data published by the Insolvency and Bankruptcy Board of India (IBBI/Board) for 4946 CIRP cases, available orders from National Company Law Tribunal (NCLT) and information available at website of IBBI are used for this study. Over the period, the insolvency law in India has improved with amendments and new regulations. The law interpreters have also provided guidance in clarifying the contentious issues. There is still room for improvement, particularly on sector specific challenges.

STATEMENT OF PROBLEM

There are various reports and studies which indicate that most of the cases, which have been admitted under CIRP have crossed the time prescribed by the Code and few are still continuing without any conclusion like resolution, withdrawal or liquidation. The delay in process involves costs and deteriorates realisable value of assets.

There are huge haircuts in the loans of financial creditors (FCs) and operational creditors (OCs) as observed in the CIRP cases and many media reports have alleged that the IBC is used as a tool for haircuts. Hence, it is essential to analyse the resolution process and recoveries of stakeholders.

It is seen that those investors, who invest in stressed assets are limited compared to general investors. Probably the reason for same is that they are not aware as to what to offer in stressed assets, as they sometime end up analysing stressed assets available by comparing it to the value based on admitted claims. Further, not all investors are aware about what relief can be sought in resolution, hence they do not participate in acquiring assets through CIRP.

Each sector/industry has few unique issues and in absence of any sector/ industry specific regulation, resolution become difficult. These are addressed by law makers and law interpreters from time to time. A handy list of such issues can be useful for law makers, stakeholders and law interpreters.

RESEARCH OBJECTIVES

The overall aim of research is to understand sectoral effectiveness of IBC by analysing sector/ industry specific behaviour of CD during resolution process. The objectives of the study are as follows:

(a) To study and understand hurdles, which cause delay in resolution and to identify sector/ industry specific attributes, pertaining to these delays;

(b) Analysis of resolution plan to understand sector-wise and industry-wise recovery by stakeholders; and

(c) To understand and list down sector-wise and industry-wise reliefs sought in resolution plans.

RESEARCH QUESTIONS

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

(a) From the selected CIRP cases, are there any sector/industry specific attributes pertaining to delay of resolution?

(b) From the selected CIRP cases, are there any sector/industry specific attributes as regards huge haircuts ? Whether there is any correlation between haircut and sector/ industry?

(c) Based on sector specific resolution plans, are there any sector-wise or industry-wise reliefs sought in resolution plans and if so, to list down few of them.

DESIGN OF THE STUDY

The objective of the research is to understand sectoral effectiveness of IBC by analysing sector/ industry specific behaviour of CD in resolution process and to identify sector/industry specific attributes, which are causing delay in resolution or resulting in higher haircuts for stakeholders.

The study adopted a two-phase approach for its research design. In first phase, the authors collected data of 4946 companies, which were admitted for commencement of CIRP upto December 31, 2021. The data has been collected from IBBI to study the objectives mentioned for sector-wise/ industry-wise time taken in resolution/ withdrawal/ liquidation etc. and sector-wise/ industry-wise recovery by stakeholders.

In second phase, the resolution plans of selected entities, which were downloaded from NCLT website and IBBI website, have been studied.

Under the first approach, based on corporate identification number (CIN) of companies under CIRP, the authors have tagged these 4946 companies to industry/ sector they belong to. Based on various newsletter data and resolution orders available with IBBI and NCLT, the authors have identified that resolution plan has been approved by the AA in 576 cases till September 30, 2022.

In phase 2, based on sector-wise/ industry wise study of CIRP cases, the authors have studied orders of the AA in which resolution plans were approved for selected companies to identify if any general relief or sector/ industry specific relief is granted by the AA.

LIMITATION OF THE STUDY

At the outset, the authors would like to point out that though an honest attempt has been made to answer the research questions at hand through the data study, the research nevertheless suffers from certain limitations. Some limitations could not be overcome due to want of data such as copy of resolution plans or incomplete information in CIRP forms and periodic date reporting by Insolvency Professionals (IPs).

The sector/ industry assigned to a company is based on CIN/LLP incorporation number and wherever there was difficulty in identifying the industry based on CIN, the industry has been assigned based on name of CD, the results of our research analysis has this limitation in classifying CDs with the sector/ industry.

While analysis of recovery for stakeholder, some recovery in kind could not be assigned a value and some recovery of contingent nature could not be assigned a value. However, instances of such recoveries were very few and have not impacted the analysis significantly.

While analysing relief sought by resolution applicants (investors), it is observed that in a few orders, reference of relief was given to resolution plan document, which was not readily available to researchers. Hence, this list is restricted to what was mentioned in NCLT orders, as available at NCLT and IBBI website.

RESEARCH FINDING

Research findings have been categorised into following three categories:

a) Hurdles, which cause delay in resolution and identified sector/ industry specific attribute, if any, in these delays;

b) Analysis of resolution plan to understand sector-wise and industry-wise recoveries by stakeholders; and

c) To understand and list down sector-wise and industry-wise relief sought in resolution plan.

Hurdles, which cause delay in resolution and identified sector/ industry specific attributes, if any

The research has been performed on selected 4946 cases, whether cases are concluded or still going on. Average days have been taken in reaching at that stage, which have been further bifurcated into sector/ industry wise. The phase wise outcome is presented in this point.

Overall analysis of outcome of CIRP and time taken in reaching that outcome

Based on CIRP cases admitted till December 31, 2021, the authors have analysed data of 4946 CIRP cases. The status as on September 30, 2022 for these cases were analysed.

It has been observed that out of these 4946 cases admitted upto December 31, 2021, i.e. after 9 months of admission, as on September 30, 2022:

(i) 562 companies were withdrawn under section 12A of the Code. Average time taken in obtaining withdrawal order, post admission of case was 157 days.

(ii) CIRP for 714 companies was closed or stayed or withdrawn by order of AA, Appellant Authority, High Court or Supreme Court. Average time taken in withdrawal order post admission of cases was 104 days.

(iii) The second major outcome of CIRP of these 4946 cases is that 1514 cases ended up in liquidation orders, which is 31% the total cases. Average time taken in obtaining liquidation order post admission of case was 391 days. This time is much beyond 330 days provided in the statute for completion of CIRP with appropriate exclusion.

(iv) There were 1580 cases, which were ongoing and average days of CIRP in these cases was 856 days. These constitutes 32% of total cases. Few cases are ongoing since 2017.

(v) The positive outcome of resolution was for 576 cases where average time taken in order approving resolution plan is 526 days, which is much beyond timeline of 180 days, 270 days and 330 days prescribed to complete the CIRP.

Below table shows gist of status of the selected 4946 CIRP cases, which covers average days in reaching the mentioned status:

Status of case as on September 30, 2022	**Numbers of CIRP**	**Average Days**	**% of total cases**
Withdrawal u/s 12A	562	157	11%
CIRP closed/ stayed/ withdrawn by NCLT/ NCLAT/ HC/SC order	714	104	14%
Liquidation ordered	1514	391	31%
Ongoing cases	1580	856	32%
Resolution order approved	576	526	12%
Total	**4946**	**487**	**100%**

Sector/ industry wise to analyse cases to identify if any sector/ industry specific reason exist for delays

With background of higher number of days taken in reaching a conclusion in CIRP cases, the research has further bifurcated the selected 4946 cases to analyse if any sector/ industry specific reason exists in delays.

a) It is observed that time taken in real estate activities sector is 590 days, which is highest among all sectors. The reason as based on reading of newspapers and orders, is larger number of land litigation. Further higher number of stakeholders, in the form of homebuyers was also a reason, which might be allotted for this delay.

b) Second highest time taken in reaching at current position is power sector. On analysis of admitted claims, it is observed that average admitted claims per case is highest in this sector. This is a reason for delay in reaching conclusion, as higher the amount, lesser number of investors or higher time required in completing due diligence of the case by investors.

c) Below table shows gist of sector/ industry wise time taken for the selected 4946 CIRP cases, which covers average days in reaching the mentioned status and average admitted claim:

Sector/ Industry	Number of Cases	Average days	Average admitted claim (₹ in crore)
Real estate activities	256	590	211
Electricity, water and gas supplies	149	584	1550
Constructions	541	528	627
Mining & quarrying	57	494	1,159
Others	688	480	586
Manufacturing	2,014	476	449
Trading	496	473	269
Renting and other business activities	745	450	311
Total	**4946**	**487**	**478**

Sector/ Industry wise analysis of cases bifurcated in concluded and yet to conclude cases

Sector/ industry wise analysis of cases has been performed by bifurcating the cases into concluded and yet to conclude category. In first category, are the cases, concluded through withdrawal under section 12A of IBC, withdrawal through court order and order approving resolution plan. Liquidation and ongoing cases were categorised in second category of yet to be concluded.

It is observed out of 4946 cases, 1856 cases were concluded, which constituted 37% of total cases analysed. On sector/ industry wise analysis it is observed that the percentage of concluded cases is within the range of 29% to 42%, hence any exceptional movement has not been observed in this analysis.

In below table, sector/ industry wise bifurcation of concluded cases and yet to be concluded cases is provided. Further the composition of mode by which the conclusion reached is also presented. Though there exists a range and a significant exception attributable to any sector industry has not been observed, the researcher observed that composition of concluded cases varies sector/ industry wise i.e. number of cases concluded through approval of resolution plan and settlement/ closure varies, which is analysed in the next section.

Sector	Conclusion reached				Yet to be concluded			Grand Total	% concluded
	With-drawal u/s 12A	CIRP closed/ stayed/ with-drawn by NCLT/ NCLAT/ HC/ SC order	Reso-lution	Total conc-luded	Liquid-ation	On going	Total yet to be concl-uded		
Constructions	64	104	60	**228**	106	207	**313**	**541**	42%
Electricity, water and gas supplies	7	15	31	**53**	44	52	**96**	**149**	36%
Manufacturing	225	253	293	**771**	660	583	**1243**	**2014**	38%
Mining & quarrying	5	7	6	**18**	19	20	**39**	**57**	32%
Trading	42	63	37	**142**	193	161	**354**	**496**	29%
Renting and business activities	113	131	60	**304**	235	206	**441**	**745**	41%
Real estate activities	24	55	15	**94**	31	131	**162**	**256**	37%
Others	82	86	74	**242**	226	220	**446**	**688**	35%
Total	**562**	**714**	**576**	**1852**	**1514**	**1580**	**3094**	**4946**	**37%**

Sector/ Industry wise approval of resolution plan

Out of 4946 CIRP cases analysed, there was approval of resolution plan in 576 cases, i.e. only 12% of admitted cases could be resolved under CIRP through approval of resolution plan, and as mentioned earlier with average 526 days taken in reaching at the stage of approval of resolution plan. This is further analysed sector/ industry wise.

It is observed that percentage count to reach at approval stage of resolution plan is highest in 'Electricity, water and gas Supplies' sector. There were 149 companies under CIRP in this segment and till September 30, 2022 resolution plans of 31 companies were approved, which is 21% of admitted companies under CIRP in this segment.

In manufacturing section this ratio of reaching at approval of resolution plan stage is at 15% of admitted CIRP cases. There were 2104 companies/ LLPs under CIRP in this segment and till September 30, 2022 resolution plans of 293 companies/ LLPs were approved.

The manufacturing sector was further analysed sub-sector wise and it has been observed that resolution is highest in 'Basic Metal Manufacturing' and 'Chemical and Chemical Products Manufacturing', which is 22% and 18% respectively.

The resolution in real estate activities is least at 6%. There were 256 cases admitted in CIRP, and resolution plan could be approved only in 15 cases. However number of cases closed through withdrawal and settlement is 79, which is higher, indicating that this segment is litigative. Further the average days taken in approval of resolution plan is also highest for this sector, which indicates that apart from the complexity of litigation, balancing higher number of stakeholders is also involved in resolution under this sector. The ongoing cases are 131 and liquidation order approved in 31 cases, which indicates that more cases would reach up to resolution level, considering lower percentage of liquidation order (only 12% for real estate, compared to 31% for all sectors).

Below table indicates sector wise approval of resolution plans and number of days taken in reaching that level:

Sector/ Industry	**Settled/ Withdrawn/ Stayed**	**Resolution plan approved**	**Not resolved**	**Total cases**	**% of resolved cases**	**Average days**
Electricity, Water and Gas supplies	22	31	96	149	21%	564
Manufacturing	478	293	1243	2014	15%	524
Basic metals manufacturing	65	76	203	344	22%	555
Chemical and chemical products Manufacturing	57	33	91	181	18%	469
Electrical machinery and apparatus manufacturing	23	8	76	107	7%	336
Equipment and Machinery Manufacturing	55	14	86	155	9%	749
Manufacture of beverages and food products	54	33	165	252	13%	497
Manufacturing fabricated metal products, except machinery and equipment	29	13	62	104	13%	517
Textile manufactures	50	29	162	241	12%	525
Other Manufacturing	145	87	398	630	14%	509
Mining & Quarrying	12	6	39	57	11%	593
Others	168	74	446	688	11%	488
Constructions	168	60	313	541	11%	575
Trading	105	37	354	496	7%	496
Renting and Business activities	244	60	441	745	8%	509
Real Estate activities	79	15	162	256	6%	612
Total	**1276**	**576**	**3094**	**4946**	**12%**	**526**

Analysis of resolution plans and sector-wise - industry-wise recoveries by stakeholders

Analysis of realisation in the resolved cases has been done by deriving ratio of total of proposed sum to OCs and FCs to amount of claim admitted. This ratio indicates recovery to creditors. It is seen that average realisation by these creditors varies from 10% to 60% based on the industry in which the CD operates.

Deterioration in value of CD on CIRP commencement date

Average expected realisation to creditors from approval of resolution plan is 31%, which indicates a higher haircut of 69% to creditors, however, on comparing liquidation value with admitted claim, it is observed that the ratio of liquidation value to admitted claim is only 18%.

Based on data of 576 CIRP cases, for which data was available with researchers, the admitted claim in these cases was ₹ 8.85 lakh crore, and liquidation value of assets was ₹ 1.58 lakh crore.

Liquidation value is the value of assets of CD as on CIRP commencement date in a stressed sale. This indicates that value of assets of CDs had already deteriorated on the CIRP commencement date. Accordingly, realisation through alternative routes would have also resulted in this haircut.

This ratio of deterioration in value of CD also varies when analysed segment wise. The ratio varies from 8% for 'Mining & Quarrying' sector to 40% for 'Constructions' sector.

The reason for deterioration in value of mining & quarrying industry can be associated to various developments in environment protection and maturity of law to impose restrictions on mining and quarrying sector.

The assets value of CD compared to admitted claims in the manufacturing sector is 14%, power sector (electricity, water and gas supplies) is also substantially lower at 10%. Change in technology and process of manufacturing may be the reason for this dip in value.

Below table provides sector/ industry wise data of admitted claims and liquidation value of entities in CIRP:

Sector/ Industry	Admitted Claims (₹ Cr)	Liquidation Value (₹ Cr)	Liquidation value to admitted claim
Electricity, Water and Gas supplies	98173	9352	10%
Manufacturing	438707	62685	14%
Basic metals manufacturing	194782	37134	19%
Chemical and chemical products Manufacturing	14929	2434	16%
Electrical machinery and apparatus manufacturing	4176	586	14%
Equipment and Machinery Manufacturing	6682	590	9%
Manufacture of beverages and food products	17944	3091	17%
Manufacturing fabricated metal products, except machinery and equipment	12019	1249	10%
Textile manufactures	44711	6247	14%
Other Manufacturing	143465	11355	8%

Mining & Quarrying	6488	527	8%
Others	136194	35078	26%
Constructions	61491	24597	40%
Trading	15534	3097	20%
Renting and Business activities	120879	22293	18%
Real Estate activities	7971	1355	17%
Total	**885437**	**158983**	**18%**

Resolution amount and haircuts to creditors and ticket size for investors

For the 576 cases, where admitted claim was ₹ 8.85 lakh crore, the approved resolution plans for these CD has offered ₹ 2.71 lakh crore as resolution amount. This brings recovery at 31% and haircut to creditor at 69%. The haircut is substantially high in these cases. Sector/ industry wise recovery in these cases were analysed.

The recovery is least in mining & quarrying sector, which is at 10% of admitted claim, this was explained by lower liquidation value of assets in CDs under CIRP in that sector.

The recovery in real estate sector is also appearing at a lower side of 20%. Few considerations in kind offered to creditors, which could not be factored in value terms are not included in this analysis. Example of consideration in kind is home/ flat to homebuyers in the project to be completed.

Average ticket size for investment in these resolved cases is ₹ 471 crore. However, this varies from industry to industry with average of ₹ 91 crore. However, while looking at individual break up of resolution plan, the investment value is as low as few lakhs offered by prospective resolution applicants for acquiring the stressed entity.

In below table, sector/ industry wise admitted claim, resolution amount, recovery in percentage terms is presented:

Sector/ Industry	Admitted claims (₹ Cr)	Resolution Amount (₹ Cr)	Number of cases	Avg. investment size per case	% recovery
Constructions	61491	36950	60	616	60%
Electricity, Water and Gas supplies	98173	14350	31	463	15%
Manufacturing	438707	122205	293	417	28%
Mining & Quarrying	6488	622	6	104	10%
Real Estate activities	7971	1584	15	106	20%
Renting and Business activities	120879	44853	60	748	37%
Trading	15534	3352	37	91	22%
Others	136194	47099	74	636	35%
Total	**885437**	**271015**	**576**	**471**	**31%**

Resolution amount, liquidation value and recovery

On comparing resolution amount with admitted claim, it is observed that recovery is at 31% for the analysed 576 cases. However on looking at valuation numbers, it was indicated that the values of assets of CDs had already deteriorated at the time of entering into CIRP.

Liquidation value as percentage of admitted claim is 18% for these resolved cases. Accordingly recovery of 31% is higher than what was envisaged by creditors, and hence those plans have been approved.

The ratio of resolution amount to liquidation value, which is an indication of recovery from the assets under CIRP, is at 170% which highlights that the recoveries when compared to admitted claims gives an indication of huge haircut, but recovery when compared to value of assets is 170%. The main reason for higher recovery under IBC compared to liquidation value is that under resolution in CIRP, the going concern status of CD is protected.

In below table, the researchers have plotted sector/ industry wise recovery in percentage terms with admitted claim and liquidation value of CD.

Sector/ Industry	Admitted claims (₹ Cr)	Liquidation value (₹ Cr)	Resolution amount (₹ Cr)	% recovery	Liquidation value to admitted claim	Resolution amount to liquidation value
Electricity, Water and Gas supplies	98173	9352	14350	15%	10%	153%
Manufacturing	438707	62685	122205	28%	14%	195%
Basic metals manufacturing	194782	37134	81538	42%	19%	220%
Chemical and chemical products Manufacturing	14929	2434	2496	17%	16%	103%
Electrical machinery and apparatus manufacturing	4176	586	715	17%	14%	122%
Equipment and Machinery Manufacturing	6682	590	807	12%	9%	137%
Manufacture of beverages and food products	17944	3091	5450	30%	17%	176%
Manufacturing fabricated metal products, except machinery and equipment	12019	1249	1388	12%	10%	111%
Textile manufactures	44711	6247	7328	16%	14%	117%
Other Manufacturing	143465	11355	22484	16%	8%	198%
Mining & Quarrying	6488	527	622	10%	8%	118%
Others	136194	35078	47099	35%	26%	134%
Constructions	61491	24597	36950	60%	40%	150%
Trading	15534	3097	3352	22%	20%	108%

Renting and Business activities	120879	22293	44853	37%	18%	201%
Real Estate activities	7971	1355	1584	20%	17%	117%
Total	**885437**	**158983**	**271015**	**31%**	**18%**	**170%**

Sector-wise / Industry-wise relief sought in resolution plan

There are certain reliefs which were claimed and allowed by the AA in its order approving resolution plan, which are listed in this section. This list is prepared based on reading/ extract from the orders of NCLT, approving resolution plan. In a few orders, reference of relief was given to the resolution plan document, which was not readily available to researchers, hence, this list is restricted to what was mentioned in the order. One should also note that the grant of relief by the AA depends on facts of the case.

General reliefs allowed

These reliefs apply to all sector depending on the facts of the case. Hence instead of repeating it, the researchers have provided then in this category. Following is the list:

a) Exempted resolution applicant from holding it liable for any offence committed prior to CIRP commencement date under section 32A of the IBC.

b) Any exemption asked in violation of law in force is constituted to be not granted.

c) Relief has been allowed by the AA that from the date of approval of the resolution plan by the AA, all such claims, which are not a part of resolution plan, shall stand extinguished and no person will be entitled to initiate or continue any proceedings in, respect to a claim, which is not part of the resolution plan.

d) Generic relief for approval of change of name such as the compliance with shareholder approvals is exempted with direction to resolution applicant to approach Ministry of Corporate Affairs (MCA) for the procedural part.

e) Approval for shift of registered office from one state to another.

f) All domain names, servers, application software etc. being currently used by the CD to the extent not owned by it, shall continue to be available for its use for a period of six months from the orders passed by the Hon'ble NCLT approving the present sector specific relief.

g) The stamp duty / registration fee/ any other tax/ levies/ demand arising on account of restructuring of the share capital and resultant change in the shareholding of the CD in terms of the provisions of this resolution plan shall be treated as exempted/ waived/ settled and extinguished and no demand on the CD or the resolution applicant will be raised by any Government Department/ Authority (granted subject to the law and applicable regulations).

h) Upon approval of the resolution plan by the NCLT, all taxes, cess , levies, and interest/ penalties thereon which are due or payable for the period upto the effective date as well as taxes/ interest/ penalties/ fines/ prosecutions for non-compliances, breaches and defaults of CD for the period prior to the effective date (including but not limited to those relating to tax authorities including property tax, sales tax and dues under demand of sales tax, GST, VAT, income tax, service tax and any other tax or duty or cess as applicable to the CD or due to the acquisition of control of the CD by the resolution applicant) shall be deemed to be waived by the concerned Government Authorities from all proceedings and penalties under all applicable laws for any non-compliance for the period prior to the effective date and no interest/penal implications shall arise due to such noncompliance /default /breach in relation to any period prior to the effective date shall cease and the CD shall be considered to have never committed any of the above mentioned non-compliance/ default/ breach. This includes, without limitation, waiver/extinguishment of any penalties / interests/ charges by whatsoever names called arising out of or related to actions/ omissions committed prior to the effective date in relation to any period upto the effective date.

i) Any right of subrogation, reimbursement, recompense or any other right of similar nature under any corporate guarantee, letter of comfort or similar guarantees or other instruments of debt or any obligation provided by any promoter, affiliate or related party of the CD, shall stand extinguished and will not be enforceable against the CD. Notwithstanding the approval of the resolution plan by the concerned NCLT, the right of the FCs as against the corporate/ personal guarantors will continue and the FCs reserve their right to proceed against the guarantors in accordance with applicable law.

j) From the effective date, all inquiries, investigations and proceedings, whether civil or criminal, suits, claims, disputes, proceedings in connection with CD or affairs of CD, pending or threatened, present or future in relation to any period prior to the effective date, or arising on account of implementation of this resolution plan shall stand withdrawn and dismissed and all liabilities and obligations therefore upon approval of this resolution plan, all new inquiries, investigations, notices, suits, claims, disputes, litigations, arbitrations or other judicial, regulatory or administrative proceedings will be deemed to be barred and will not be continued, initiated or admitted against CD and/ or its new management in relation to any period prior to the effective date (granted in terms of the *Ghanashyam Mishra and Sons Pvt Ltd v. Edelweiss Asset Reconstruction Company Ltd* wherein the Hon'ble Supreme Court has held in para 95(i) that once a resolution plan is duly approved by the AA under sub-section (1) of section 31, the claims as provided in the resolution plan shall stand frozen and will be binding on the CD and its employees, members, creditors, including the Central Govt., any State Govt. or any local authority, guarantors and other stakeholders. On the date of approval of resolution plan by the AA, all such claims, which are not a part of resolution plan, shall stand extinguished and no person will be entitled to initiate or continue any proceedings in respect to a claim, which is not part of the resolution plan. The Hon'ble Supreme Court also held that all the dues including the statutory dues owed to the Central Govt., any State Govt. 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).

k) Local municipal corporation, local water and electricity supply agency / department to waive off all demands, penalties, taxes, dues, charges, levies, and cess for any period prior to the plan effective date and neither the CD nor the resolution applicant shall be liable for the above under applicable laws for the period prior to an effective date and the Hon'ble AA shall pass an order to that effect (granted in terms of the *Ghanashyam Mishra and Sons Pvt Ltd v. Edelweiss Asset Reconstruction Company Ltd* wherein the Hon'ble Supreme Court has held in para 95(i) that once a resolution plan is duly approved by the AA under sub-section (1) of section 31, the claims as provided in the resolution plan shall stand frozen and will be binding on the CD and its employees, members, creditors, including the Central Govt., any State Govt. or any local authority, guarantors and other stakeholders. On the date of approval of resolution plan by the AA, all such claims, which are not a part of resolution plan, shall stand extinguished and no person will be entitled to initiate or continue any proceedings in respect to a claim, which is not part of the resolution plan. The Hon'ble Supreme Court also held that all the dues including the statutory dues owed to the Central Govt., any State Govt. 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).

l) All existing bank accounts will be deemed to be closed from effective date and all instruments already issued or contracts already signed by the CD which are found to be adversarial to the interest of the CD or give rise to any claim against the CD in future will be deemed to have been cancelled, without any further act, from effective date.

m) The FCs or the Reserve Bank of India (RBI) to issue no dues certificate, satisfy all existing charges created with MCA/ Central Registry of Securitisation Asset Reconstruction and Security Interest of India, handover all ownership documents of assets of the CD, remove all lien on all assets of the CD and confirm that, on and from the plan effective date, all accounts of the CD shall stand regularised and their asset classification shall be 'standard' for the purposes of all applicable laws. The uninvoked guarantees will be dealt with in the manner specified hereinabove in this resolution plan.

n) All existing share certificates issued/ printed by the CD shall be deemed to have been cancelled.

o) Request to instruct the State Electricity Board / PSPCL to reinitiate the power connection for the units situated.

p) All legal proceedings against the CD (including criminal proceedings but excluding those against the existing promoters) including by Serious Fraud Investigation Office, Enforcement Directorate, Central Bureau of Investigation or any other Governmental or regulatory authority and all reference to enquiry, investigation, summon, notice or any other proceedings pertaining to seizure or attachment of the assets of the CD shall stand irrevocably and unconditionally withdrawn, abated, settled and extinguished in perpetuity on and with effect from the approval date (granted in terms of section 32A of the Code).

q) The MCA and/or the AA shall exempt procedural compliance including but not limited to the provisions of section 66 of the Companies Act, 2013 (and the corresponding rules issued under the Companies Act, 2013) and section 42 read with section 62 and other applicable provisions of the Companies Act, 2013 (and the corresponding rules issued under the Companies Act, 2013) in respect of the capital reduction, conversion of debt into equity, issuance of new equity shares and issuance of non-convertible debentures (NCDs) proposed under the plan. Further, capital reduction, conversion of debt into equity, allotment of equity shares and NCDs in the manner envisaged under this resolution plan shall not require the consents of any of the creditors of the company or approval of any of the shareholders of the company, or any other person having security interest over such shares and the approval of the NCLT (pursuant to section 31 of the IBC) to the resolution plan shall constitute approval of the reduction of share capital, conversion of debt into equity, allotment of equity shares and NCDs and shall be binding on the company and its stakeholders (including its creditors and shareholders).

Sector/ industry specific reliefs

Few sector/ industry specific reliefs have also been allowed by AA. Most of these reliefs were granted with the intent to make resolution plan successful and in many of reliefs sought, the AA has directed the applicant to apply to concerned authority for the procedural part.

a) Construction sector

1. Concessions to the CD that, on and from the plan effective date, National Highways Authority of India and Public Works Department shall not blacklist the CD for its previous failure to timely complete the awarded contract.

2. Each of the landlords/ lesser/ owners of the assets where the CD conducts its business shall provide unrestricted access to the resolution applicant and shall handover all the assets of the CD located at such premises.

3. The collector of stamps, Revenue department of concerned State Government and the MCA to exempt the resolution applicant and the CD, from the levy of stamp duty and fees applicable in relation to this resolution plan and its implementation, including any stamp duty applicable on the issue of shares or NCDs by the CD (granted subject to the law and applicable regulations).

4. Hon'ble AA may kindly give appropriate directions that after the bid is successful, no capital asset or any movable material shall go outside the premises without the prior approval of the resolution applicant (granted subject to the law and applicable regulations).

5. The period of CIRP, days from CIRP commencement date to the plan approval days, shall be excluded while calculating the existing validity of empanelment/ eligibility of the CD, to be eligible to bid for/ be awarded any project/ tender of/ by the State & Central Government / Departments/Companies.

b) Trading sector/ industry

1. The permits, licenses, leases, or any other statutory right vested in the CD shall remain with the CD and for the continuation of such statutory rights, the resolution applicant has to approach the concerned statutory authorities under relevant laws.

c) Power (Electricity, Water and Gas supplies) sector

1. Licenses and approvals held by the company, which have expired or may expire prior to the transfer date or may expire within a period of six months from the transfer date, thereafter, shall be renewed / extended by the relevant Governmental authorities, and the company shall be permitted to continue to operate its business and assets in the manner operated prior to submission of this plan until the renewal / extension of such licenses and approvals. The relevant Governmental authorities will provide a reasonable period of time after the transfer date (at least one year) in order for the resolution applicant to: (a) assess the status of licenses and approvals required by the company and to procure that the company applies for the same; and (b) regularize any non-compliances under the applicable law (including non-registration, inadequate / non-stamping of documents as required under applicable law) existing prior to the transfer date.

2. The relevant Governmental authorities shall not initiate any investigations, actions or proceedings in relation to any noncompliance with applicable law by the company during the period prior to the transfer date. Neither shall the resolution applicant, nor the company, nor their respective directors, officers and employees appointed on and as of the transfer date be liable for any violations, liabilities, penalties or fines with respect to or pursuant to the company not having in place the requisite licenses and approvals required to undertake its business as per applicable law, or any non-compliances of applicable law by the company. Further, the relevant Governmental authorities will provide a reasonable period of time after

the transfer date, for the resolution applicant to assess the status of any non-compliances under the applicable law (including with respect to applicable environmental laws, directions or orders by the Ministry of Environment and Forest, permits, clearances and forest related clearances) and to procure that the company regularizes such non compliances under the applicable law existing prior to the transfer date (granted in terms of section 32A of the Code).

3. Under section 115JB of the Income-Tax Act, 1961, assessee company for which a rehabilitation scheme was approved, or reference was made under the provisions of the erstwhile Sick Industrial Companies (Special Provisions), Act, 1985 (SICA) was not subject to minimum alternate tax until the net worth becomes positive. Accordingly, a similar benefit ought to be extended to a resolution plan approved in accordance with the IBC since the IBC supersedes all other applicable law and deals with the same subject matter as the erstwhile SICA. In light of this, the Central Board of Direct Taxes, Department of Revenue shall: (a) exempt income / gain / profits, if any, arising as a result of giving effect to the plan as on the transfer date from being subjected to minimum alternate tax in the hands of Company under the provisions of the Income Tax Act, 1961; (b) exempt income / gain / profits, if any, arising as a result of giving effect to the plan as on the transfer date from being subjected to tax in the hands of the company under the provisions of the Income-tax Act, 1961; (c) grant an exemption to receive all income without deduction of any tax under the provisions of Chapter XVII-B of the Income Tax Act, 1961 for a period of 10 years from the transfer date; and (d) waive all liabilities in respect of taxes (including interest and penalty) arising in respect of periods up to the transfer date, including such liabilities for the period up to the transfer date that may crystallize subsequent to the transfer date (granted in terms of section 32A of the Code).

4. The AA shall direct that all consents/ approvals shall be deemed to have been given by all relevant authorities in relation to approval for 100MW and 115 MW power purchase agreements (PPas) as per terms of executed PPAs of the company with Kerala State Electricity Board and no further action in respect of such consents/permissions shall be required to be taken by the company.

5. The Directorate of Industries shall be deemed to have given its approval/ consent, if required, in respect of change in ownership/ constitution / management of the company and shall continue to grant all incentives.

d) Manufacturing

1. State Excise Department: Resolution applicant shall on approval of the resolution plan, after determining the status of finished goods quality, make suitable application to the State Excise for re-processing permission and approval for label registration. State Excise authorities on such application shall grant approval on payment of the requisite fees without demanding any additional penalty or past dues. Further State Excise Department shall also renew the license on application being made by the resolution applicant and shall not demand any old outstanding existing as on the date of approval of the resolution plan for such renewal.

2. West Bengal State Electricity Board (WBSEB), Calcutta Electric Supply Corporation (CESC) and Damodar Valley Corporate (DVC) or other Electricity Board or Authority: Resolution applicant has envisaged in the plan that liquidation value due to the OC is expected to be nil. Since electricity connection is main requisition for effective revival of the unit, although liquidation value due against the pending electricity charges are expected to be nil and further no claims has been received by any such OCs. As such CESC, WBSEB, DVC or the other Electricity Board or authority is required to provide immediate re-connection of electricity to the CD, without seeking additional securities or payment towards the revival of the CD once

application has been made in this regard. Resolution applicant further reserves its right to apply for the electricity connection with other utility in addition to the existing connection with DVC and that no prior permission for the same would be required (granted subject to payment of requisite charges).

3. West Bengal Beverage Corporation (WBBC): On approval of the resolution plan, WBBC shall release all payments due to the CD immediately on instruction of the successful resolution applicant, without seeking any further orders or instruction in this regards from any court or authorities. Further any stock and inventory lying at the locations under the control of WBBC or with it, shall be released immediately on approval of the resolution plan, without seeking any payments or further documents in this regard.

4. Following specific relief were recommended to be granted based on view of the AA that success of resolution plan depends on these reliefs:

   a. Ministry of Food Processing Industries, Govt. of India (MoFPI) vide its letter dated September 24, 2019 has cancelled/terminated the final approval granted to the CD for setting up a mega food park at Village Getalsud, Ranchi. The approval from MoFPI for setting up a mega food park is an integral and one of the most important parts in reviving the CD under this CIRP, failing which the entire exercise under this CIRP shall be rendered futile. Consequently, upon approval of this resolution plan by the NCLT the final approval granted to the CD for setting up a mega food park at Village Getalsud, Ranchi shall stand revived, and the resolution applicant shall not be required to separately seek approval of the same.

   b. The premises of the CD's food park at Getalsud, Ranchi is a 56 acre land taken on lease from Ranchi Industrial Area Development Authority (RIADA) for a 30-year term renewable twice at an interval of 30 years. The success of the resolution plan depends entirely upon the availability of the aforesaid land on a fresh land lease from RIADA for a period of 30 years renewable twice at an interval of 30 years. Upon approval of this resolution plan by the NCLT, RIADA shall immediately provide the aforesaid land on a fresh lease for a period of 30 years term renewable twice at an interval of 30 years and on the same terms and conditions as originally entered into with the CD.

   In refrence to the above, the AA passed following order:

   > We are convinced that the success of the Resolution Plan is entirely dependent on the approval to be granted by the MoFPI and RIADA. Therefore, we strongly recommend that MoFPI reconsider and reverse its decision to cancel the final approval granted to the Corporate Debtor, since it is integral to the success of the Resolution Plan for revival of the Corporate Debtor. This will be in line with the object and intent of the Insolvency & Bankruptcy Code, 2016, and also various judgments of the Hon'ble Supreme Court, which have held that the basic purpose of the insolvency resolution process is to enable a fresh start for the Corporate Debtor under a new management. On its part, the Resolution Applicant shall apply to the appropriate authority for renewal or revival of the licence granted to the petitioner for setting up the Mega Food Park at Village Getalsud, Ranchi.

5. It is probable that certain of the business permits/ import licenses/ Directorate General of Foreign Trade (DGFT) licenses/health & safety license/ District Industries Centre (DIC) approvals/factory license etc. of the CD have lapsed, expired, suspended, cancelled, revoked or terminated or the CD has non compliances in relation thereto, accordingly, the resolution applicant requests all Governmental authorities to provide reasonable time period after the effective date in order for the resolution applicant to assess the status of these business permits

and ensure that the CD is compliant with the terms of such business permits and applicable law without initiating any investigations, actions or proceedings in relation to such non compliances and all such non compliances stands ratified by this order. Further, time period with regard to such business permits/ import licenses/ DGFT licenses/Health & Safety License/DIC approvals/factory license etc. should be extended for one year (granted, the applications to be made as per the law and applicable regulations).

6. The NCLT order passed shall be binding on all the concerned Government departments / authorities. Further, any overdue stamp duty, property tax, Howrah Municipal Corporation dues, West Bengal State Power Distribution Company Limited clearance, income tax dues penalty/ charges etc. with respect to the CD shall be assumed to be settled/ foregone. Further, following approvals shall be provided, application and procedures shall be followed by the resolution applicant:

   a. 132 / 33 KVA grid connectivity from nearest sub-station
   b. Restoration of water permission from Water Resource Department
   c. Coal linkage for power plant from Ministry of Coal
   d. Boiler Inspector permission
   e. Electrical Inspector permission
   f. Factory license
   g. Health & safety licenses
   h. Labour licence from the concerned Labour Department
   i. Valid Pollution Consent from the Pollution Control Board to operate both the units (Granted in the interest of implementation of the resolution plan and keeping the CD as a going concern).

Rejection of relief by AA:

The AA rejected following reliefs in general in its order approving resolution plan, however these rejections also depend on facts of individual cases:

1. Any relief sought in the resolution plan, where any contract, agreement understanding, proceeding, action, notice etc. not specifically identified, or is for a future contingency is rejected.

2. On seeking relief in the resolution plan for extension for renewal of 'consent to operate' under section 21 of the Air (Prevention and Control of Pollution) Act, 1981 for discharging of emission arising out of premises. In one of the orders the NCLT has clarified that the AA has powers to decide the reliefs claimed which are directly relatable to the resolution process and not over those pertaining to extraneous issues. Regarding the reliefs/waivers pertaining to the domain of various departments/governmental authorities, it is further clarified that this AA has no power to sanction those waivers and the successful resolution applicant is at liberty to approach the competent authorities/courts/legal forums/office(s) Government or Semi-Government/State or Central Government for appropriate relief(s) sought in the plan. Approval of the resolution plan does not mean automatic waivers.

3. The Department of Registration and Stamps of the relevant states (including State of Madhya Pradesh, Kerala and West Bengal) and the MCA shall exempt the resolution applicant and the company, from the levy of stamp duty and fees applicable in relation to this plan and its

implementation. The concerned state revenue/ stamp authorities shall waive off any penalties for non-registration and inadequate/ non stamping of the documents executed by the company.

(Not granted. The resolution plan cannot be in violation of any law for the time being in force. Therefore, if there are any documents on which stamp duty is required to be paid, or in respect of which non-registration will have adverse consequences, they shall apply with full force and no waiver can be granted in this regard).

CONCLUSION

Based on analysis of CIRP data, it is understood that average days consumed in reaching resolution is substantially higher compared to the model timeline prescribed by the IBBI. The delay in few sectors/ industries is substantially high compared to other sectors/ industries. It is a known fact that time is of essence in value maximisation and resolution of stressed assets. The longer it remains in stress, the higher is the loss of value. Its value decreases if post admission, there is delay in attracting the new investors or delay in approval of resolution plan by the AA.

The sector/ industry wise analysis of recoveries is presented in the research finding section. Overall recovery was at 31% of admitted claims, which was analysed sector/ industry wise. The haircut in some sectors is too high. On linking it with liquidation value of the CD, it is observed that value had already eroded on the CIRP commencement date. The recovery in terms of liquidation value of CD was at 170%, which indicates that by protecting status of going concern of CD, good recovery can be generated.

The reliefs sought in resolution plans by resolution applicant (investors) were analysed and few reliefs allowed in the order of NCLT approving resolution plans were mentioned in the research finding section. The awareness of permissible reliefs may be used to attract more investors.

Based on the observations in the research finding section, the researchers make following suggestion to the law makers and the regulator:

1. Few sector-specific regulation needs to be made to expedite resolution. Issues in manufacturing units may differ from construction or real estate sector. Judgement in Supertech Limited allowing project-wise resolution of real estate company is a welcome move, which was subsequently incorporated in regulations as well.

2. More awareness activities need to be imitiated to attract investors in stressed assets under IBC. The amendment in regulation guiding Resolution Professional to prepare strategy for marketing of assets of the CD is a welcome move.

3. Resolution of stressed assets not only resolve the issue of recovery for FC, it is also a mechanism to save/ generate employment and contribute in manufacturing/ service sector of the country's gross domestic product. Accordingly, to promote start of such shut-units/ under-run units under a stressed corporate, guidance must be given by law makers for specific relief to new investors, who take risk of running such stressed units. A clarity upfront in form of regulation stating an industry specific relief to attract investors is suggested. Currently based on facts of the case, the AA allows the reliefs, however an upfront clarity in relief will attract more investors and good value may be generated.

7 TREATMENT OF CROWN DEBTS IN INDIAN INSOLVENCY: PERSPECTIVES AND WAY FORWARD

-Bahram N Vakil, Nilang T Desai, Suharsh Sinha and Saloni Thakkar

'The law must clearly lay out the priority of distributions in bankruptcy to all stakeholders. The priority must be designed so as to incentivise all stakeholders to participate in the cycle of building enterprises with confidence'.

– Bankruptcy Law Reforms Committee[1]

EXECUTIVE SUMMARY

The Insolvency and Bankruptcy Code, 2016 (IBC) was enacted to overhaul India's existing insolvency laws in several respects. In particular, the legislation revised the priority of payment to creditors in the event of the corporate debtor (CD) being liquidated (liquidation waterfall), providing for secured creditor dues to be paid in precedence to dues owed to statutory authorities (referred to as crown debts). In the context of crown debts, the liquidation waterfall has been subject to differing interpretations by the judiciary, most notably in the recent Supreme Court decision in *State Tax Officer (1) v. Rainbow Papers Limited*[2] (Rainbow Papers). The focus of this article is to analyse the treatment of crown debts under IBC, the interpretations by judiciary thereof, and make suggestions for reform.

Keywords: IBC, Crown Debts, Statutory Dues, CIRP.

INTRODUCTION

Treatment of crown debts prior to IBC in India

Prior to the enactment of IBC, the treatment of crown debts was addressed under the Companies Act, 1956, and the Companies Act, 2013, by providing for a waterfall for priority of payment to different classes of creditors from the liquidation estate of the company undergoing liquidation.

The waterfall mechanisms under section 529, 529A and 530 of the erstwhile Companies Act, 1956, and sections 326 and 327 of Companies Act, 2013, both provide for:

a) First, payment of workmen dues and payment to secured creditors; and

b) Second, payment of statutory dues to the Central Government or State Government or to a local authority, which has ranking *pari passu* with:

- wages or salary of employees for a period not exceeding four months;
- accrued holiday remuneration payable to employees;
- employer's contributions payable under the Employees' State Insurance Act, 1948;
- compensation under the Workmen's Compensation Act, 1923;

- sums due to any employee from the provident fund, pension fund, gratuity fund or any other fund for the welfare of the employees, maintained by the company;
- expenses of any investigation insofar as they are payable by the company, in priority to payment to all other classes of creditors apart from workmen and secured creditors.

In other words, payments to secured financial creditors (FCs) clearly ranked over payment of crown debts, and the payment of statutory debts was in priority to payment to unsecured FCs.[3]

Treatment of crown debts in the UK

Section 1 of the Preferential Payments in Bankruptcy Act, 1888 first introduced the concept of 'preferential payments'. The Preferential Payments in Bankruptcy Amendment Act, 1897 (61 Vict. c.19) amended the category of 'preferential payments' for rates, taxes and wages, to take priority over a floating charge in an insolvent company's assets. The preferential debts consisted of a category of claims that had been in various enactments granted statutory priority, including obligations to pay employees' wages, pension contributions and holiday pay, certain rates and various claims of the crown in respect of unpaid tax.[4]

These provisions were restated in the Companies (Consolidation) Act, 1908, the Companies Act, 1929 and the Companies Act, 1948. Section 319 of Companies Act, 1948 provided that in a winding up of a company, statutory dues were to be paid in priority to all other debts owed by the company.[5]

The UK insolvency underwent an overhaul with the introduction of the UK Insolvency Act, 1986. Section 386 read with Schedule 6 (*The Categories of Preferential Debts*) of the UK Insolvency Act, 1986 established priority of payment of debts due to Inland Revenue and debts due to Customs and Excise over payment of other debts of a company, creating a 'crown preference'.

This construct was once again amended with the introduction of sections 251 and 252 of the Enterprise Act, 2002, effectively abolishing the crown preference and instilling a new waterfall mechanism whereby the payment for – (a) debts owed to secured creditors, (b) insolvency costs, (c) costs of any petitioning creditor in a winding up, (d) office holders costs (subject to creditor's approval) and (e) debts owed to preferential creditors – would all be in priority to the payment of crown debts to tax authorities (i.e. His Majesty's Revenue & Customs or the HMRC).

Thereafter, the Finance Act, 2020 was passed whereby it was provided that HMRC will be considered a secondary preferential creditor, and the UK Government published the Insolvency Act, 1986 (HMRC Debts: Priority on Insolvency) Regulations, 2020.[6] The new law partially reverses the effect of the Enterprise Act, 2020, whereby from December 1, 2020, HMRC will rank ahead of floating charge holders and unsecured creditors in respect of certain taxes that the relevant company collects on behalf of HMRC (termed as priority taxes).

Treatment of crown debts under UNCITRAL Model Law

UNCITRAL's Legislative Guide on Insolvency Law suggests that prioritizing payment of government dues should be minimized to avoid complications and inequities. It may encourage government authorities to delay collection of dues due to the comfort of priority under insolvency, and such '*failure to collect taxes can compromise the uniform enforcement of tax laws and may constitute a form of state subsidy that undermines the discipline than an effective insolvency regime is designed to support.*'[7]

Reforms introduced under IBC

To appreciate the intentions behind the introduction of IBC, it is relevant to bear in mind the economic background in which the IBC was enacted. The Indian banking sector witnessed an increase in stressed assets during the mid-2010s. Many overleveraged Indian companies started defaulting on repayments, resulting in piling up of non-performing assets (NPAs) with the banks. In 2015, India had net NPAs amounting to ₹ 3.5 lakh crore.[8] In fact, after the Reserve Bank of India (RBI) intervention in 2016 whereby more stringent norms were put in place for banks to detect and classify NPAs,[9] the net NPA ratio shot up to 6% in 2017,[10] reflecting a more accurate picture of stress faced by the Indian banking sector. To address this, the Government introduced a recapitalization plan to infuse additional capital in banks for meeting stabilization requirements.[11]

Coupled with the problem of rising NPAs was the inadequacies associated with recoveries. During the period 2015-2017, the average recovery ratio of Indian banks was a meagre 26.4%, with public sector banks (PSBs) recovering only around half of what the private sector banks could recover.[12] The Indian banking sector has historically been dominated PSBs. For instance, in 2015 PSBs accounted for 74.3% of all credit lent, 75.9% of all deposits held by scheduled commercial banks,[13] and amounted to 72.1% of the total banking sector assets in the country.[14] The Government had infused over ₹ 700 billion in PSBs between 2007-2015.[15] The stress in the banking sector thereby implied direct consequences for the Government as the majority stakeholder.

The stress faced by PSBs, and the minimal recovery rates buttressed the requirement to revamp the extant legal mechanisms for banks to initiate recovery. The Bankruptcy Law Reforms Committee (BLRC) in its interim report to the Government of India dated February, 2015 (BLRC Interim Report) emphasized that a proper functioning insolvency system would create a robust market for credit through rehabilitation of distressed assets and maximization of recovery for lenders where such rehabilitation is not viable.[16] In this regard, the BLRC Interim Report noted that priority of payments towards crown debts over secured creditors hampers the recoveries made by banks in an event of the debtor being wound-up:

> Allowing crown debt (whether state or central) to prevail over the security interest of secured creditors is problematic for several reasons- (i) it leads to uncertainty for secured creditors regarding the sums that would be payable to them in the event of a company's insolvency; (ii) it may slow or otherwise complicate the exercise of out-of-court enforcement rights by secured creditors and increase costs; (iii) the cost of credit for the debtor company may increase as secured creditors may ultimately pass on the risks arising from these to the debtor through higher interest rates; and (iv) it may reduce the attractiveness of certain kinds of security interests that would otherwise generate positive externalities, as where they encourage monitoring ex ante.
>
> Moreover, the dues payable to the Government in such circumstances are unlikely to be significant when compared to total government receipts, whereas the impact of non-payment on commercial creditors (including public sector banks) is likely to be substantial and may even lead to their insolvency and systemic issues for the economy.[17]

The BLRC also highlighted that while the Government has other avenues for enforcing its debt (such as imposition of penalties), private commercial creditors do not have such recourse.[18] The BLRC also noted the economic benefits associated with the subordination of crown debts:

> The Committee has recommended to keep the right of the Central and State Government in the distribution waterfall in liquidation at a priority below the unsecured financial creditors in addition to all kinds of secured creditors for promoting the availability of credit and developing a market for unsecured financing (including the development of bond markets). In the long run, this would increase the availability of finance, reduce the cost of capital, promote entrepreneurship and lead to faster economic growth. The government also will be the beneficiary of this process as economic growth will increase revenues. Further, efficiency enhancement and

> consequent greater value capture through the proposed insolvency regime will bring in additional gains to both the economy and the exchequer.[19]

Thus, the BLRC in its recommendations suggested secured creditors take precedence over crown debts in the priority of payments on winding-up/liquidation of the company in distress.

Treatment of crown debts under IBC

The recommendations of BLRC formed the bedrock for the formulation of the IBC. The IBC does not define the term 'crown debts', however section 3(21) of IBC stipulates any dues arising under any law in force and payable to the Government or local authority shall be treated as operational debt. Thus, the Central Government, any State Government and any local authority to whom such an operational debt is owed would come within the ambit of operational creditor (OC).[20]

The treatment prescribed for crown debts has been enshrined in section 30 and section 53 of IBC. Section 30(1) of IBC states that a resolution plan submitted must provide for payment of debts of OCs such that it is not less than the higher of the amount that would have been paid to such creditors (i) in the event of liquidation and (ii) if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority under section 53(1) of IBC.

Section 31 of IBC provides that the if the Adjudicating Authority (AA) is satisfied that a resolution plan as approved by the committee of creditors (CoC) meets the requirements under section 30(2) of IBC, it shall approve the resolution plan which will be binding on all creditors and stakeholders, including the Central Government, any State Government or any local authority to whom statutory dues are owed.[21]

Section 53 of IBC provides for the priority / waterfall as per which the proceeds of the liquidation estate are to be dispersed to stakeholders. This waterfall places the payment of statutory debts at a relatively lower priority compared to the previous legislations such as the Companies Act, 1956 and the Companies Act, 2013. While the payment of crown debts would still be in priority to certain creditors such as preference or equity shareholders, payment of financial debts owed to unsecured FCs would be in priority to payment of statutory debts.

JUDICIAL INTERPRETATION OF CROWN DEBTS PRIOR TO RAINBOW PAPERS

Whether crown debts amount to operational debt

As mentioned above, crown debts are treated as operational debt under IBC. Specific instances on the treatment of crown debts are provided as follows: In relation to tax dues payable by the CD, the National Company Law Appellate Tribunal (NCLAT) in *Pr. Director General of Income Tax (Admn. & TPS) and Ors. v. Synergies Dooray Automotive Ltd. & Ors.*,[22] has held that since statutory dues arising out of the existing law such as Income Tax and Value Added Tax arise when the company is operational, such statutory dues have direct nexus with the operation of the company. Therefore, all such statutory dues would come within the meaning of operational debt. The same interpretation has been adopted in other cases such as *Electrosteel Steels Limited v. State of Jharkhand & Ors.*[23]

In relation to crown debts in the form of spectrum dues payable by the CD to the Government under a telecom license, the NCLAT in *Union of India v. Vijayakumar V. Iyer & Ors.*,[24] has held that admitted claims of Telecom Licensors qua the operational debts would have to be settled as the part of the approved resolution plan or in liquidation, as the case may be. The Court included dues of 'Licensor-DoT' under operational debt payable to the Government.

In *Ultra Tech Nathdwara Cement Ltd. v. Union of India and Ors.*,[25] the Rajasthan High Court held that once the resolution plan is accepted and approved by the appropriate authority, the same is binding on all creditors owed statutory dues, and no right of audience can be given to such creditors in the resolution proceedings.

Priority of crown debts in pay-outs under IBC

In *Leo Edibles and Fats Ltd. v. Tax Recovery Officer and Ors.,*[26] the High Court of Telangana, on the question of priority of tax dues, held that when an assessee-company is being liquidated, the Income-tax Department must take recourse to distribution of assets as per section 53 of the IBC since it is not a secured creditor. The Court iterated that tax dues clearly come within the ambit of section 53(1) of the IBC which provides the order of priority for such distribution, wherein such dues are assigned the fifth position in the order of priority.

In *Sundaresh Bhatt, Liquidator of ABG Shipyard v. Central Board of Indirect Taxes and Customs*,[27] addressing the conflicting treatment and priority of customs dues under the Customs Act, 1962 (Customs Act) and the IBC, the Supreme Court held that the IBC overrides the Customs Act due to its comparative recency. The Court referred to section 142A of the Customs Act and section 238 of the IBC which recognizes the IBC overriding the Customs Act in case of any conflict. Accordingly, the Supreme Court upheld that customs dues would have lower priority than secured FC's dues.

In *Jalgaon Janta Sahakari and Ors. v. Joint Commissioner of Sales Tax, Nodal-9, Mumbai and Ors.,*[28] the High Court of Bombay held that a debt which is secured or becomes a 'first charge' on a property must be held to prevail over a crown debt, which is an unsecured one. The Court stated that, '*The law, as it stands even today, is that a Crown debt enjoys no priority over secured debts.*' With regard to the priority of secured creditors as per the SARFAESI Act over the relevant department of the Government in appropriating the amount realized from the sale of a secured asset, the Court held that, subject to the IBC and Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) registration, the dues of a secured creditor would rank superior to dues of the relevant department of the State Government.

RAINBOW PAPERS JUDGEMENT

The primary point of contention in *Rainbow Papers* was whether the liquidation waterfall under section 53, IBC overrides section 48 of Gujarat Value Added Tax Act, 2003 (GVAT Act) which provides the Government a first charge over the payer's property in relation to their dues under the legislation. The respondent, a company owed tax dues to the sales tax authorities under the GVAT Act and had initiated recovery proceedings to recover dues. Pending such proceedings, the respondent was admitted to the corporate insolvency resolution process (CIRP) under IBC upon an application filed by one of the OCs. The resolution plan submitted for the resolution of the respondent had sought to waive all dues payable to the appellant. Aggrieved, the appellant filed an application before the NCLT Ahmedabad Bench challenging the validity of the resolution plan on the ground that the appellant was to be treated as a secured creditor and thereby owed its claims in full.

The NCLT rejected the application on grounds on maintainability since the appellant had raised the claim after approval of the resolution plan. On appeal, the NCLAT upheld the decision, opining the appellant cannot be construed a 'secured creditor' under IBC by interpreting section 53 of IBC to override section 48 of GVAT Act. On subsequent appeal, the Supreme Court took a contrary position, opining that the debt owed to the Government under the GVAT Act is a secured debt given the statutory lien creates a 'security interest' under section 3(31) of IBC and the appellant would be a secured creditor as per section 3(30) of IBC. The Supreme Court held that since the appellant would have priority in the liquidation waterfall as a secured creditor, there would be no inconsistency between section 48 of GVAT Act and section 53 of IBC. Thereby, it set aside the resolution plan as approved by the CoCs for not having made requisite provisions for payment of statutory creditors like the appellant.

Issues in the Rainbow Papers rationale

The Supreme Court has equated the first charge under section 48 of GVAT Act to be 'security interest' under section 3(31) of IBC. Notably, the definition of security interest only covers rights, interests or title created by a transaction which secures payment or performance of an obligation. Section 48 of GVAT Act does not contemplate any commercial transaction which creates such a statutory charge (rather, has deeming provisions implying such charge).

On the contrary, section 77(3) of the Companies Act, 2013 prescribes a *non-obstante* clause stating no charge created by a company shall be taken into account by a liquidator or creditor unless the charge has been duly registered with the Registrar of Companies (ROC) and a certificate of registration has been issued by the ROC in accordance with section 77.

In the event of liquidation, the secured creditor is required to prove the existence of a charge as per regulation 21 of the IBBI (Liquidation Process) Regulations, 2016 (Liquidation Regulations). The existence of a security interest may be proved on the basis of: (a) records with the information utility; (b) certificate of registration of charge issued by ROC (as mentioned above); or (c) registration of charge with the CERSAI.

In this context, section 48 of GVAT Act does not provide for getting the first charge registered with the ROC or as per the Liquidation Regulations. In view of the absence of a valid security interest created and registered as per the IBC and the Companies Act, 2013, which are the determinative provisions of law, there are strong arguments that the Supreme Court had erred in interpreting the appellant to be a secured creditor under section 3(30) of the IBC.

Additionally, the Supreme Court in its decision passed the following observation: '*52. If the Resolution Plan ignores the statutory demands payable to any State Government or a legal authority, altogether, the Adjudicating Authority is bound to reject the Resolution Plan.*' This observation may lead to an interpretation whereby even crown debts that are not secured in any manner may require priority payment under a resolution plan. This falls foul of the liquidation waterfall which explicitly subordinates the treatment of crown debts.

Implications of the Rainbow Papers judgement

With the ostensible aim to instil fairness in recovery, the decision in *Rainbow Papers* has ended up opening the pandora's box for treatment of crown debts. For instance, the NCLT Chandigarh Bench in its recent order, relying on the rationale in *Rainbow Papers* has rules for income tax liabilities under rule 93 of Par VI (Miscellaneous) of the Second Schedule of the Income Tax Act, 1961 to be treated as secured debt under IBC.[29] As mentioned above, such interpretations are contrary to the treatment as per the liquidation waterfall and the scheme of the IBC.

The scheme of IBC requires a time-bound resolution of distressed companies and all prospective resolution applicants are given a limited opportunity to conduct a due diligence on the CD. It is often the case that statutory authorities do not submit their proof of claims within stipulated timelines (as evidenced in *Rainbow Papers*). The uncertainty will create an increase in the transactional cost to be expended by the resolution applicants on due diligence to apportion the adequate payment to statutory authorities and even then, there is no certainty on the quantum of crown debts outstanding or eventually payable. To counter this risk, applicants will look to caveat their bids or plans with an option to reduce or modify the bid amounts on an *ex-post facto* basis, which not a desirable option for both the CoCs and the timely resolution of the CD.

Further, as mentioned above, PSBs are the dominant market players in the Indian banking sector and one of the objectives of introducing IBC was to alleviate the stress faced by PSBs. If larger chunks of resolution proceeds are sought to be diverted from financial creditors to the statutory authorities, this will end up diminishing the returns for PSBs. As highlighted above, statutory authorities have other avenues to recover their dues, while PSBs do not have the same benefit.

Given the economic landscape, the BLRC's recommendations and explicit provisions under IBC, the Supreme Court's decision in *Rainbow Papers* amounts to an act of judicial overreach. As a general principle, the Supreme Court has held in numerous decisions that the judiciary should exercise greater restraint in interfering with economic legislations. In *BALCO Employees' Union v. Union of India*,[30] the Supreme Court opined that:

> Laws, including executive action relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion, etc. that the legislature should be allowed some play in the joints because it has to deal with complex problems which do not admit of solution through any doctrine or straitjacket formula and this is particularly true in case of legislation dealing with economic matters, where having regard to the nature of the problems greater latitude require to be allowed to the legislature.

This rationale was approved and squarely applied by the Supreme Court in *Swiss Ribbons (P) Ltd. v. Union of India*,[31] wherein constitutionality of IBC, the liquidation waterfall and treatment of OCs (including treatment of crown debts) under IBC was upheld. The decision in *Rainbow Papers* contravenes this principle insofar as it alters the liquidation waterfall without due regard to the legislative intent.

RECENT DEVELOPMENTS AND RECOMMENDATIONS

The recoveries made by creditors under the IBC process have reduced over the years, with the recovery rate being 30.6% in the second quarter of financial year 2022-2023 based on analysis by CARE Ratings Ltd. of data published by the Insolvency and Bankruptcy Board of India (IBBI).[32] As general practice, most recoveries by OCs (including statutory authorities) range around the liquidation value, which is a negligible amount. Given such low recoveries, there have been demands from industry bodies for allotting OCs a larger portion of the resolution or liquidation proceeds than what is currently provided.[33] From an international perspective, in the UK, the Finance Act, 2020 and the amendment to the Insolvency Act, 1986 in the UK has also rejigged the payment waterfall by priority in pay-out distribution to crown debts owed to HMRC, as mentioned above.

We believe that even if there is any policy or commercial justification for reconsidering the position of crown debts in the priority of payments under IBC, such changes must necessarily be undertaken by way of legislative amendments and not through judicial overreach. If such decisions are left to judicial discretion, we may be confronted with inconsistent outcomes based on the subjective notions of individual judges across judicial fora.

To break the *impasse* in treatment of crown debts, we suggest two routes that the Government may adopt by way of legislative amendments:

Option 1: Expressly exclude crown debts from the ambit of secured debts under IBC

The Government may consider amending the IBC along with relevant rules and regulations thereunder to clarify that secured debts do not include crown debts. This may be undertaken by inserting the following proviso to section 3(31) of IBC:

> Provided further that security interest shall not include any right, title or interest or a claim to property, created pursuant to or by operation of any law in favour of, or provided for securing payment or performance of any obligation or debt in respect of dues arising under any law in force owed to any authority including the Central Government, any State Government or any local authority and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement created pursuant to or by operation of any law in favour of, or provided for securing payment or performance of any obligation or debt in respect of dues arising under any law in force owed to any authority including the Central Government, any State Government or any local authority.

Further, section 53(1) of IBC may be amended in the following manner:

- Section 53(1)(b)(ii) be revised to state that the priority shall be given only to financial debts owed to secured FCs who have relinquished their security in the manner set out in section 52 of IBC;
- Section 53(1)(d) be revised to state that the priority shall be given only to financial debts owed to unsecured FCs;
- Section 53(1)(e)(i) be revised to state:

  any amount due to the Central Government and the State Government and local authorities including (a) the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any; or (b) any such amount secured by any mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement created pursuant to or by operation of any law for securing payment or performance of any obligation or debt in respect of dues arising under any law owed to any authority including the Central Government, any State Government or any local authority or secured by any right, title or interest or a claim to property, created pursuant to or by operation of any law in favour of, or provided for securing payment or performance of any obligation or debt in respect of dues arising under any law owed to any authority including the Central Government, any State Government or any local authority;

Option 2: Distribution of proceeds up to liquidation value and pro-rata distribution of surplus resolution amount

Alternatively, if the intent is to optimize recoveries to OCs as a class, we suggest an amendment to the liquidation waterfall under section 53 of IBC to provide for a distribution framework similar to what is followed in the resolution of IL&FS Ltd. and its group companies (IL&FS resolution framework). The IL&FS resolution framework stipulates the financial bid amount shall be distributed in the order of priority laid down in section 53 of IBC, up to the liquidation value of each class of creditors.[34] Any surplus remaining after making these payments shall then be distributed *pro-rata* to the creditors' remaining debt.[35] This mechanism provides a better opportunity for OCs (including statutory authorities) to recover amounts beyond their liquidation value.

CONCLUSION

The IBC has proven to be a dynamic law and the Central Government has been alive to changing policy needs and market perspectives. It is imperative that any change in interpretation or application of the clear letter of the law is only driven through the Parliament and not through courts. The BLRC

Report clearly captures the economic rationale for subordinating crown debts in favour of bolstering recoveries for the banking sector. Depending on the gravity of the loss being suffered by statutory authorities the Government may consider one of the options set out above to address the issue conclusively.

[1] The Report of the Bankruptcy Law Reforms Committee, Volume 1: Rationale and Design, November 4, 2015, p. 29.

[2] *State Tax Officer (1) v. Rainbow Papers Limited*, 2022 SCC OnLine SC 1162.

[3] Section 327(7) of Companies Act, 2013 specifically provided that sections 326 and 327 would not be applicable in the event of liquidation under the IBC.

[4] Insolvency Law Review Committee (1982), Ch 32, Keay and Walton (1999).

[5] Section 319, The Companies Act, 1948.

[6] The Insolvency Act, 1986 (HMRC Debts: Priority on Insolvency) Regulations, 2020.

[7] Management of Proceedings, UNCITRAL's Legislative Guide on Insolvency Law (2004), Part two (V), para 74.

[8] RBI, "Database on Indian Economy".

[9] Vishwanathan N. (2016), "Asset Quality of Indian Banks: Way Forward, Reserve Bank of India Bulletin", October.

[10] Supra Note 8.

[11] RBI, "Insolvency and Bankruptcy Code and Bank Recapitalisation", December 17, 2017.

[12] *Ibid*.

[13] RBI, "Basic Statistical Returns of Scheduled Commercial Banks in India", Vol. 44, March, 2015.

[14] RBI, "Operations and Performance of Scheduled Commercial Banks", December 23, 2015.

[15] Supra Note 11.

[16] Interim Report of the Bankruptcy Law Reform Committee, February, 2015, pp. 35-36.

[17] *Ibid*., p. 95.

[18] *Ibid.*, p. 96.

[19] Supra Note 1, p. 14.

[20] *Ghanashyam Mishra and Sons Private Limited v. Edelweiss Asset Reconstruction Company Limited*, (2021) 9 SCC 657.

[21] *Ibid.*

[22] *Pr. Director General of Income Tax (Admn. & TPS) and Ors. v. Synergies Dooray Automotive Ltd. & Ors*., 2019 SCC OnLine NCLAT 691.

[23] *Electrosteel Steels Limited v. State of Jharkhand & Ors*., 2020 SCC OnLine Jhar 454.

[24] *Union of India and Ors. v. Vijaykumar V. Iyer and Ors.*, 2021 SCC OnLine NCLAT 355.

[25] *Ultra Tech Nathdwara Cement Ltd. v. Union of India and Ors*., 2020 SCC OnLine Raj 1097.

[26] *Leo Edibles and Fats Ltd. v. Tax Recovery Officer and Ors.,* 2018 SCC OnLine Hyd 193.

[27] *Sundaresh Bhatt, Liquidator of ABG Shipyard v. Central Board of Indirect Taxes and Customs*, 2022 SCC OnLine SC 1101.

[28] *Jalgaon Janta Sahakari and Ors. v. Joint Commissioner of Sales Tax, Nodal-9, Mumbai and Ors*., 2019 SCC OnLine Bom 1552.

[29] *Assistant Commissioner of Income Tax Department v. Mr. Anil Goel, Monitoring Agrncy & Ors*., CA No.1123/2019 in CP (IB) No.07/Chd/Hry/2017 (Admitted).

[30] *BALCO Employees' Union v. Union of India*, (2002) 2 SCC 333.

[31] *Swiss Ribbons (P) Ltd. v. Union of India*, (2019) 4 SCC 17.

[32] "Recovery rate of insolvency cases resolved at NCLT stood at 30.6% in June quarter", India Infoline News Service, September 8, 2022.

[33] Prasad R. and Iyer S. (2022), "A raw deal for operational creditors in IBC", *Hindustan Times*, 9 August.

[34] *Union of India v. Infrastructure Leasing & Financial Services Limited & Ors*., Company Appeal (AT) No. 346 of 2018 With I.A.3616, 3851, 3860,3962, 4103,4249 of 2019,182,185 of 2020, Company Appeal (AT) No. 347 of 2018 With I.A. No. 3850, 3859 of 2019 & Company Appeal (AT) No. 256 of 2019.

[35] *Ibid.*

8 EVALUATION OF THE GUIDELINES FOR COMMUNICATION AND COOPERATION BETWEEN THE ADJUDICATING AUTHORITY IN INDIA AND A FOREIGN COURT IN CROSS-BORDER INSOLVENCY PROCEEDINGS - A COMPARATIVE PERSPECTIVE

- Debaranjan Goswami and Dr. Andrew Godwin

EXECUTIVE SUMMARY

This paper examines the experience of foreign jurisdictions in relation to communication and cooperation in cross-border insolvency proceedings and the relevant protocols (including India's experience to date, such as in the *Jet Airways* case). Communication and cooperation between bankruptcy courts in a cross-border context are key drivers behind the formulation and implementation of insolvency protocols and agreements. An insolvency protocol between the Resolution Professional (RP)/Liquidator and foreign representative is a creature of a private agreement between the parties. It is, however, efficacious to get an insolvency protocol approved by the courts in all jurisdictions where parallel insolvency and bankruptcy proceedings are underway. Insolvency protocols or insolvency agreements play a critical role in the coordination of concurrent insolvency proceedings. The paper highlights the factors determining the success of court-to-court cooperation and insolvency protocols and offers insights into legal developments in India.

Keywords: Cross-Border Insolvency, Communication and Cooperation, Insolvency Protocols, JIN Guidelines

INTRODUCTION

While the efficacy of court-to-court cooperation, communication and insolvency protocols is well appreciated, there is limited analysis of the factors that lead to their success and what India might learn from their successes in other jurisdictions. This is particularly relevant as India moves forward with the adoption of its own guidelines in this area. This paper aims to fill this gap by evaluating the guidelines for communication and cooperation adopted by various jurisdictions and multilateral organizations and the various insolvency protocols that have been implemented in other jurisdictions, and also examining the factors that have contributed to their success.

The JIN Guidelines, 2016 (JIN Guidelines), the NAFTA Guidelines, 2000, the EU Guidelines, 2014 and the ALI III Global Guidelines for court-to-court communications in International Insolvency Cases, 2012, are some of the internationally recognized guidelines on court-to-court communication.[1] In India, the Cross Border Insolvency Rules/Regulations Committee (CBIRC) has formulated draft guidelines for communication and cooperation between the Adjudicating Authority (AA) and foreign courts (CBIRC Draft Guidelines).[2] The CBIRC suggested to adopt the JIN guidelines in accordance with the recommendations of the Insolvency Law Committee (ILC).[3] They are designed to play a critical role in fostering cooperation in concurrent cross-border proceedings. A selection of key provisions of the CBIRC Draft Guidelines appears in the Schedule to this paper.

According to the UNCITRAL Guide to Enactment in respect of the Model Law on Cross-Border Insolvency (Model Law), the objective of Chapter IV of the Model Law is '*to enable courts and insolvency representatives from two or more countries to be efficient and achieve optimal results*'.[4] As noted by the CBIRC, when there are concurrent insolvency proceedings against a corporate debtor

(CD), the substantive law in each jurisdiction may lead to the adoption of a 'different strategy to deal with the debtor's insolvency'.[5] Communication and cooperation assume importance when there is a possibility of a global resolution of the CD that ultimately leads to better outcomes for all creditors. The AA can devise a framework for efficient cooperation and cohesion between the concurrent insolvency proceedings after examining the 'objectives of concurrent insolvency proceedings' in the concurrent jurisdictions.[6] The AA and foreign insolvency courts can also grant relief in a coordinated manner to support the effective insolvency resolution of the CD. With the assistance of the AA and the foreign Court, the RP /Liquidator and the foreign representative can agree on an insolvency agreement or a protocol, under which differences between the substantive laws of the two legal systems may be resolved to bring cohesion to the insolvency proceedings.

In a cross-border insolvency context, communication and cooperation can exist at two levels. At one level, communication and cooperation can exist between courts in the jurisdictions where concurrent proceedings are underway. At another level, communication and cooperation can exist between courts and non-court actors; namely, foreign representatives, insolvency professionals (IPs) and CDs.[7] While there is no specific provision under the draft cross-border insolvency guidelines dealing with the second scenario, it is nevertheless a critical component of cross border insolvency.[8] Under the CBIRC Draft Guidelines, the AA in India (namely, the National Company Law Tribunal (NCLT)) plays an important role in the process of communication and cooperation and is required to adopt the guidelines for cooperation and communication with the foreign courts. While the insolvency protocol between the Indian RP /Liquidator and the foreign representative is a privately negotiated agreement, the same must ultimately be approved by the AA.

Communication and coordination between the courts and IPs can take place pursuant to the substantive law of the jurisdictions, applicable treaties, or case-specific agreements or insolvency protocols. Substantive laws expressly authorising cooperation and communication ensure that the courts have a necessary legislative basis for cooperating and communicating with courts in another jurisdiction. The presence of legislative support for communication and cooperation is important as it ensures that courts can exercise their jurisdiction in a more effective manner.

This paper will outline the global experience and endeavour to identify the corresponding best practices in facilitating communication and cooperation between the various insolvency courts. The paper will then evaluate the circumstances under which the AA must consider adopting the CBIRC Draft Guidelines and how they may be modified to suit the specific circumstances of a case. The paper will thereafter analyse the strategies that the AA may employ to communicate effectively with the foreign courts and ensure that the foreign courts are receptive to the guidelines. It will also examine the factors that can contribute to establishing a smooth channel for communication and cooperation. Local legal cultures and legal traditions have a bearing on the effectiveness of court-to-court communication and cooperation.[9] The paper will explore how these local judicial biases may be overcome in facilitating communication and cooperation between courts. The CBIRC had recommended that the guidelines on court-to-court communication be modelled on the JIN Guidelines but incorporate the best practices of the other internationally recognised guidelines to suit the Indian context.[10] In this context, the paper will examine to what extent the CBIRC Draft Guidelines are consistent with its aims and objectives. The paper will also offer suggestions as to whether the functions of the NCLTs adjudicating cross-border insolvency will need to be reformed and reconceptualized to achieve effective communication and coordination in cross-border insolvency proceedings.

PURPOSE OF COOPERATION AND COMMUNICATION IN CROSS-BORDER INSOLVENCY

Communication and cooperation between the main proceedings and secondary proceedings in cross-border insolvency cases is integral to the realization of the benefits arising out of modified universalism.[11] In the absence of communication and cooperation there would be not much difference between the outcomes in modified universalism and territorialism.[12] It is communication with the foreign courts that enables the courts to look beyond the interest of the local creditors in support of global resolution efforts and ultimately achieve the objectives of modified universalism.

Depending on the influence of legal culture and the conception of the judicial role, courts may be reluctant to cooperate with foreign insolvency practitioners without any express authorisation in any applicable cross-border insolvency provisions.[13] Many jurisdictions perceive that a court's task is to identify and reconcile any relevant legal principles and apply them to the dispute at hand. Judicial cooperation with a court from another jurisdiction may not fit into such a conceptual framework. Justice Jacqueline Gleeson, now of the High Court of Australia, attributes the hesitance or reluctance on the part of courts of different jurisdictions to communicate directly with each other to various factors such as ethical considerations, legal culture, language or lack of familiarity with foreign laws and their application.[14]

The legal culture of a country also has a bearing on the approach of the courts. Some countries take a relatively liberal approach to communication between courts, while in other countries courts may not communicate directly with parties or insolvency representatives or, indeed, with other courts. In some countries, *ex parte* communications with the judge are considered normal and necessary, while in other countries such communications would not be acceptable.[15]

In particular, judges and lawyers may have quite different views about the propriety of contacts between judges without the knowledge or participation of the representative or counsel for the parties. Some judges, for example, accept that there is no difficulty with private contact between them, while some lawyers would strongly disagree with that practice. Courts in common law jurisdictions are typically expected to dispense justice based on the pleadings by the parties, particularly when the proceedings for which they are responsible do not involve an international element in the form of a foreign debtor, foreign creditors or the foreign operations of the debtor.[16] Therefore, if the domestic RP or the creditors do not see any value in pursuing the foreign assets of the CD, the court has no reason to recognise the interests of a foreign representative as it does not form part of the pleadings of the domestic creditors who have initiated the insolvency proceedings in India.

In the Indian context, the limited jurisdiction of the NCLT can also prevent it from communicating and cooperating with a foreign court or insolvency practitioner in the absence of express authorisation under law.[17] The NCLT may take the view that it would be acting outside the powers conferred on it by statute if it communicated and cooperated with a foreign court or a representative. The Model Law fills this gap by expressly empowering courts and insolvency practitioners to communicate and cooperate with each other.[18]

Chapters IV and V of the Indian draft cross-border insolvency provisions contain provisions dealing with cooperation and coordination. The Model Law though Articles 25 and 26 not only recommends but mandates cooperation and direct communication between courts and insolvency practitioners.[19] The ILC in India, however, noted that 'given the nascent stage of the insolvency infrastructure under the Insolvency and Bankruptcy Code, 2016 (IBC/Code) and lack of experience of AAs in communicating with foreign courts', it would not be prudent to allow them to communicate directly with the foreign courts. Communication with foreign courts must instead be undertaken pursuant to guidelines framed by the Central Government framed in consultation with the AA.[20] Apart from this modification, the relevant provisions concerning cooperation have been incorporated into the draft part inserting the cross-border insolvency provisions without substantial modifications from the Model Law.[21] In accordance with the spirit of the Model Law, direct cooperation between AAs and foreign IPs, foreign and domestic IPs *inter se* and between domestic IPs and foreign courts has been permitted in the draft cross-border insolvency provisions.[22]

The CBIRC modelled the CBIRC Draft Guidelines for court-to-court communication (Guidelines for communication and cooperation between the AA and Foreign Courts in cross-border insolvency matters') on the JIN Guidelines with minor modifications to suit the Indian context.[23] These guidelines represent the framework under which the Indian insolvency courts are required to communicate and coordinate with their foreign counterparts.

A review of cross-border insolvency provisions of leading jurisdiction reveals divergent frameworks on cooperation and communication.[24] Chapter 15 of the US Bankruptcy Code prescribes that '*the court shall cooperate to the maximum extent possible with a foreign court or a foreign representative either directly or through the trustee*'.[25] The Canadian Companies' Creditors Arrangement Act uses similar words.[26] In contrast, the UK's Cross-Border Insolvency Regulations, 2006 confer a discretion on its domestic insolvency courts, stating that 'the court may cooperate to the maximum extent possible with foreign courts or foreign representatives'.[27] Singapore also makes cross border assistance discretionary in favour of its domestic courts.[28] Japan has also departed from the original text of the Model Law and decided not to adopt Article 25 at all and to limit the application of Article 26 to cooperation between foreign and local representatives, thus excluding courts.[29] As noted by Godwin,

> Japan is an interesting case in point. Yamamoto suggests that Japan's civil law tradition and judicial practice militate against adopting provisions in the Model Law that give courts too much flexibility or discretionary powers. For example, Article 25 of the Model Law, which provides that 'the court shall cooperate to the maximum extent possible with foreign courts or foreign representatives', was not adopted in the Japanese legislation for the reason that such cooperation would only be relevant where a local Japanese proceeding had been commenced and concurrent proceedings were underway; in such circumstances, there would be a limit to the extent of cooperation that would be necessary. Yamamoto also suggests that consistent with the trend of Japanese insolvency legislation, the courts are expected to perform a passive role in supporting cooperation between the insolvency representatives instead of an active role in cooperating and communicating directly with foreign courts.[30]

The International Bar Association has distinguished between hard and soft forms of cooperation.[31] It has also distinguished between cooperation touching upon substantive issues and those issues that are merely procedural in nature.[32] Courts may be unwilling to engage in substantive cooperation as it has an impact on the domestic legal system of a country. On the contrary, procedural cooperation only regulates the procedures between the courts and representatives of concurrent jurisdictions and is therefore less controversial.

McCormack and Wan have identified three principal modes of cooperation in the cross-border insolvency context.[33] Courts providing standing to a foreign representative to represent the estate of a CD is one of the most basic forms of cooperation.[34] At a more advanced level, providing relief to the foreign representative in support of global resolution efforts.[35] Third, at an even more advanced level, a foreign order may be enforced by a local court during the course of the foreign insolvency proceedings, requiring a contractual counterparty or defendant to pay a sum of money or to restore property to a debtor.[36] The basis on which foreign insolvency orders may be enforced by local courts has continued to be unsettled since the judgment of the UK Supreme Court in *Rubin v. Eurofinance SA* and has given rise to an intense academic debate.[37] In *Rubin*, the UK Supreme Court refused to enforce an insolvency-related judgment of a US Bankruptcy Court, which was the main insolvency forum[38] on the ground that a judgment *in personam* cannot be enforced against persons who were not present in the foreign country or did not submit to the jurisdiction of the court entering the judgment.[39]

Apart from these legal bases, communication and cooperation is essential for devising a framework or a roadmap for global resolution efforts. This ensures that concurrent proceedings are conducted in a coordinated manner and that there is value maximisation at an enterprise level. It seeks to align the interests of parties in different jurisdictions and ensures that courts do not pass inconsistent orders or relief that ignores the commonality of purpose and overall efficient outcomes.

Communication and cooperation are of critical importance in group insolvency of integrated groups. The UNCITRAL Legislative Guide, 2010 also advocates the same, stating that '*cooperation may be the only way to reduce the risk of piecemeal insolvency proceedings that have the potential to destroy going-concern value and lead to asset ring-fencing, as well as asset shifting or forum shopping by debtors*'.[40] It therefore encourages courts and insolvency practitioners in insolvency proceedings concerning enterprise group members 'to cooperate to the maximum extent possible'.[41] This may be realized through direct communication, coordination of hearings (e.g. joint or simultaneous video hearings), the appointment of a person to act at the direction of the court or to represent multiple debtors, or with the help of cross-border insolvency agreements.[42] Efficient communication and cooperation can lead to agreed insolvency protocols that ensures treatment of an enterprise group as if it were one company, in the absence of procedural or substantive consolidation.[43]

Over the past decades, the business structures adopted by global corporations have undergone a transformation.[44] No longer do corporations, including Indian corporations, conduct global business by setting up branches. Business is instead carried out by setting up subsidiaries, joint ventures and associated companies. It is funds from the parent company that funds these subsidiaries. Furthermore, funds from the parent corporations are often transferred by way of over-invoicing and round-tripping of funds.[45] Under the IBC, the assets of the CD includes its foreign shareholdings.[46] However, control over foreign shareholdings is rarely exercised by the Indian RP. Currently, a promoter who is responsible for the financial defaults of the main company may continue to run the offshore subsidiaries and benefit from the principle that each corporation has a distinct legal identity.

India's draft cross-border insolvency provisions do not recognise the concept of group insolvency. In the absence of a group insolvency framework, an India-incorporated CD will have to be independently admitted to corporate insolvency proceedings in India. This means that foreign insolvency proceeding against its parent company will not thereby lead to recognition in India. However, insolvency protocols can be used to achieve substantive consolidation of global insolvency proceedings. On this basis, once the Indian subsidiary is admitted to insolvency proceedings in India, the foreign representative may rely on an insolvency protocol for a substantive consolidation of the proceedings in respect of the parent company.

Further, the CBIRC Draft Guidelines are applicable to parallel proceedings. A parallel proceeding has been defined under the guidelines to mean '*cross-border proceedings relating to insolvency opened in more than one jurisdiction*'.[47] Therefore, the application of the guidelines is not limited to cross-border insolvency proceedings against the same CD. This opens the possibility of the AA deciding to communicate with a foreign court supervising the insolvency of a group company of an Indian CD, even in the absence of an express group insolvency framework.

Communication between the courts becomes very important when deciding whether granting recognition to a foreign insolvency would be contrary to public policy. When deciding what action might be contrary to public policy, courts in the US have focussed on whether: (a) the foreign proceeding is procedurally unfair (b) the application of the foreign law would 'severely impinge the value and import of the US statutory or constitutional right so that granting relief would severely hinder the US bankruptcy Court's ability to protect those rights'.[48] Before recognizing a foreign insolvency proceeding, directing the transfer of assets outside its jurisdiction, approving a reorganisation plan in foreign proceeding or approving the sale of the foreign debtor's US assets, bankruptcy courts in US have often communicated with their foreign counterparts to understand the procedures and rights of creditors that exist under the foreign laws where an insolvency proceeding is pending.[49]

Hanjin Shipping Co. Limited was one of the largest container shipping companies. Rehabilitation was commenced against it in Republic of Korea.[50] The Korean proceedings subsequently was recognised in US. Shortly thereafter, the CD sought to sell its equity exposure and related assets in various port facilities in the US and sought assistance from the courts in US to transfer the sale proceeds to the Republic of Korea. The US creditors objected to the sale and sought to be paid first. The US Bankruptcy judge held a joint conference call with the Korea Bankruptcy Judge in the presence of the creditors. The US Bankruptcy judge approved the transfer of the sale proceeds after being satisfied that Korean law allowed creditors to effectively assert their claims.[51] This case highlights the benefits of making provision for communication between insolvency courts.

India has decided not to adopt the JIN guidelines but has instead framed its own guidelines along the lines of the JIN guidelines. Therefore, its adoption will be subject to the agreement with the foreign court(s). While the guidelines are not meant to be exhaustive it is unclear whether the AA may derogate from the guidelines issued by the government while adopting the guidelines. This is important because a foreign court may similarly be bound by its own internal guidelines and practice directions. Therefore, it would be helpful for the CBIRC Draft Guidelines to offer some guidance on how such conflicts may be resolved.

The adoption of the guidelines may enable the courts to 'jockey for influence' and promote positive legal outcomes such as litigation efficiency on a transnational basis.[52] Communication between the courts in cross-border insolvency cases gives rise to judicial networks, which have been described as a species of 'judicial diplomacy' conducted between the judiciary.[53] Therefore, the role of the court is transformed from an adjudicator of the disputes before it to a facilitator for achieving the best outcome for the parties to the dispute. This transformation in the judicial system requires a more interventionist judiciary that is willing to engage and deliberate with its counterparts in other jurisdictions. There appears to be two challenges on this front. First, determining how to negotiate an agreement with its foreign counterpart within the parameters of the guidelines issued by the government. Second, how to resolve the question as to whether engaging in open dialogues with the foreign courts is outside its strict judicial functions.

Communication between courts ensure that courts are aware about judicial developments in concurrent jurisdictions. This helps in minimising inconsistent judicial rulings, which can hinder global insolvency resolution process.[54] The *Belmont Park Investments* case, which ensued before the courts in the US and UK after the collapse of the *Lehman Brothers*, demonstrates the importance of communication between courts.[55] The dispute arose out of the enforceability of a flip clauses in a collateralised debt obligation that altered the priority of a Lehman affiliate upon the affiliate's bankruptcy filing. The dispute was litigated concurrently before the courts in US and UK with opposite judicial outcomes. The court in UK had upheld the enforceability of the flip clauses while the court at New York had reached an opposite conclusion. This saw some of the investors applying to the courts in US to enforce the judgement passed by the court in UK on the basis of comity.[56]

When the courts directly communicate with each other it fosters a sense of trust and cooperation. This breeds a fertile ground for insolvency protocols between RP /Liquidators and foreign representatives. As discussed previously, insolvency protocols are privately negotiated between the RP/Liquidator and foreign representative within the confines of national law and courts. Communication between courts ensure that the conflicts between national law can be harmonised in favour of a more cohesive framework for cooperation. Insolvency protocols will be analysed in more detail in the following sections.

HOW DO INSOLVENCY PROTOCOLS FACILITATE CROSS-BORDER INSOLVENCY COOPERATION AND COMMUNICATION

Under the draft notification prepared by the CBIRC, which accompanies the CBIRC Draft Guidelines, a 'protocol' has been defined to include an agreement intended to facilitate the coordination of cross-border insolvency proceedings and cooperation which may be between (a) the AA and foreign courts, (b) the AA, foreign courts, and domestic and foreign representatives, and (c) domestic and foreign representatives.[57] Cross-border protocols are instrumental in enabling parties to agree on a framework for resolution of cross-border disputes that arise out of insolvency, with the backing of judicial recognition.[58] Protocols are drafted to outline how proceedings would be recognized and how parties may exercise their right to appear and be heard before the courts.[59]

Before outlining the benefits of insolvency protocols, it is important to provide some context. As the definition of protocols suggests, there are three ways in which protocols can be conceptualised. First, they can be conceptualised as protocols between courts that are limited to cooperation between the courts only. The RPs and the foreign representatives have no place in such a framework. The Indian draft cross-border insolvency provisions do not allow direct communication between the insolvency courts. The courts must communicate in accordance with the guidelines framed by the Government. Second, protocols can be conceptualised as an agreement between the AA, foreign courts, and domestic and foreign representatives. This is difficult to implement as courts will not want to be party to any agreement with the RP and foreign representative(s). A modified version of this formulation can be accommodated where a court adopts a framework for communicating with foreign courts and approves the insolvency agreement arrived between the RP and foreign representatives in the same protocol. Third, a protocol can be conceptualised as one that is arrived at solely between the RP and the foreign representatives. Such a protocol ultimately needs to be approved by the courts in accordance with the local law and practice of each local jurisdiction[60] as it lacks any enforceability without judicial backing. It is this type of insolvency protocol entered between RP and foreign representatives that is the focus of the present discussion.

There are several benefits of negotiating an insolvency protocol between the RP and foreign representatives. From a procedural point of view, they help in coordinating insolvency proceedings in all jurisdictions in which concurrent proceedings are occurring.[61] Insolvency protocols are seen as flexible tools that ensure that cooperation among the parties bring more predictability to the process. Most protocols have the common element of harmonizing procedural issues and go further to address aspects of substantive laws. The inconsistent policy solutions emerging out of the differences in substantive laws in the different jurisdictions can be better harmonized by entering an insolvency protocol.[62]

While insolvency protocols touching upon substantive legal issues are uncommon, the Maxwell protocol is an outlier in this regard.[63] In Maxwell, the CD had made certain payments to European banks during the twilight period. These payments were avoidable under the prevailing law in US but valid under the law in the UK.[64] By the use of an insolvency protocol, the parties were able to harmonize the actions of the administrators in UK and the examiner in the US chapter 11 proceedings. This enabled the courts in US and the parties involved in the dispute to 'take a worldwide view of the case, rather than a parochial one'[65] and apply the law prevalent in UK to the overall insolvency proceedings.[66]

From a legal perspective, an insolvency protocol can be conceptualized into two categories. First, from a public law perspective it can be viewed as a 'court created treaty'[67] and second, as a contract or agreement concluded between the parties to the agreement.[68] Insolvency protocols being viewed as treaties is premised on the fact that they are often approved and sanctioned by the courts and therefore obtain judicial recognition and enforcement. A court may simply approve a protocol or incorporate it into a judgment or an order, raising the possibility of it being enforced as an insolvency related judgment.[69] However, conceptualizing an insolvency protocol as a treaty has been criticised, as unlike treaties, they are not binding on the courts and each of the principals to the protocol have the discretion not to adopt the protocol.[70]

Insolvency protocols can also be conceptualised as contracts or agreements entered between the parties.[71] Such an understanding is supported by the UNCITRAL Legislative Guide, 2010, which considers insolvency protocols to give rise to contractual obligations between the signatories.[72]

As opposed to a treaty, an insolvency protocol that operates as a contract or agreement can be tailored to the context of a specific case. This has been one of its most beneficial features.[73] However, despite being specific to the facts of a particular case, insolvency protocols do share some core common features. They make provision for communication and cooperation between the courts by way of facilitating information exchange to provide all necessary information in relation to the insolvency proceedings.[74] The protocols harmonise the procedures for providing notices to creditors and provide that all interested parties have the right to be heard. The protocols also provide for the retention and payment of professional.[75] After analysing several leading insolvency protocols, Kokorin and Wessels have found that most protocols follow a certain pattern in terms of their overall structure and separate clauses.[76] In their study they found that most protocols usually include provisions explaining the background of a protocol, its aims and purposes; elaborating cooperation and participation rights; confirming the comity between, and the independence of, courts; and setting the rules on notices, retention and compensation of RPs and resolution of disputes arising from the protocol.[77] They attribute the ultimate success of the protocol to its provisions being integrated and made compatible with the procedural systems of the countries for which they are employed.[78]

In case there is hesitance in incorporating provisions relating to substantive law in the insolvency protocols, the parties may approach the issue in an innovative manner. Instead of excluding all issues of substantive law, the protocol can agree on substantive issues that are within the jurisdiction of the courts that must ultimately approve the protocol for it to be effective. Here, direct communication between courts may become useful. The courts can communicate between themselves to understand how each of them would deal with the substantive legal issue involved and guide the RPs on reaching an agreement. For instance, the place of centre of main interest in an insolvency proceeding must be adjudicated by the courts. Therefore, parties may designate the centre of main interest of the insolvency proceeding in the protocol and a court while approving a protocol may independently decide whether the parties' contractually agreed centre of main interest is indeed valid.

WHAT FACTORS HAVE CONTRIBUTED TO THE SUCCESS OF COURT-TO-COURT COMMUNICATION AND INSOLVENCY PROTOCOL

Communication between relevant courts assumes relevance because of their supervisory role over insolvency proceedings and may assist in preventing a 'duelling' of insolvency proceedings, undue delays and costs, unduly cumbersome and lengthy hearings, inconsistent treatment of similarly situated creditors and the loss of valuable assets.[79] However, in the entire process, courts should not lose their independence and should decide issues independently. Even if the insolvency judges reach the same outcome as a result of the consultations, they must reach the outcome by independent judicial reasoning, uninfluenced by the reasoning adopted by the other judge.[80] The communications with a foreign court must be used to understand an issue relating to foreign insolvency, resolve conflicts in the legal system and devise procedures to complete the proceedings in a coordinated yet expeditious manner. However, during the course of such communication, judges must be cautious not to pass opinions on ongoing matters or on matters that may subsequently come before them. For instance, the courts in UK and US had developed a protocol for court-to-court communication in the reorganisation proceedings of Federal Mogul. However, during the course of his consultations with Judge Lyons of US Bankruptcy Court, Justice Richards in the High Court of Justice in the UK decided it was not prudent to participate in a conference call with the US court regarding issues that may subsequently come before the High Court. This ensured that the High Court could decide the issues uninfluenced with what might have been opined by Justice Richards.[81] Accordingly, if a foreign insolvency court inquired about how a legal issue might be addressed by courts in India, the NCLT must be cautious in its discussions to refrain from passing any opinions that influence subsequent decisions.

The success of an insolvency protocol is dependent on various factors. The most important is the effectiveness with which insolvency courts communicate with each other. By including in the protocol potential areas of conflicts the parties can pre-empt any disputes between them. In this regard it is important to outline the implications arising out of the application of foreign law, especially differences or overlaps that may otherwise result in litigation.[82] Parties may also reach a negotiated solution in the protocol that is acceptable to all the interested parties and reduces the risk of conflict. The protocols must be designed after eliciting reliable responses from the parties, and in this way avoid any 'inherent bias and adversarial distortion' that may be apparent if parties represented their own particular concerns in their own jurisdictions.[83] Ensuring that the parties understand the judicial systems under which the protocols operate will assist in encouraging international business and preserving value that would otherwise be lost through fragmented judicial action. The protocols must ensure that there is mutual cooperation for asset-tracing to combat international fraud that is committed by insolvent debtors, in particular through concealing assets or transferring them to foreign jurisdictions.[84]

Protocols may however avoid being too prescriptive and retain their flexible character. It appears that one of the most successful protocol is the protocol adopted between the Delaware Bankruptcy Court and the Ontario Superior Court of Justice in the *Loewen* case.[85] Such has been the success of the protocol adopted in this case that a large number of bankruptcy cases filed before bankruptcy courts in New York and Delaware seek approval of protocols drafted along the lines of *Loewen* on the first day of hearing.[86] Some attribute the success of the *Loewen* protocol to its brevity especially with respect to those issues (such as jurisdiction, applicable law or creditors' claims) that are more likely to cause conflicts between the courts involved in parallel bankruptcy proceedings.[87] Therefore, while negotiating a protocol the focus should not be to address all potential areas of conflict but to come up with a mechanism that leads to effective communication and coordination.

The success of a protocol is also dependent on the extent to which it promotes procedural efficiency.[88] In order to achieve procedural efficiency the protocols may reconcile conflicting national law provisions as to the requirement for giving notices to the creditors. For instance, the Indian draft law dispenses with the requirement for providing individual notices to all foreign creditors which may be at odds with the law applicable in the concurrent jurisdiction.[89] Disagreements as to the exact scope of the participation rights in the insolvency proceedings may also be reconciled in the protocol. For instance, during the negotiations of the Jet Airways protocol there was disagreement among the Indian creditors about the foreign representative participating in the meeting of the committee of creditors (CoC). Ultimately, the National Company Law Appellate Tribunal (NCLAT) had to intervene to allow the participation of the Dutch Trustee in the meeting of the CoC. The success of a protocol is thus contingent on recognition of effective participation of the foreign creditors in the domestic insolvency proceedings within the bounds of the applicable law. This also ensures greater transparency in the insolvency proceedings, leading to the fostering of mutual trust between the parties.

The protocols must facilitate information-exchange. The protocols can specify the subject for which information may be exchanged. This might relate, *inter alia*, to the contemplated restructuring or liquidation plans, the planned disposition of material assets and other transactions outside the ordinary course of business, the termination of key contracts and the resolution of certain claims. Sharing of non-public (e.g., commercially sensitive) information should be subject to confidentiality arrangements and applicable privileges.[90] While it is appreciated that in certain occasions, conflicts of interest may intervene in the free exchange of information, protocols must clarify that these situations must be narrowly construed and must be the exception as opposed to being the norm.[91]

As highlighted before, an insolvency protocol is the result of negotiation between the IPs with the courts playing a facilitative role in the entire process. Therefore, there must be engagement between the courts and insolvency practitioners in all the concurrent jurisdictions. This is only possible when a foreign court or an insolvency practitioner sees utility in cooperating with their counterparts in other jurisdictions. Cultural biases and different system of laws often discourage such interaction. Therefore, it is important that India develops a sense of predictability and foreseeability of outcomes in its insolvency law system.[92] By this is meant that a foreign court will be able to foresee the outcomes arising out of approving an insolvency protocol and may therefore encourage an insolvency practitioner within its jurisdiction to engage in dialogue. Certainty is the key to the success of a protocol. Without certainty in the judicial system, it is difficult to trust the adequacy and transparency of the legal system with which a foreign court or a representative is being asked to cooperate. A foreign court and a representative may believe that an insolvency protocol is beneficial to the interest of all the creditors, yet the uncertainty of the legal system may deter the parties from entering into a protocol.

The perceived establishment of the rule of law in a jurisdiction is also integral to the development of mutual trust required for entering an insolvency protocol. The values supported by legal systems based on the rule of law generally include broad categories of independence, impartiality, professionalism and integrity as well as the conduct of judges in the performance of their judicial roles as well as their behaviour and reputation outside the courtroom.[93] This also helps in overcoming judicial biases associated with cooperating with a foreign insolvency court, thus making foreign insolvency courts more receptive to cooperating with the Indian AA.

Insolvency protocols must not be seen as curtailing the independence of the courts. A lot of the success of a protocol is attributable to the extent to which the parties can achieve their desired outcomes while acting within the bounds of the domestic law and the jurisdiction of the national courts. This has given rise to various procedural innovations. Parties may reduce jurisdictional issues through insolvency protocols by allocating specific responsibilities among the courts.[94] These jurisdictional allocations can take place following well established rules of private international law whereby responsibility for the approval of certain transactions may be allocated to the court of the state in which the assets that are the subject of the transaction are located.[95] Responsibility for dealing with claims against the debtor can be allocated to the forum where the debtor resides.[96] Parties may also agree to await another court's ruling before hearing submissions and 'independently' adjudicating the same or a closely related matter.[97] Furthermore, the parties may agree to jointly negotiate and submit substantially similar reorganisation/resolution plans within their jurisdiction in order to prevent any conflicts arising after the approval of the reorganisation/resolution plan.[98] These innovations are directed towards ensuring that even without dealing with substantive issues, the parties may use procedural issues as proxies to achieve the same outcome.[99]

For instance, in the Jet Airways protocol[100] the parties adopted various measures procedurally to ensure convergence in the substantive outcomes. The protocol imposed an obligation on the Dutch Trustee not to take any decision that would adversely impact the operations of the CD or its creditors.[101] Furthermore, the Dutch Trustee was under an obligation to cooperate in marshalling of the assets of the CD located in Netherlands for the benefit of all the stakeholders. This would ensure that the Dutch Liquidator would satisfy the claims of its domestic creditors by proceeding first against such assets that were exclusively charged in favour of the Dutch creditors. Even if an asset was sold, the Dutch Trustee had to ensure that the sale amount was deposited in a bankruptcy account and that the proceeds could only be distributed with the prior consent of the Indian RP.[102] The protocol provided that the claims in the Dutch insolvency proceedings would be verified and admitted by the Indian RP and the claims in the Indian proceedings would similarly be verified and admitted by the Dutch Liquidator.[103] This was done to ensure that all claims were collated in one place and dealt with appropriately.[104] In the event that a resolution plan was submitted in the India insolvency proceedings, the Dutch Trustee was under an obligation to facilitate the submission of a 'consistent' resolution plan in the Dutch proceedings incorporating the payment mechanism of the resolution plan submitted before the Indian proceedings for the payment of all stakeholders in accordance with the Dutch law.[105] It is possible that this was done to address the issue of differing priority outcomes under the Indian and Dutch insolvency regime.

ANALYSIS OF INDIA'S DRAFT GUIDELINES ON COMMUNICATION AND COOPERATION

The CBIRC Draft Guidelines have been annexed to the report of the CBIRC on cross-border insolvency provisions in India. Under the Indian draft cross-border insolvency provisions, while the RPs or Liquidators (as the case may be) have been mandated to cooperate and communicate with their foreign courts and representatives to the maximum extent possible (subject to the supervision of the AA) there is no corresponding duty to do so on the part of the AA. As discussed previously, the ILC believed that instead of allowing the AA to directly communicate with the foreign courts, it must only do so pursuant to the guidelines framed by the Government.

The CBIRC Draft Guidelines prescribe that the AA must consider offering cooperation to the foreign courts at the earliest possible opportunity and encourage the parties to file necessary applications before the foreign courts. The establishment of a framework for communication between courts ensures that RP and foreign representatives can effectively agree on an insolvency protocol.

The AAs are the drivers of the process under the proposed guidelines. Under the guidelines, it is now incumbent upon the AAs to devise a framework for communication with foreign insolvency courts. Specifically, the guidelines provide that the AA shall consider in all cases involving parallel proceedings whether and how to implement these guidelines.[106] It may take place pursuant to an application made by the parties, but the initiative lies with the AAs. The Federal Court of Australia in its Cross-Border Insolvency Practice Note: Cooperation with Foreign Courts or Foreign Representatives has adopted a slightly different approach.[107] Under this framework, the parties (IP and foreign representatives) must draft the coordination agreement guided by the JIN Guidelines and the Modalities of Court-to-Court Communication (the Modalities) both published by the Judicial Insolvency Network and the Practice Guide on Cross-Border Insolvency Co-operation, 2009 (the Practice Guide) published by UNCITRAL.[108] This coordination agreement has to be approved by the courts. As opposed to the proposed approach in India, in Australia the process is driven by the parties and courts have to approve the concluded coordination agreement.

Ideally, it is submitted, it is the parties that should drive the entire process. After a CD is admitted to insolvency in India, the RP must obtain custody over all the assets of the CD. This includes any foreign assets. If there are no concurrent foreign proceedings, the RP must make application for recognition of the Indian proceedings before a foreign court. In case there are concurrent proceedings underway, the RP must reach out to the foreign representative and agree on a protocol for cooperation. Such a protocol may have provisions for communication and cooperation between the courts.

The present approach in India is, however, premised on communication between courts to achieve coordination in insolvency proceedings and to facilitate the entering into of an insolvency agreement by the IPs. Having the courts as the driver of the process ensures a level of predictability and trust in the entire process. However, it also has the effect of making courts central to the cooperation framework and may relegate the parties to mere supporting actors in the insolvency proceedings.

The utility of entering insolvency protocols at the earliest available opportunity is well appreciated.

If an insolvency protocol is approved when concurrent proceedings are already underway, it will focus on conflicts that have already arisen between the parties. On the contrary, if a protocol can be approved at the time of commencement, it will tend to provide a roadmap for the addressing of issues that the parties expect to arise.[109] Therefore, the framework for communication and cooperation between courts should be considered in the initial stages of the insolvency proceedings. This will in turn ensure that an effective insolvency protocol is negotiated between the insolvency representatives.

The notification accompanying the CBIRC Draft Guidelines stipulates that the guidelines are limited to agreements concerning coordination of proceedings or protocols for cooperation and communication between the AA and foreign courts. They are not intended to serve as guidelines for insolvency agreements or protocols between RPs/Liquidators and foreign representatives. However, on reading the guidelines one gets the impression that the guidelines not only serve as a channel for cooperation and communication between insolvency courts but have a broader compass. The guidelines also prescribe limitations on the form and content of the corresponding insolvency protocols. Therefore, the title of the guidelines appears to be a misnomer if it is broad enough to include agreements or protocols between RPs/Liquidators and foreign representatives. Otherwise, it may be prudent to clarify in the body of the guidelines that it is intended to serve as a framework for communication and cooperation between courts only and that the limitations prescribed under the guidelines are not applicable to the insolvency protocols entered into between RPs. It is also recommended that the guidelines only limit communication and cooperation between courts and if the legislature believes that it should impose limitations on insolvency protocols between RP and foreign representative, it should do so by means of separate regulations.

The CBIRC Draft Guidelines provide that where the AA intends to apply the guidelines, it must do so by means of a protocol or an order.[110] Therefore, when the AA decides on applying these guidelines it will lay down the form and content of such communication in an order. In the event the parties can negotiate an insolvency protocol between the RPs or Liquidators, the insolvency protocol can simultaneously be approved by the AA in the same proceedings. The guidelines state that its adoption by the AA can be pursuant to its own motion or upon application made by the parties.[111] This allows the AA to implement the guidelines if only one party agrees to it or neither of the parties agrees to it. Here again a distinction must be drawn between protocol for communication between courts and an insolvency protocol between the RPs. While a protocol for communication between courts can be approved on the court's own motion the insolvency protocols cannot receive the same treatment as they are a result of negotiation and agreement between the RPs. There may be instances where the IPs are not willing to engage with each other, but the AA believes that communication and cooperation between the courts can lead to better insolvency outcomes. It may therefore enter into a dialogue with foreign insolvency courts pursuant to the guidelines. As discussed previously, while communication between courts leads to efficient insolvency protocols between IPs, it is not the only foreseeable benefit. For instance, communication between courts ensures that courts can pass orders in a concurrent insolvency proceeding in a coordinated manner. In case an AA sees potential benefit in communicating with a foreign court, it may pass an order for communication between the courts in accordance with the guidelines. Thereafter, it may communicate with the foreign courts pursuant to the said order. The absence of an agreed insolvency protocol between the IPs should not deter the courts from communicating with each other.

There is an ongoing debate about whether a foreign representative can apply for cooperation pending the outcome of the application for recognition of a foreign proceeding or when such an application has been rejected. Some scholars are of the view that under the Model Law, cooperation is not dependent on recognition and may occur even before the application for recognition has been satisfied.[112] Adopting the approach prevalent in the UK and Singapore, CBIRC has stated that recognition does not need to be a prerequisite for making an application for cooperation.[113] It can also be granted in instances where the relief for recognition has been denied.[114] The AA in facilitating cooperation in such cases cannot grant relief that is only permitted at the stage of recognition by the foreign court.[115] This has been done to ensure that a foreign representative cannot use provisions for cross-border cooperation to bypass the rigour of the recognition process.[116] Furthermore, relief in such cases must not impose any substantive burden on the CD or the RP.[117]

The adoption of the CBIRC Draft Guidelines is intended to take place only where there is a parallel proceeding in place. Therefore, where there are no concurrent local insolvency proceedings and there are only proceedings initiated for recognition of foreign insolvency proceedings, such guidelines do not appear to be applicable. It is suggested that the scope of the guidelines should be extended to situations where recognition proceedings have been filed before a foreign court but there is no parallel proceeding in India. It may also be useful for the adjudicatory bodies to communicate and cooperate at the stage of recognition of an Indian insolvency proceeding in a foreign jurisdiction. For instance, under existing US jurisprudence, prior to granting recognition of a foreign proceeding, US bankruptcy judges may first want to understand the procedures and rights of creditors that exist under the foreign laws in the foreign jurisdiction where insolvency proceeding is pending. Direct communication with the Indian AA in this regard may help to facilitate this understanding.

The adoption of the guidelines will provide a framework where the AA in India can directly communicate with foreign courts without the fear of being challenged for a lack of statutory mechanism in India. But it is important to appreciate that adoption of the guidelines is only one step in the right direction. To ensure effective coordination of the insolvency proceedings, there is need for a protocol between the RPs or Liquidators to be in place and for it to be effectively implemented. While an AA can facilitate the negotiations on such a protocol, it cannot itself take part in the negotiation process. The protocol must be negotiated between the RPs or Liquidators with the foreign representatives in consultation with the creditors.

Guideline 5 of the CBIRC Draft Guidelines is of particular relevance. It states that for the avoidance of doubt, a protocol or order under the guidelines is procedural in nature. It should not constitute a limitation on or waiver by the AA or foreign courts of any powers, responsibilities, or authority or a substantive determination of any matter in controversy before them or a waiver by any of the parties of any of their substantive rights and claims. This clarifies that any protocol approved under the guidelines can only be procedural in nature and cannot affect the substantive rights of the parties. Protocols on how courts communicate with each other should not address substantive issues. The same is, however, not true for insolvency protocols between IPs or Liquidators. As discussed previously, insolvency protocols between IPs or Liquidators may often need to address substantive legal issues.

While insolvency protocols have been conceptualized as being procedural in nature there, may be instances where it becomes necessary to deal with substantive issues. For instance, the same factual scenario may lead to divergent outcomes in different jurisdictions. Protocols often aim to reconcile these divergent outcomes to promote a coordinated approach. Therefore, mandating insolvency protocols between RPs to be strictly procedural in nature may not be beneficial in all situations. The CBIRC itself acknowledges in its report that protocols play a critical role in address the issues arising out of the rights and priorities of creditors.[118] Generally, the rights and priorities of the parties are a matter of substantive law of the relevant jurisdiction. Under the Indian insolvency regime, the existing promoters are disallowed from bidding for their own assets unless the CD qualifies as a small and medium enterprise. The Indian and foreign IPs may agree to relax this criterion in their insolvency protocol. Furthermore, there may be agreements reached on choice of law of certain claims and proceedings. As discussed previously, under the Jet Airways protocol, the parties agreed that Jet Airways was an Indian company with its centre of main interest in India, and that the Indian proceedings were the main insolvency proceedings, and the Dutch proceedings were the non-main insolvency proceedings. By virtue of the same, the parties agreed on matters pertaining to public law. The parties were in essence contractually agreeing on international insolvency jurisdiction, which is undoubtedly *'a matter of mandatory, public law'*.[119] The AA while approving an insolvency protocol between IP must do so with an open mind and must not impose a restriction of them on the basis that they are procedural in nature.

Guideline 7 prescribes the mode of communication. The ability of the courts to communicate directly without the need for an intermediary is a welcome step. The guidelines stipulate that any communication in respect of substantive issues must take place in the presence of the counsel for each side.[120] While this provides transparency to the judicial process, what constitutes substantive and procedural issues for the purposes of communication remains debatable. Apart from engaging in communication, the guideline also permits the courts to send or transmit orders, judgments, opinions and other records of proceedings directly to the foreign court after providing advance notice to the parties when it is appropriate to do so.[121] This will ensure that the courts are regularly updated about the developments in each jurisdiction.

Guideline 11 is significant as it permits 'a party to a foreign proceeding, or an appropriate person' to appear before it and make submissions on a specific issue without becoming subject to its jurisdiction apart from the special matter in respect of which it has been called to make submissions. This guideline is aimed at allowing foreign parties to make submissions without fully exposing themselves to the jurisdiction of the court in India for general purposes.[122] The draft cross-border insolvency provisions do not allow direct rights of admission for foreign representatives and creditors. This provision may be utilised by the AA to permit foreign parties and other appropriate persons to make submissions on limited issues. The guideline is expansive as it allows any appropriate persons to make submission and does not restrict itself to individuals who are party to the proceedings.

Guidelines 12 and 13 accords sanctity to foreign law and orders without the need for any further proof unless there are objections raised on valid grounds. This displaces the burden on the AA to individually scrutinize the applicable foreign law and orders passed thereto and brings more expediency to the proceedings. This means that in the absence of any objections from the parties, the AA will take judicial notice of the foreign law or order without requiring the parties to make submissions or provide expert evidence.

Guideline 14 appears contentious as it allows the AA to modify an approved protocol to reflect a change in circumstances. While the guidelines prescribe that the same may be done only in the course of a joint hearing, it can also be done unilaterally with advance notice. Therefore, the AA while approving an insolvency protocol must ensure that the protocol makes provision for modifications. The foreign counterparty may not see such a clause favourably as it hampers the predictability of the process as discussed above. Ideally the right to modify an approved protocol should only arise in case of certain pre-agreed contingencies.

As discussed, the guidelines are modelled on the JIN Guidelines with only minor modifications to suit the India context. An informed review suggests that it upholds the aims and objectives of the JIN Guidelines in promoting court-to-court communication and cooperation.

CONCLUSION

When approaching the issue of communication and cooperation, it is important to distinguish between, on the one hand, protocols that address the issue of communication and cooperation between courts and, on the other hand, protocols between IPs or Liquidators on coordinating the conduct of the insolvency proceedings. It is important to appreciate that communication between courts is not a *sine* *qua non* for the implementation of an insolvency protocol between insolvency representatives. The establishment of a framework for court-to-court cooperation and communication only ensures that the courts can play a more facilitative role in the agreement on insolvency protocols between insolvency representatives. Ultimately insolvency protocols between insolvency representatives will have to be approved by the courts in each jurisdiction where concurrent insolvency proceedings are underway.

It is also important to appreciate that a protocol on cooperation and communication between courts must always be procedural in nature. However, depending on the facts and circumstances of the case, an insolvency protocol between the IPs may involve the substantive rights of the parties. It has been acknowledged by the ILC that insolvency protocols are a means of channelling the discretionary remedies at the disposal of the AA in an efficient and coordinated manner. Therefore, it will invariably involve substantive rights. Cross-border insolvency cases often involve allocation of duties and responsibilities between the foreign main and non-main proceedings. Remitting assets from the jurisdiction of the local courts to the foreign courts is often the subject matter of cross-border insolvency disputes. If the same issues are pre-emptively addressed by means of a protocol, and the protocol anticipates the role of the judiciary in this regard, there should not be reason for concern. Ultimately insolvency protocols will have to be approved by the courts and therefore courts will continue to retain jurisdiction over the substantive legal issues.

The NCLT and its Appellate Authority are tribunals of limited jurisdiction and cannot act as courts of equity and exercise plenary powers.[123] NCLT's residuary jurisdiction, although wide, is nonetheless defined by the text of the Code. Importantly, the NCLT cannot do what the Code expressly does not provide it with the power to do.[124] It has been suggested, therefore, that the NCLT may hesitate to fully embrace a cooperative regime.[125] Once the guidelines are notified, it is expected that the NCLT will be able to freely communication with foreign insolvency courts. However, its limited jurisdiction will necessitate that it strictly follows the guidelines, which may limit the scope for judicial innovation in cooperation. Often foreign courts may be bound by their own internal guidelines, which may conflict with Indian's proposed guidelines on court-to-court communication and cooperation. While the guidelines are categorical in stating that they are not intended to be exhaustive and, in each case, consideration ought to be given to the special requirements in that case,[126] it will be interesting to see how the NCLT finds its way through areas of conflict.

In order to ensure efficiency in insolvency coordination and cooperation, there should be certain judicial innovations when dealing with insolvency protocols. Parties can ensure that even without dealing with substantive issues, they may use procedures in the protocol as proxies to achieve the same substantive law outcome. Furthermore, as discussed previously, in case there is hesitance to consensually incorporate provisions relating to substantive law in the insolvency protocols, the courts may pre-emptively address the issues in a fair and independent manner and include them in the protocol. Insolvency protocols can also assume importance while dealing with insolvencies of enterprise groups. Here, insolvency protocols may ensure that India benefits from a coordinated group insolvency framework even without having an established group insolvency regime. Judicial innovation may also step in to enforce a judgment approving an insolvency protocol as an insolvency related judgment and thus make them binding upon the parties. This may prevent parties from walking away from concluded bargains and bring more predictability to the entire process.

The other issue that will be extremely important is the ability of the AA to preserve its level of independence in its communications with its foreign counterparts. It should reach decisions by way of independent application of mind, uninfluenced by its deliberations with the foreign courts. It may therefore be necessary for the AA to adapt its mindset in terms of how it perceives its role, at least in cross border insolvency cases. As has been opined by a scholar, communication between courts fosters 'judicial diplomacy' where courts are no longer seen as mere adjudicators but bodies that interact to advance their own judicial interests.[127]

The CBIRC Draft Guidelines are a step in the right direction. The fact that is the guidelines are modelled on the JIN Guidelines should increase their global acceptance. The CBIRC Draft Guidelines firmly establish the ability of the Indian insolvency courts to communicate with their foreign counterparts. The success of the guidelines, however, will be contingent on the level of trust and predictability that the Indian insolvency law regime is able to achieve in practice.

SCHEDULE

Certain key provisions of the Guidelines for Communication and Cooperation Between the Adjudicating Authority and Foreign Courts in Cross-Border Insolvency Matters

D. These Guidelines are not intended to be exhaustive and in each case consideration ought to be given to the special requirements in that case.

E. The Adjudicating Authority shall consider in all cases involving Parallel Proceedings whether and how to implement these Guidelines. The Adjudicating Authority shall encourage and where necessary direct, if they have the power to do so, the parties to make the necessary applications to the Adjudicating Authority or foreign courts to facilitate such implementation by a protocol or order derived from these Guidelines and encourage them to act so as to promote the objectives and aims of these Guidelines wherever possible.

Guideline 1: In furtherance of paragraph E above, the Adjudicating Authority shall encourage administrators in Parallel Proceedings to cooperate in all aspects of the case, including the necessity of notifying the Adjudicating Authority or foreign courts involved at the earliest practicable opportunity of issues present and potential that may (a) affect those proceedings; and (b) benefit from communication and coordination between the Adjudicating Authority and foreign courts. For the purpose of these Guidelines, “administrator” includes a foreign representative, interim resolution professional, resolution professional, or liquidator.

Guideline 5: For the avoidance of doubt, a protocol or order under these Guidelines is procedural in nature. It should not constitute a limitation on or waiver by the Adjudicating Authority or foreign courts of any powers, responsibilities, or authority or a substantive determination of any matter in controversy before them or a waiver by any of the parties of any of their substantive rights and claims.

Guideline 10: The Adjudicating Authority may authorise a party, or an appropriate person, to appear before and be heard by a foreign court, subject to approval of the foreign court to such appearance.

Guideline 12: The Adjudicating Authority shall, except on proper objection on valid grounds and then only to the extent of such objection, recognise and accept as authentic the provisions of statutes, statutory or administrative regulations, and rules of the foreign courts of general application applicable to the proceedings in other jurisdictions without further proof. For the avoidance of doubt, such recognition and acceptance does not constitute recognition or acceptance of their legal effect or implications.

Guideline 14: A protocol, order or directions made by the Adjudicating Authority under these Guidelines is subject to such amendments, modifications, and extensions as may be considered appropriate by the Adjudicating Authority, and to reflect the changes and developments from time to time in any Parallel Proceedings. Such amendments, modifications and extensions should become effective upon being accepted by all the foreign courts involved. If the Adjudicating Authority intends to supplement, change, or abrogate any protocol, order or directions issued under these Guidelines in the absence of joint approval by foreign courts involved, the Adjudicating Authority shall give the other foreign courts involved reasonable notice of its intention to do so.

[1] Report on the rules and regulations for cross-border insolvency resolution, Cross Border Insolvency Rules/ Regulations Committee, p.63.

[2] Draft Guidelines for communication and cooperation between the Adjudicating Authority and foreign courts (2020).

[3] Supra Note 1, p.63.

[4] UNCITRAL (2014), "Model Law on Cross-Border Insolvency Guide to Enactment", para 211

[5] Supra Note 1, p.60.

[6] Kamalnath A. (2013), "Cross Border Insolvency Protocols: A Success Story?", Vol 2(2), International Journal of Legal Studies and Research.

[7] Supra Note 1.

[8] *Ibid.*

[9] Fannon I. et. al. (2022), "Corporate Recovery in an Integrated Europe", Edward Elgar Publishing.

[10] Supra Note 1.

[11] Maltese M., "Court-To-Court Protocols in Cross-Border Bankruptcy Proceedings: Differing Approaches Between Civil Law and Common Law Legal Systems", Submission to International Insolvency Institute for 2013 Prize in International Insolvency Studies, p.6.

[12] *Ibid.* citing Liza Perkins L. (2000), "A Defense of Pure Universalism in Cross-Border Corporate Insolvencies", New York University Journal of International Law and Politics, Vol. 32.

[13] UNCITRAL (1997), "Guide to Enactment of Model Law", para 213.

[14] Gleeson J. (2019), "Judicial cooperation in cross-border insolvency", 46(8), Brief 28.

[15] *Ibid.*

[16] *Ibid.*

[17]Misra P. and Feibelman A. (2021), "The Institutional Challenges of a Cross-Border Insolvency Regime", Arizona State University Commercial and Business Law Journal, p.349.

[18] Kokorin I. and Wessels B. (2021), "Cross-Border Protocols in Insolvencies of Multinational Enterprise Groups", Edward Elgar Publishing, p.55.

[19] UNCITRAL (1997), "Model Law on Cross-Border Insolvency", Articles 25 and 26.

[20] Supra Note 1, pp.14-42.

[21] Das I. (2020), "The Need for Implementing a Cross-Border Insolvency Regime within the Insolvency and Bankruptcy Code, 2016", 45(2) *Vikalpa*, p.107.

[22] Supra Note 1, p.14.

[23] Supra Note 1, p.12.

[24] Supra Note 18, p.56.

[25] 11 US Code § 1525.

[26] Companies' Creditors Arrangement Act (R.S.C., 1985, c. C-36), sec. 52(1).

[27] The Cross-Border Insolvency Regulations, 2006, Art. 25 note that unlike courts which 'may cooperate', under Art. 26 of the Cross-Border Insolvency Regulations 2006, insolvency officeholders 'shall to the extent consistent with his other duties, [...] cooperate to the maximum extent possible with foreign courts or foreign representatives'.

[28]Insolvency, Restructuring and Dissolution Act, 2018, Third Schedule, Article 25.

[29] K. Yamamoto (2011), "New Japanese Legislation on Cross-border Insolvency as Compared with the UNCITRAL Model Law", International Insolvency Review, Vol 11(2), p. 91, arguing that the 'cooperation between representatives of both proceedings is not only necessary but also sufficient'. For an overview of nearly all countries having implemented their version of the Model Law, see Look Chan Ho (ed.), Cross-Border Insolvency: A Commentary on the UNCITRAL Model Law (4th edn, Global Law and Business, 2017).

[30] Andrew Godwin, "Convergence, Divergence and Diversity in Financial Law – The Experience of the UNCITRAL Model Law and Cross-Border Insolvency" in Gary Low (ed) Convergence and Divergence of Private Law in Asia (Cambridge University Press, 2022), 46-47, citing K. Yamamoto, New Japanese Legislation on Cross-Border Insolvency as Compared with the UNCITRAL Model Law (2002) INSOL International Insolvency Review p.67.

[31] International Bar Association, IBA Insolvency Section Task Force on U.N. Insolvency Convention, in Executive Summary and Working Papers for International Insolvency Convention Discussions (2014) (highlighting the difficulties of 'soft law' mechanisms).

[32] International Bar Association, Comments for the United Nations Commission on International Trade Law, Working Group V (Insolvency Law) Respecting Proposals for the Working Group to Consider an International Convention and/or Model Law on Cross-Border Enterprise Group Insolvency, in Executive Summary and Working Papers for International Insolvency Convention Discussions (2014) (mentioning procedural and substantive issues arising in cross-border enterprise group insolvency cases).

[33] McCormack G. and Wai Yee W. (2019), "The UNCITRAL Model Law on Cross-Border Insolvency Comes of Age: New Times or New Paradigms", Texas International Law Journal, Vol 54(2), p.275.

[34] Chapter II of the UNCITRAL Model Law on Cross Border Insolvency.

[35] Chapter IV of the UNCITRAL Model Law on Cross Border Insolvency.

[36] UNCITRAL (2014), "Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation", p. 30, para 37, U.N. Sales No. E. 14. V.2.

[37] *Rubin v. Eurofinance SA* [2012] UKSC 46, paras 125-128.

[38] Mevorach I. (2021), "Overlapping International Instruments for Enforcement of Insolvency Judgments: Undermining or Strengthening Universalism?", European Business Organization Law Review, Vol 22(2), p. 290

[39] *Ibid.* p.291.

[40] UNCITRAL, Legislative Guide, 2010, Ch. III, para 7.

[41] UNCITRAL, Legislative Guide, 2010, Recommendations 240–245, pp.100-103.

[42] Supra Note 18, pp.63-64.

[43] *Ibid.*

[44] Peter H. et al. (2006), "Insolvency in a group of companies, substantive and procedural consolidation: when and how?" in "The challenges of insolvency law reform in the 21st century" (Schulthess, 2006).

[45] Maheshwari S. (2020), "Overseas Direct Investment from India: Setting Up of Step-Down Subsidiaries", Business Law Review, Vol 41(4), p. 146. Round-tripping occurs when related companies engage in the sale and buy-back of assets between themselves, or invest and re-invest funds in each other, to achieve accounting and other benefits, often on an unlawful or irregular basis.

[46] Section 18f(i) & 18f(v) of the IBC.

[47] Guidelines for Communication and Cooperation Between the Adjudicating Authority and Foreign Courts in Cross-Border Insolvency Matters, Guidelines Para A.

[48] Nathan B. and Gross P. (2017), "Impact of Cross-Border Court-to-Court Communications on U.S. Creditors' Rights: The National Magazine of Business Fundamentals", Business Credit, 119(7), p.2.

[49] *Ibid.*

[50] *In Re Hanjin Shipping Co. Ltd*. US Bankruptcy Court District of New Jersey, September 6, 2016, Case No.: 16-27041 (JKS).

[51] Supra Note 48.

[52] Lee E. and Ip E. (2020), "Judicial diplomacy in the Asia-Pacific: Theory and evidence from the Singapore-initiated transnational judicial insolvency network", Journal of Corporate Law Studies, Vol. 20(2), p.389, citing Law D.S. (2015), "Judicial Comparativism and Judicial Diplomacy", University of Pennsylvania Law Review, Vol. 163, pp.1004, 1023; see generally, Nicola F. and Davies B. (2017), "Judges as Diplomats in Advancing the Rule of Law: A Conversation with President Koen Lenaerts and Justice Stephen Breyer", American University Law Review, Vol.66, p.1159.

[53] Lee E. and Ip E. (2020), "Judicial diplomacy in the Asia-Pacific: theory and evidence from the Singapore-initiated transnational judicial insolvency network", Journal of Corporate Law Studies, 20(2), pp.389 - 390.

[54] Henderson A. et al. (2017), "Singapore and Delaware courts adopt Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency matters", p.14.

[55] *Belmont Park Investments PTY Ltd v BNY Corporate Trustee Services Ltd & Anor* [2011] UKSC 38.

[56] Supra Note 54.

[57] Supra Note 1, p.81.

[58] Kurpad M. (2020), "Formulating an Effective Cross-Border Insolvency Framework under the Indian Insolvency and Bankruptcy Code".

[59] Kevyn D. et al. (2017), "Courts, Cooperation, and More: A review of U.S. Cross Border Insolvency Protocols-Part I".

[60] Supra Note 6, p.172.

[61] European Union, Transnational Protocols: A Cooperative Tool for Managing Cross-Border Insolvency — ToP, 'Newsletter no.1'.

[62] *Ibid.*

[63] See generally *In re Maxwell Commc'n Corp.*, 170 B.R. 800 (Bankr. S.D.N.Y. 1994).

[64] Jamie A. (2010), "A test case in international bankruptcy protocols: The Lehman Brothers Insolvency", San Diego International Law Journal, Vol. 12, p.491 citing Westbrook L. (1996), "The Lessons of Maxwell Communication", Fordham Law Review, Vol. 64, p.2536.

[65] *Ibid.*

[66] Jamie A. (2010), "A test case in international bankruptcy protocols: The Lehman Brothers Insolvency", San Diego International Law Journal, Vol. 12, p.491.

[67] Dargan S. (2001), "The Emergence of Mechanisms for Cross-border Insolvencies in Canadian Law", Connecticut Journal of International Law, Vol.17(1), pp.107, 124.

[68] Sexton A. (2012), "Current Problems and Trends in the Administration of Transnational Insolvencies Involving Enterprise Groups: The Mixed Transnational Insolvencies Involving Enterprise Groups: The Mixed Record of Protocols, the UNCITRAL Model Insolvency Law, and the EU Insolvency Regulation", Chicago Journal of International Law, Vol.12(2), pp.811, 818.

[69] Supra Note 18, p.86.

[70] Supra Note 68, p.818.

[71] Supra Note 18, p.87.

[72] Supra Note 18, p.87, citing UNCITRAL, Legislative Guide 2010, Ch. III para 50.

[73] Supra Note 6.

[74] Supra Note 18, p.109.

[75] Supra Note 6.

[76] Supra Note 18.

[77] *Ibid.*

[78] *Ibid.*

[79] UNCITRAL, "Practice Guide on Cross Border Insolvency Cooperation" (Practice Guide, July 2009).

[80] Mason R. et al. (2014), "What further benefit, if any, might Australia get from the ALI-III Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases?", p.67 citing *Re PSI Net Inc* Ontario Superior Court of Justice, Toronto, No. 01-CL-4155 (July10, 2001) and the US Bankruptcy Court for the Southern District of New York, No. 01-13213, (Bankr SDNY 10.7.2001) (cross-border insolvency protocol and order approving protocol) and UNCITRAL, Judicial Perspective, pp.48-49.

[81] Justice Farley J. M., et al. (2006), "Cooperation and Coordination in Cross-Border Insolvency Cases", INSOL International Annual Regional Conference, Scottsdale, Arizona, USA.

[82] Mason R. et al. (2014), "What further benefit, if any, might Australia get from the ALI-III Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases?", p.69.

[83] *Ibid.*

[84] *Ibid.* citing UNCITRAL, Model Law on Cross Border Insolvency Guide to Enactment, para 14.

[85] See Cross-Border Insolvency Protocol for Loewen Group Inc. and its Affiliates, *In re Loewen Group Inc.*, Case No. 99-1244 (Bankr. D. Del. June 30, 1999).

[86] Supra Note 11, p.16.

[87] *Ibid.* citing Wessels B. et al. (2009), "International Cooperation in Bankruptcy and Insolvency Matters", *Oxford University Press*, p.188.

[88] Supra Note 18, p.102.

[89] Section 11 of the Draft Indian Cross Border Insolvency Provisions.

[90] Supra Note 18, p.121.

[91] *Ibid.*

[92] Gant J. (2020), "Research Report: Judicial Co-Operation Supporting Economic Recovery in Europe: Report 2 on Judicial Cooperation in Preventive Restructuring and Insolvency in the EU", Published on the University College Cork Website and Submitted to the European Commission, p.50 citing Mangano R. (2017), on legal certainty being a key element underpinning co-operation, "From 'Prisoner's Dilemma' to Reluctance to Use Judicial Discretion: The Enemies of Cooperation in European Cross-Border Cases", International Insolvency Review, Vol.26, p.314.

[93] *Ibid.* p.78 citing Mak E. (2018), "Researching Judicial Ethical Codes, or: How to Eat a Mille-Feuille?", International Journal for Court Administration, Vol. 9(2), p.55.

[94] Supra Note 11, p.27.

[95] *Ibid.* citing the protocol in *Everfresh case.*

[96] *Ibid.* citing the protocol in the *Solv-Ex case.*

[97] UNCITRAL, "Practice Guide on Cross Border Insolvency Cooperation" (Practice Guide, July 2009) para 56.

[98] Everfresh Protocol. See Order Approving Cross-Border Insolvency Protocol, *In re Everfresh beverages Inc.*, (Bankr. S.D.N.Y. 1995).

[99] Supra Note 11, p.30.

[100] The protocol is a part of the judgment of the NCLAT in *Jet Airways (India) Limited v. State Bank of India* arising out of Company Appeal (AT) (Insolvency) No. 707 of 2019 dated September 26, 2019.

[101] Clause 7.1.1 of the Jet Airways Insolvency Protocol.

[102] Clause 8.1.3 of the Jet Airways Insolvency Protocol.

[103] Clauses 9.1.2 and 9.1.3 of the Jet Airways Insolvency Protocol.

[104] Chhawchharia A. and Krishna S. (2022), "Jet Airways-Cross Border Insolvency A Narrative", Insol Newsletter

[105] Clause 7.1.1 of the Jet Airways Insolvency Protocol.

[106] Para E of the Guidelines for Communication and Cooperation Between the Adjudicating Authority and Foreign Courts in Cross-Border Insolvency Matters.

[107] Federal Court of Australia, Cross-Border Insolvency Practice Note: Cooperation with Foreign Courts or Foreign Representatives, (Web Page, January 31, 2020).

[108] *Ibid.* para 2.5.

[109] Supra Note 11, p.24.

[110] Guideline 2 of the Guidelines for Communication and Cooperation Between the Adjudicating Authority and Foreign Courts in Cross-Border Insolvency Matters.

[111] *Ibid.*

[112] Supra Note 18, p.55 citing Guide to Enactment of Model Law 1997, para 212.

[113] Supra Note 1, p.64.

[114] Supra Note 66.

[115] Supra Note 65.

[116] Supra Note 66.

[117] *Ibid.*

[118] Supra Note 1, p.59.

[119] Wessels B. (2020), "2020-07-doc1 Jet Airways Insolvency Protocol".

[120] Guideline 8 of the Guidelines for Communication and Cooperation Between the Adjudicating Authority and Foreign Courts in Cross-Border Insolvency Matters.

[121] Guideline 7 of the Guidelines for Communication and Cooperation Between the Adjudicating Authority and Foreign Courts in Cross-Border Insolvency Matters.

[122] Martin R. and Fairbairn M. (2017), "U.S. and Foreign Courts Adopt the Judicial Insolvency Network's Cross-Border Guidelines", American Bankruptcy Institute Journal, Vol. 36(5), pp.24, 25.

[123] *K. Sashidhar v. Indian Overseas Bank* (2019) 12SCC150, para 38.

[124] *Gujarat Urja Vikas Nigam Limited vs. Amit Gupta and Ors.* (2021)7SCC209, para 163.

[125] Supra Note 17, p.349.

[126] Guideline D of the Guidelines for Communication and Cooperation Between the Adjudicating Authority and Foreign Courts in Cross-Border Insolvency Matters.

[127] Supra Note 53, p.389.

9 INDIVIDUAL INSOLVENCY UNDER IBC: CRITICAL ANALYSIS AND WAY FORWARD

- Deeksha Dhingra, Deepansh Jain and Muskan Khandelwal

EXECUTIVE SUMMARY

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) was a breakthrough legislation in the field of corporate insolvency however it did not initially provide for a regime for the governance of the individual insolvencies which is governed by a complex network of social economic and political relations. This paper aims to analyse the different approaches to individual insolvency, analyse the issues in the current regime, evaluate the different possibilities of resolution. The authors aim to analyse World Bank's Report on the Treatment of the Insolvency of Natural Persons, 2014, the legislation in countries such as USA and UK and compare them to find a suitable well rounded solution and determine where do Indian laws stand in this comparison and how can the loopholes/limitations be addressed.

Keywords: Insolvency, Individual Insolvency, IBC

INTRODUCTION

The IBC was a breakthrough legislation in the field of corporate insolvency however as per data available in the public domain, over 97% of Indian small scale industries are proprietorships or partnerships.[1] It's plausible that loans for 'micro and small industries', 'personal loans', and agriculture are predominantly granted to people. Further, it's possible that some of the loans made for 'services', 'trade', and 'non-banking financial companies' (NBFCs) are also transferred to people. The majority of bank loans i.e. 43% go to householders. It is also crucial to remember that the market for personal loans is expanding more quickly than the market for business loans.[2]

The Presidency Towns Insolvency Act, 1909 (PTIA), for Calcutta, Bombay, and Madras, and the Provincial Insolvency Act, 1920 (PIA), for the rest of India, both date back to the British era. Given the state of the economy today, these laws are long outdated and ineffective. The two laws have been in existence on paper, and section 138 of the Negotiable Instruments Act, 1881 has been used quite frequently, but their effectiveness is limited by the ineffectiveness of the Indian judicial system, which is made worse by cases involving real estate, contracts, and mortgages.[3]

For instance, while Securitisation and Reconstruction of Financial Asset and Enforcement of Security Interest Act, 2002 (SARFAESI Act) initially showed success, recovery rates have started to drop over time. It's also critical to remember that these procedures are only open to a particular kind of creditors, namely banks and financial organisations. A sizable group of other creditors are left without any means of recoupment. There have been two major consequences of the lack of a framework to deal with personal insolvency. The first one concerns credit markets' structure.[4] The issue of financial exclusion is most likely caused by inadequate frameworks for recovery just as much as it is by information asymmetry. If lenders lack confidence in their capacity to recoup their losses and turn to informal sources, the cost of financing is greater.[5]

Collateralized lending has become more prevalent as a result of the lack of an insolvency framework, which worsens the issues associated with financial exclusion. Additionally, there are credit limitations because the market is unwilling to take a chance on people without a large credit history or sufficient collateral, which keeps the cycle going. For those who don't own a house, have debts up to ₹ 35,000, have a gross yearly income under ₹ 60,000, and have a total net worth of less than ₹ 20,000, the IBC does offer provisions for a 'fresh start' scheme. Such individuals who are unable to pay off their debts might be released from their obligations through the process.[6] However, personal bankruptcy laws for individuals may pose significant concerns about data security and privacy.

Numerous social and economic regulation concerns, including family and housing policy, individual therapy, education, and social welfare provision, are involved as individual insolvency affects society directly, whereas corporate insolvency merely has an economic impact. This significant distinction serves as the foundation for the treatment of individuals and businesses during insolvency. Therefore, a procedure that is straightforward, affordable, and easily accessible is required for individual insolvency.[7]

There are several approaches to individual insolvency such as 'fresh start' and 'earned fresh start' and further categorising individual insolvencies and providing mechanisms which are quasi-judicial, conciliatory or judicial in nature with easier procedure. This paper aims to analyse the different approaches to individual insolvency, analyse the issues in the current regime, evaluate the different possibilities of resolution.

NEED FOR PERSONAL INSOLVENCY IN INDIA

In contrast to corporate insolvency, personal bankruptcy is applicable to both individuals and partnerships, as well as any and all creditors as it gives it a far wider scope. The need for research on personal bankruptcy and insolvency is necessary for a number of reasons, one of which is the rise in the rate of personal insolvency, which may become a larger issue on a national scale due to the fact that the burden of consumer indebtedness is increasing and can pose a risk to the stability of the economy. Furthermore, the growth rate is an indication of a problem when it comes to personal finances. There is an urgent need to have an understanding of this problem as well as the potential solutions that are available to address it.[8]

And last, it appears like it would be desirable to find out that the current Code and the procedure stated within it are running effectively, in the sense that they are accomplishing the objectives that they were designed to meet.[9]

Growth in personal credit

There are also indications that personal credit may see significant growth rates in the near future, which would suggest an increase in the number of defaults on personal loans. The challenge of coordinating group efforts during the recovery process will also be critical.[10]

A significant portion of business loans need a personal guarantee from the borrower and in the event that the limited liability company fails to make its loan repayments, the banks have the power to activate this personal guarantee; if they do so, the obligation is transferred to the individual. The individual is the one who is responsible for payment in each of these scenarios.[11] In the event that these loans are defaulted on, as it is almost certain that some of them will be, collective action against a defaulting debtor will not be able to proceed via the path of corporate insolvency. Creditors will need to depend on the regulations that pertain to individual insolvency in this situation.

It is not of evidential value when news of farmer suicides dominates the media or when there is a farmer protest going in some regions of the country; yet this illustrates how the borrower's over-indebtedness and suffering is prevalent among them. When viewed from this angle, this is seen from the standpoint of the homes. As a result of this, the tales convey the impression that a considerable number of borrowers who may be in debt are unable to access the formal bankruptcy processes or find means to settle their debts.[12]

Lack of framework

The current system that is present for personal insolvency is already broken and the acts that are existing are not dynamic enough and have not changed since the British times and these provisions are rarely used.

The absence of a legislative framework for insolvency has also resulted in an excess of collateralized lending, which makes it much more difficult to address the concerns around financial exclusion. Individuals have continued to have limited access to credit as a result of the market's unwillingness to take a risk on those who lack a large credit history or collateral, which has helped to prolong the cycle.[13]

The laws date back to British times with respect to personal insolvency which includes PTIA and the PIA for the rest of India. But these acts have rarely been used and instead the formal process of recovery goes through these two legislations –

The Negotiable Instruments Act, 1881

The Negotiable Instruments Act of 1881 has been there since the time of the British, but it did not become an essential instrument for credit recovery until 1988 when section 138 was introduced. It has been a vital device for credit recovery and this provision was used majorly by lenders in the home mortgage industry due to the lack of any other alternative law in place. This section made it a crime to have a cheque 'bounced'. The lender had the option of requiring the borrower to write post-dated cheques, and in the event that the borrower's cheque was returned unpaid, the lender had the right to seek criminal legal action against the borrower.

The growing utilization of section 138 has resulted in an overburdening of the courts, which has contributed to inefficiency as well as delays in the resolution of problems relating to mortgages and properties.[14]

The SARFAESI Act

The SARFAESI Act is reserved exclusively for use by financial institutions (FIs) and banks. It gives powers to banks and FIs to recover non-performing assets by taking possession of their collateral and assets without court intervention, but the flaw here is that is only useful for only a certain class of creditors – banks and FIs that provide secured loans.[15]

So, because of this flaw, a large number of creditors do not find a way to recover their debts. Additionally, since it was first implemented, there has been a gradual decline in its efficiency.

A social insurance option

There has been an explosion of modifications in legislation pertaining to personal insolvency, which has led to the framework for personal insolvency being clearer.

Numerous legal structures highlight the social insurance feature of consumer insolvency legislation. According to this concept, debt forgiveness gives relief to financially challenged households that do not have access to social safety nets and, as such, operates as an 'insurer of last resort'.[16]

This framework is based on two perspectives:

a) The economic perspective and

b) The social perspective[17]

The former contends that debt cancellation meets the economic criteria of insurance. It transfers the risk from the debtor (the insured) to the creditor (the insurer), for which the creditor may demand a higher interest rate. The debt discharge in bankruptcy is social insurance as opposed to private insurance since it is a fundamental feature of the relationship between debtors and the vast majority of unsecured creditors, where the debt-discharge right of the former cannot be waived. According to an alternative social perspective, bankruptcy is a form of social insurance with greater functional value than economic theory. Consequently, the bankruptcy framework functions as an 'insurer of last resort', protecting individuals who are inadequately safeguarded by legal and institutional systems designed to promote economic security. These academics have focused less on the risk-transfer function of bankruptcy and evaluated it as a reflection of broader socioeconomic issues. If the bankruptcy framework is studied in the context of the larger social insurance framework, its ideal function in obtaining the desired goal can be determined.[18]

The relative costs of bankruptcy protection and other social safety net programs may be examined in order to conceptualize the least expensive solution within the personal bankruptcy framework, particularly the 'new start'. These costs include administrative costs, self-insurance costs, moral hazards, macroeconomic costs to the credit and labour markets. The authors believe that the current economic climate provides a compelling justification for reorienting the law toward the fresh start policy and its social insurance role.[19]

An important aspect of a credit contract is the predictability of what will occur if the borrower is unable to repay. Debtors may be able to renegotiate their payments. This calls for a discussion between the creditors and the debtor.

Personal insolvency needs to be treated as a mechanism which relies on the interaction between creditors and debtors. Market-based, bi-partisan mechanism for restructuring of personal debt is practically non-existent in India. Borrowers could have nowhere else to turn except to a legislative procedure that allows for the reorganisation of their debt or the cancellation of their obligations.[20]

Credit market on the rise

Individual credit necessitates the promotion of an entrepreneurial culture, particularly in those families where low-income households demand credit on seasonal cycles, and in the case of unanticipated occurrences, it enables the stability of spending.

Agriculture credit is a large part of the total bank credit and there is concern that a large proportion of these loans given to farmers have gone bad and moreover the lack of availability of timely credit is the basic problem of all the small-scale enterprises which leads to hampering of development for an economy like India.

The quantum of credit that is being given to 'individuals' rather than limited liability firms is one factor that is contributing to the expansion of the individual credit market. And this is primarily the banking industry, which also includes personal loans, agricultural loans, and loans issued for services provided by NBFCs. Add to that the estimation of the size of loans offered under non-food credit, other sources like shops, friends, and family, which comes under the category of informal sources of credit, and the market for personal loans is expected to grow at a rate that is faster than that of the market for corporate loans in the near future.[21]

No reliable procedure

In conclusion, debtors do not have dependable means at their disposal for getting effective relief from the efforts of collection agencies because there is no established system in place. Because of this, it is impossible for a debtor to put a stop to a chapter of default, begin a new chapter with a 'clean slate', and resume engaging in productive activity. This has an effect on the amount of entrepreneurial activity in the economy since borrowers are more likely to become risk-averse and less ready to borrow in an environment where there is no such 'insurance'.

While the personal insolvency legislation is intended to offer partial consumption protection, it should also increase credit supply through a fair distribution of debtor assets between a debtor and a creditor. However, the act fails to strike a balance between the two objectives.

The effect

The absence of a system to deal with personal insolvency has resulted in two significant side effects. The initial focus will be on the organizational framework of credit markets.

The second factor to evaluate is the impact on borrowers. The psychological and physiological consequences that debtors may incur as a result of forceful debt collecting tactics may be substantial. It also results in political pressure to take action, which might take the form of limits on certain forms of credit or loan waivers. Unfortunately, this further exacerbates the problem of restricted access to credit and causes more market inefficiencies. If they do not have recourse to personal insolvency procedures, debtors have severely limited options for negotiations with their creditors if they believe it is possible to save their businesses as going concerns.[22]

As a result, the Code should be given a framework for personal insolvency during the tranquil time and relatively early phases of consumer credit expansion, when no over-indebtedness or consumer credit crisis is threatening financial stability. Individual credit has expanded in recent years, with people accounting for about 38% of non-food credit, and the stress on personal loans is growing. As a result, now is the best moment to learn from the experiences of other nations that have recently introduced personal insolvency legislation. This may also help develop strategies to further expand credit markets for individual loans.

The draft which is there under IBC which deals with the law governing individual insolvency and for it to work the ecosystem of Resolution Professionals (RPs), the Insolvency and Bankruptcy Board of India (IBBI/Board), Information Utilities (IUs) which basically smoothens the process and help identify default. With the help of better infrastructure and implantation of the code the huge change is awaiting in the working of the individual credit market, and this is something for the banks and financial institutions to look upon.

WORLD BANK'S REPORT ON THE TREATMENT OF THE INSOLVENCY OF NATURAL PERSONS, 2014

It is most certainly the case that there is no one size fits all approach to the design and implementation of an insolvency regime for natural people. However, there are real benefits and drawbacks to the various solutions to the myriad practical problems that come up when designing an insolvency regime for natural persons, and those features need to be taken into account and addressed by policymakers. The achievement of an effective insolvency regime is the main goal. Most policymakers believe that this entails giving aid exclusively to those debtors who are in need and doing so in a simple and rapid manner. [23]

In 2011, the World Bank convened its Insolvency and Creditor/Debtor Regimes Task Force to examine international practices in personal insolvency. Subsequently, the World Bank issued its Report on the Treatment of the Insolvency of Natural Persons in 2014. That Report systematically, thoroughly, and effectively reviewed existing global practices on personal insolvency issues.[24]

The Report on the Treatment of the Insolvency of Natural Persons provides that an effective and well-developed regime for the insolvency of natural persons addresses a number of critical issues and that the challenges presented by the peculiarities of the insolvency of natural persons require the consideration of the following parameters.

General regime design

Interaction with informal channels for amicably resolving financial hardship is a crucial component of the establishment of a formal regime for the treatment of natural person insolvency. Encouragement of informal negotiation and resolution of cases of personal over-indebtedness is a crucial function of a formal insolvency system.[25]

Legislators have given the prevention of formal insolvency procedures top priority in many nations, in part through encouraging negotiated solutions to financial issues. Negotiated solutions have benefits such as avoiding stigma, having a less negative effect on debtors' credit scores, being less expensive than formal insolvency proceedings, providing better results for creditors, being less expensive to prepare for, having more flexibility to meet the needs of both the debtor and the creditors, and FIs being more willing to renegotiate loans.[26]

In the case of the insolvency of natural persons, voluntary conciliation is even more desired but has also proven to be more elusive, particularly since creditors have frequently showed little interest in participating actively and constructively in such processes. In reality, reaching voluntary settlements with all of a debtor's creditors is difficult since some of those creditors demand the enforcement of their claims, which makes discussions impossible.[27]

The effectiveness of informal alternatives to insolvency in the few systems demonstrates the significance of a number of factors that support plan confirmation. It is crucial to have affordable or free professional aid; advisors must have previous bargaining expertise with creditors. Negotiations must continue without the imminent fear of debt collection in order to be as effective as possible.[28]

The institutional framework

The overall social costs are reduced by a well-functioning institutional framework for natural person insolvency. The sheer volume and largely homogeneous nature of the cases that need to be handled forces a re-evaluation of the best legal administrative framework to be used, especially in terms of funding that framework. When designing a structure for a system of insolvency for natural persons, policymakers have numerous objectives in mind. These objectives include treating people in similar situations equally, preventing fraud and abuse, and cutting back on pointless bureaucratic procedures. There is a continuum of institutional frameworks for personal insolvency procedures.[29]

These institutional frameworks encompass systems in which an administrative agency oversees insolvency procedures, hybrid public/private systems in which public insolvency procedures coexist with private restructuring alternatives, and court-based systems largely served by publicly-funded or private intermediaries.[30]

The majority of nations have court-based personal insolvency and restructuring regimes. However, a number of high-income nations have embraced administrative strategies with courts acting as the backdrop for disputed cases. There are also hybrid public-private models, in which private insolvency practitioners serve as the main actors and evaluate, manage, and investigate debtors under the close supervision of a public regulator that issues licences to practitioners and may also get involved in the process. A country's existing institutions and the availability of qualified intermediaries must be taken into account while designing an institutional framework.[31]

Access to the formal insolvency regime

Many individuals have difficulties in financing access to the insolvency procedure. There are five basic approaches to financing access to insolvency relief: (a) state funding of the process; (b) cross-subsidization of low value insolvencies by higher value estates; (c) state subsidies to professionals involved in the process and write-off of court costs where there is an inability to repay; (d) levies on creditors, such as taxation of distressed debt to fund those cases where individuals have no ability to pay; and (e) no state support beyond any general public funding of the court system.[32]

By addressing the expense side of the system, adopting summary procedures, and leveraging information technology, financing concerns can be mitigated. Individual insolvency and restructuring procedures should be accessible under clear, unambiguous rules that guard against abuse by either creditors or debtors.[33]

Accessibility concerns are particularly crucial in systems with many possibilities for choosing an insolvency procedure (sometimes known as 'multi-track insolvency systems'). An overindebted person will have more difficulty navigating a bankruptcy system that is more complicated in terms of different and overlapping procedures, especially if that person is in a vulnerable situation.[34]

Participation of creditors

Creditor involvement does not play the crucial role it typically does in company insolvency in the insolvency of natural people. A certain amount of contractual flexibility and creditor involvement continue to be crucial components of many insolvency procedures. The problem of passive creditors and their ignorance of the debtor's circumstances plagues the majority of insolvency systems. On the other hand, significant creditors who have filed numerous claims, such as tax authorities, huge banks, or debt collection agencies, may occasionally decide as a matter of policy to oppose all or most types of bankruptcy filings by natural people. In response to the challenges that creditor participation presents, and taking into account the small economic value of most claims, many systems have simplified the procedure for submission and verification of claims.[35]

Solutions to the insolvency process and payment of claims payment through liquidation of the estate

The insolvency process still prioritises maximising returns for creditors, but in the case of natural person debtors, evidence has shown that there are major challenges in the process of extracting payment not just from current assets but also from future income. However, this traditional focus on assets to be liquidated raises long-standing concerns about leaving natural person debtors with a sufficient basis from which to resume their productive lives. The majority of modern personal insolvency systems continue to take the approach of focusing on the debtor's assets, at least initially, with a view to maximising returns for creditors.[36]

A Public Administrator or Trustee of some form is typically appointed in practically every system to determine the extent of the debtor's estate and to inventory, gather, and sell the debtor's assets (if accessible) to maximise value for creditors. However, a number of systems have essentially stopped trying to liquidate the bankrupt's assets unless it appears that the debtor has enough assets to justify the high administrative costs of the inventory and liquidation procedure.[37]

Another crucial component of the personal insolvency regime is exemptions. The idea of shielding a portion of the debtor's assets from being sold and given to creditors is strongly related to the discharge principle and the idea of a 'fresh start'. The concept is that when debtors receive a discharge, exit from bankruptcy, and start again, they should be in possession of enough property to cover their post-insolvency essential needs for themselves, their families, and, if necessary, essential business needs.[38]

For determining which categories of property should be exempt from liquidation and distribution to creditors, there are basically two different methods. The first strategy is reserving a variety of assets having a value up to a certain cap that the debtor may attempt to have excused from the insolvency estate. A second strategy, used by many systems today, updated the original strategy by defining categories of specific assets (and their values), which the debtor could attempt to have excused.[39]

Payment through a payment plan

The majority of natural person debtors have few valuable assets, and current insolvency regimes frequently demand a payment from future income in exchange for the system's benefits (usually a discharge of unpaid debt). The majority of systems addressing the insolvency of natural persons anticipate a 'earned start' rather than a simple 'fresh start' with no input or effort required of debtors. This is true regardless of the kind and scope of the relief provided.[40]

The expansion of distributable value to include future income raises fundamental questions about how to treat real people who owe money and must keep enough money to provide for their family. How to establish suitable baseline costs, fair and realistic payment expectations, and the length of payment plans have all been questions that have been raised.[41]

IBC ON INDIVIDUAL INSOLVENCY

The salient features of the Code with respect to individual insolvency are as follows:

Eligibility

There are three ways to consider eligibility for the individual insolvency process under IBC : a) the filing threshold, b) the entities that make the filing, and c) the debt that qualifies for a filing.

A single default of at least ₹ 1,000 is sufficient to qualify for IBC filing eligibility. The Code allows the Government to increase this amount to ₹ 10,00,000, but not higher.[42]

Either the debtor, designated as an individual or partnership, or the creditor may file for insolvency under the IBC. However, only the debtor is eligible for the 'fresh start' process detailed later in this section. A creditor consists of a financial, operational, secured, and unsecured creditor, in addition to a decree holder.[43]

This implies that all creditors, including moneylenders, friends, and relatives, might legally seek for bankruptcy protection.

Lastly, a filing can only be made if the debt is not excluded. The IBC includes the following in its category of excluded debts: court or tribunal fines, maintenance of any person needed by law, student loans, negligence, annoyance, or breach of statutory contractual or other legal responsibilities. The Code leaves open the possibility that rules will include new kinds of debts in the category of excluded debts.[44]

Processes

The IBC contains two kinds of procedures. The first route is the 'insolvency resolution process', which is followed by 'bankruptcy'. The second is the 'new start' route for debt cancellation. The choice of route is contingent on specific eligibility requirements, and the IRP-bankruptcy route appears to be the preferable route for the vast majority of insolvencies.

The IRP-bankruptcy route

In the insolvency resolution process (IRP), all creditors and the debtor agree on a negotiated repayment plan.[45] The IRP can be launched at the appropriate Debt Recovery Tribunal (DRT) by either the debtor or the creditor via an application whose form and procedure shall be prescribed by regulations. The application is to be reviewed by a RP, who is responsible for making an acceptance or rejection recommendation to the DRT.[46]

Once the IRP application is accepted, there will be a six-month moratorium on any collection actions.[47] A public notice will be issued by the DRT, and the RP will collect creditor claims.[48] Under the supervision of an RP, the debtor is required to propose a repayment plan that is acceptable to the majority of creditors, defined as more than three-fourths in value. Once authorised by the creditors and sanctioned by the Adjudicating Authority, the plan would be enforceable against the debtor and all creditors included in the plan. The IBC gives no direction on the content of the plan and does not require that the plan provide the debtor with a minimum quality of living. These particulars may be included in the regulations that govern the process. However, it stipulates that the debtor's approval is required for any amendments to the plan suggested by the creditors.[49] The IBC thus, strikes a balance between the tendency of Indian law and regulations to micromanage every process and the debtor's well-being.

The approved plan must be presented to the DRT, which subsequently passes the plan's final order.[50] The RP is responsible for monitoring the plan's implementation. A discharge order may be issued to the debtor if the terms of the resolution plan are met.[51]

The IBC identifies three causes of IRP failure that might result in bankruptcy proceedings: (a) if the application to the IRP is not accepted owing to a failure of required information, (b) if creditors and the debtor cannot agree on a repayment plan, and (c) if the debtor fails to implement the repayment plan within the implementation prescribed in the plan.[52] The creditor or the debtor must submit an application to initiate the bankruptcy case. This is due to the greater stigma associated with an individual's bankruptcy status.

On the admission of the bankruptcy application, the IBBI will appoint a professional Insolvency Practitioner as the Bankruptcy Trustee if neither the debtor nor the creditor proposes one.[53] The DRT will issue a declaration of bankruptcy.[54] It will result in declaring the debtor bankrupt and vesting the debtor's estate in the bankruptcy trustee.[55] A class of the debtor's assets would stay outside the estate, such as property held by the bankrupt in trust for another person, amounts owed to workmen or employees from the provident or pension fund, and assets that may be specified by the Central Government or financial sector regulator.[56] The Bankruptcy Trustee will register claims and administer them in accordance with the IBC's priority order upon the transfer of the bankrupt's estate.[57]

The Code does not define filing fees for either the IRP or bankruptcy process, leaving open the possibility that fees could be prescribed in the future.[58] Fees to the insolvency profession are anticipated to be accommodated in both the IRP and bankruptcy procedures.[59]

The fresh start route

Fresh Start is a concept proposed by the IBC to provide debt relief to the poorest. A debtor whose gross yearly income is less than ₹ 60,000, whose assets are less than ₹ 20,000, whose qualifying obligations[60] are less than ₹ 35,000, and who does not own a residence is eligible for a total debt waiver.

Only the debtor is able to initiate this procedure.[61] The default must be on 'qualifying debts'. If the debtor initiated the procedure via a resolution professional, the DRT will just look for disciplinary proceedings against the RP and will permit the RP if none are identified. If the debtor initiates the procedure without an RP, the IBBI will have to appoint one.[62] The Code outlines a list of information that must accompany the application.[63]

The RP will provide a recommendation to the DRT as to whether the application should be accepted or denied based on an evaluation of the provided information.[64] The DRT will consider the application on the suggestion of the RP.[65] For a period of six months, a moratorium will be imposed on all of the applicant's creditors in order to facilitate the procedure.[66] At the conclusion of the moratorium period, the DRT must issue a discharge order for eligible debts.[67] The IBBI will be provided with the order's specifics for record-keeping purposes.[68]

For low-income, low-asset debtors, the processing costs of the IRP-bankruptcy path seem to be more than the debt at risk, which appears to be the reason for the fresh start. The fresh start also serves as an insurance policy[69] by enabling a more methodical debt cancellation.

Importance of secured creditors

In individual bankruptcy, secured creditors are enabled to completely avoid the IRP by exercising their security interest, in contrast to the laws applicable to corporations. The secured creditors must file an affidavit to the RP to this effect, and if the same lender has also granted unsecured credit, they may only participate in the voting procedure to the same degree.[70] The position of the BLRC was that, in contrast to the situation of a company, where the preservation of organisational capital is enhanced when all assets, including those pledged as collateral, are held together, in the case of a person this is less significant. It is the person herself who is the capital repository (human capital).

Once a bankruptcy order is issued and the estate is transferred to the bankruptcy trustee, all collection attempts by unsecured creditors will be halted. Secured creditors will have the choice to either engage in the procedure or claim their collateral outside of it.[71]

Priority

The repayment plan's design under the IBC does not prioritise anything. But in bankruptcy, there is a priority as follows:[72]

1. The bankruptcy trustee's expenditures and expenses
2. Worker's compensation for the 24 months previous to the bankruptcy commencement date; and debts owed to secured creditors.
3. Wages and outstanding obligations owing to employees (other than workmen) for the 12 months previous to the bankruptcy commencement date.
4. The sum that must be paid to the federal or state governments.
5. Unsecured obligations are included in the bankrupt's other debts.

While the IBC mandates that all loans within one class rank equally among themselves, this list does offer a rating between different classes of debt. This is an issue, according to Feibelman (2018).

The DRT's functionality

Compared to corporate insolvency, the Tribunal's role in personal insolvency is broader. For instance, the DRT is in charge of approving the application based on the report provided by the RP after the

IRP has been initiated. The legislation makes no advice as to how the DRT should make its decisions or if it should just rely on the RP's recommendations. The DRT may also provide guidelines for how discussions between the debtor and creditors should be conducted if the RP so desires.[73]

Similarly, to this, the DRT may approve or reject the repayment plan that the RP submits to it based on the report. In its order approving the plan, the DRT may provide instructions for its implementation or, if it believes the repayment plan needs to be modified, it may instruct the RP to call another meeting of creditors.[74]

In particular, in situations when a creditor has provided an indemnity or made payments that have safeguarded the bankruptcy, the DRT may also be involved in determining the priority of payments in a bankruptcy. In this situation, the Code permits the DRT to favour that particular creditor over other creditors.[75] With the help of these clauses, the DRT could possibly wind up having a far bigger impact on how the IRP is run than what the BLRC and the corporate insolvency procedure had in mind.

INDIVIDUAL INSOLVENCY LAWS IN USA

US bankruptcy law has two separate personal bankruptcy procedures covered under Chapter 7 and Chapter 13. Chapter 7 deals with liquidation whereas Chapter 13 deals with a repayment plan. The main difference between the two chapters is that Chapter 7 requires bankrupts to repay only from their assets and Chapter 13 requires them to only repay from future income.[76]

Chapter 7 requires a bankrupt to list all of their assets some of which are 'exempted' by law which means that the debtor can keep these assets with themselves and need not use these for repayment. The assets which are exempt are decided separately by each state but mostly include clothing, furniture, 'tools of the trade', and some equity in a vehicle, moreover, all states have a Homestead exemption for equity in owner occupied houses.[77] Debtors who choose Chapter 7 must give up all of their non-exempt assets, which are then used to repay creditors however they are allowed to keep all of their post-bankruptcy income.

Alternatively, Chapter 13 allows a debtor to keep all of their assets and use their post-bankruptcy income to repay the creditors. Before the introduction of the Bankruptcy Abuse Prevention and Consumer Protection Act, 2005 (BAPCPA), the law did not provide for a predetermined income exemption and the debtors filing for Bankruptcy under Chapter 13 had to propose their own repayment plan.[78] What was taking place in actuality because of this loophole was that the debtors either proposed to repay an amount equal to the value of their non-exempt assets as the law provided that the debtor cannot repay an amount less than the value of the non-exempt assets and in the rare case where all of their assets are exempted, they usually only pay a token amount.[79]

US bankruptcy law used to permit extra debt to be dismissed under Chapter 13 in order to encourage more bankrupts to file under Chapter 13 and repay from future income. To the extent that the loan principle surpassed the market value of the vehicle, the debtors' auto loans may be dismissed. These characteristics were referred to as the Chapter 13 'super-discharge'.[80]

By filing under Chapter 7 first, where the majority of their debts were dismissed, and then switching their pleadings to Chapter 13, where they offered a plan to repay some of the additional debt covered by the super-discharge, some bankrupts took advantage of the super-discharge. The debtors' financial gain from bankruptcy was higher because to this two-step process, known as filing a 'Chapter 20', compared to filing under either procedure alone. Since non-exempt assets are typically scarce for debtors, they usually chose filing under Chapter 7.[81]

However, because of this decision, most bankrupts were not required to repay from their future earnings, regardless of how much money they were making. Debtors with significant assets may benefit from filing under Chapter 7 if they make plans ahead of time to convert their non-exempt assets to exempt assets prior to filing. They could achieve this by moving to a state with a large homestead exemption, using non-exempt assets to pay down their mortgages, or if the greater home equity would be excluded under the state's homestead exemption.[82]

Overall, prior to the BAPCPA, debtors had the choice of filing for bankruptcy under Chapters 7 or 13, so their duty to repay bore no relation to their ability to pay. Even if a debtor had a great ability to pay, filing for bankruptcy might often result in financial gains.[83]

Several significant modifications to bankruptcy law were enacted by the BAPCPA. First, it eliminated the debtors' option to select between Chapters 7 and 13 and introduced a 'Means Test' to decide whether a debtor can opt for the process under Chapter 7.[84] The ability of debtors to create their own Chapter 13 repayment programmes has also been removed. Third, by placing several new demands on debtors and their attorneys, BAPCPA significantly increased the expense of bankruptcy.[85]

INDIVIDUAL INSOLVENCY LAWS IN ENGLAND

A citizen of England has the following individual insolvency resolution:

Application for bankruptcy

For those whose circumstances are unlikely to alter and who have no chance of paying off their obligations within a reasonable amount of time, bankruptcy is a legal process that can provide debt relief. One cannot be declared bankrupt until a judge issues a bankruptcy order against them. A bankruptcy order may be issued for one of two reasons:

1) If someone is unable to pay their debt, they can apply to the court.

2) If one owes £5,000 or more to their creditors (the individuals you owe money to), one of them may apply to have you declared bankrupt (following a formal demand, unsatisfied judgement execution or if you have broken the terms of an Individual Voluntary Arrangement (IVA)).[86]

The Official Receiver is given control over all of a person's assets in England and Wales when a person is declared bankrupt by the court. The Secretary of State may appoint a Trustee, or the bankrupt's creditors may summon a meeting of creditors if there are sufficient assets to fund the costs of the proceedings. At this meeting, creditors may designate an Insolvency Practitioner to serve as the trustee for the bankrupt. After then, the trustee is in charge of selling the assets and giving the money to the creditors.[87]

In most cases, the bankrupt can keep his assets, especially his car and his belongings. A bankrupt in England and Wales is typically released within 12 months of the bankruptcy order, at which point any remaining obligations are written off. When the Official Receiver informs the court that there are no matters requiring additional inquiry, that will be the exact day of discharge.[88]

IVA

In England and Wales, irrespective of whether the person is already bankrupt or not, they can put forward a plan to their creditors to pay off all or part of your debts. This arrangement between the creditor and the debtor is called an IVA.

An IVA is a type of insolvency proceeding that leads to a person renegotiating the payments they must make to each of their creditors or to some other type of financial restructuring. In order for an IVA to be approved, 75% of creditors (by debt value) must be present and vote in favour of it. An

Insolvency Professional (IP) must oversee each IVA. The insolvency practitioner will serve as the nominee while the arrangement is pending approval and will typically take over as the supervisor after it is implemented. One will make scheduled payments to the IP if their IVA is accepted, who will subsequently distribute the funds among all of their creditors (and pay his or her fees).[89]

Debt relief orders

On April 6, 2009, debt relief orders (DROs) were made accessible in England and Wales. They are intended as a viable individual bankruptcy remedy for anyone with debts under £15,000 and assets under £300. (Based on gross, not net value).

DROs are also intended for people who have little or no discretionary income (less than £50 per month) to use as payment to creditors.

DROs are not available to anybody with an interest in property investment however, there are exemptions, such as those for vehicles valued at less than £1,000.[90]

ANALYSIS

In comparing bankruptcy policies, it is useful to think of such policies as summed up by seven parameters:

1) the amount of debt discharged,
2) the asset exemption,
3) the income exemption,
4) the fraction of income above the exemption that debtors must use to repay,
5) the length of the repayment obligation,
6) bankruptcy costs, and
7) the bankruptcy punishment. [91]

A bankruptcy policy is more pro debtor if the amount of debt discharged or the exemption levels are higher, or if bankruptcy costs, the bankruptcy punishment, the length of the repayment period, or the fraction of non-exempt income that must be used to repay are lower.

The authors believe that India should adopt a strategy which is 'mildly' debtor friendly as can be seen in the US after the introduction of BAPCPA because Indian socio-economic and political framework are that of a welfare state, however this should not come at the expense of the creditors interest as that would in turn have a negative impact on the economy and the country's functioning at large.

The eligibility criteria given under the IBC has an extremely low threshold which should be increased to be proportionate to the level of corporate insolvency which could lead to the legal infrastructure being extremely inadequate to deal with such a high turnover of applications resulting in inefficiency of the procedure itself. Secondly, the authors believe that relatives of the debtor should not be allowed to file the application at the same threshold as unrelated creditors and should be considered as the last priority in the repayment plan as well so that the purpose of the repayment plan can be fulfilled.

The authors also believe that the repayment plan should also follow a priority list wherein the top five creditors by value (not including relatives) should be given priority and disbursed in proportion to their respective debts.

The current regime on the fresh start route has also been made in consonance with the laws in USA and England and learning from the mistakes of the USA. It should be noted that the threshold for the fresh start route should be cross confirmed with the RBI based on a survey of the 'Economic Conditions of Individuals in the Country.'

The role of the DRT is extremely crucial therefore adequate measures should be taken for speedy and effective disposal and a timeline for the implementation of the plan like that seen in the corporate insolvency resolution process (CIRP). Moreover, the training which the IPs undertake for the CIRP cannot be as it is used for the individual insolvency process and therefore adequately trained professionals should be prepared for effective regime.

THE WAY FORWARD

When personal insolvency under the IBC will be notified, it will go into effect in a credit market that has developed over a number of decades in reaction to a system with weak debtor rights on postponing creditor enforcement and limited creditor rights on recovery. The credit market is extremely politicised, particularly when it comes to debt forgiveness and agricultural loans.

The IBC's impact on the expenses, time to recovery, and recovery rates will determine how enthusiastically these current creditors react. However, this will take place over a longer period of time and will also be a result of a demonstration effect based on the experiences of the current market players. Of course, it is plausible that the law will give rise to the development of fresh business models and new classes of lenders who now feel more confident entering the market.

The IBC offers a mechanism for dealing with distress that is now unattainable from the standpoint of the debtor. The IBC gives debtors a legal means of obtaining a halt to enforcement efforts by allowing the debtor to petition for bankruptcy. Additionally, it gives debtors a platform to revise their plan, which might be incredibly helpful if the debtor has several creditors. The debtor may find the fresh start terms, in particular, to be quite helpful when applying for a loan waiver.

Two factors are crucial for the debtors to be able to implement the IBC. First, even if it would be in their financial best interest to do so, debtors are reluctant to pursue redress if there is a social stigma attached to the bankruptcy proceedings. Second, debtors might not consider it beneficial to undertake this course of action if the procedure of accessing the law is expensive and time-consuming, is perceived as 'creditor-friendly', or if it does not provide an acceptable mechanism of dealing with creditors while sustaining a minimal standard of living. Therefore, a lot relies on the institutional framework and legal environment that underpin the procedure.

Policy issues

Laws governing personal bankruptcy must balance the interests of creditors and debtors since they have varied effects on each. From the standpoint of the debtor, personal insolvency must provide a temporary halt to the collection of a single debtor's obligations, allow for a repayment plan, and eventually cancel certain debts. A compassionate, equitable, and debt-relieving method may greatly lessen the psychological pain experienced by borrowers and promote risk-taking and entrepreneurship. On the other hand, if the procedure results in large debt relief at the expense of the creditors, the creditors would ultimately charge the debtors with excessive credit charges. In order for creditors to feel confident about lending in the future, the procedure must also provide them with appropriate recovery rates. This balance must be outlined in both the Act and the Regulations.[92] Prior to making judgements on law changes or the creation of regulations, a strategy must be developed that, at the very least, incorporates the following components:[93]

a) **Descriptions of assets and income:** The choice of debtors for a new beginning or an IRP is based on their definitions of their assets and income. The qualifying requirements for the fresh start are now hard-coded into the statute. In order to make the procedure more user-friendly for debtors, it could be helpful to re-evaluate the relevance of the thresholds so that more individuals are potentially eligible. Additionally, it's critical to connect these thresholds to an indicator in order to align them with both inflation and GDP growth.

The ability of creditors to be paid back during an IRP or bankruptcy procedure depends on the assets that are still exempt from the insolvency process (such as a portion of the debtor's property, tools of trade that enable him to obtain employment, and items required to maintain a certain minimum standard of living), as well as the portion of disposable income that is deemed 'reasonably necessary' for the debtor's and its family's maintenance. This necessitates a consideration of how these assets and income are defined.

b) **Repayment plan format:** The IBC offers no guidelines for repayment plan framework or prioritization in the IRP. The inconsistent priority between an IRP and bankruptcy, as noted by Feibelman (2018), may encourage creditors to choose one over the other, which in certain cases may be counterproductive, particularly if there may be value in preserving a small business as a going concern. The policy should take into account banning onerous conditions, as well as clauses on exorbitant transactions and favoured transfers.

c) **Fast-track processes conducted by a non-judicial body:** There may be value in creating 'fast-track processes' that include receiving prompt relief for a large number of instances. One instance is to offer a typical 'three-year repayment plan', in which debtors agree to give creditors a portion of their income in exchange for a full debt discharge. The hardest aspect of this process will be figuring out who qualifies for the plan in the first place. It will be necessary to show that debtors can give up a portion of their income while still keeping a liveable quality of life. This procedure is probably going to be difficult and contentious.

Presenting a standard repayment plan with a guaranteed recovery rate is an alternate choice. The borrower commits to pay back this sum over time. It's possible that in certain instances this results in lesser recovery for creditors compared to what they would, but overall it lowers the price of disclosure, negotiation, and potential lawsuits. This should be an option that may be presented via an administrative body rather than in court. A policy choice on such possibilities should be made.

d) **Loan waiver procedures:** Under the fresh start process, borrowers who meet specified asset, income, and debt levels will get total debt relief. This procedure could make it possible to carry out debt waivers in a more organised manner. It is necessary to consider the specifics of administering loan waivers via the new start procedure.

e) **Credit ratings and discharge:** The IBC permits a discharge even when the repayment plan is still in effect. Similarly, to that, it enables people who qualify for the fresh start programme to get total debt relief. To prevent ethical risks, these actions need to cost the borrowers something. This may be achieved by a system of records that keeps track of these debtor selections for a certain period of time, giving creditors information on which debtors to give credit to and at what rate. It is necessary to create the procedures for the acquisition, preservation, and integration of these records with the credit bureaus.

f) **Fees:** The IBC makes no mention of the costs associated with the two procedures. It is anticipated that the agreed-upon repayment plan or the bankruptcy estate's proceeds from its liquidation would cover the costs of the experts' (as well as the court's) services. This remains the issue of how to handle many instances when the parties involved have no income, no assets, and may not be able to pay for the IBC procedures. These may come from a budget that the IBBI manages using fees collected from regulated firms, from general tax income, or they may not be received at all. It is necessary to review the exchange between these options.

Structure of institutions: Courts

In contrast to corporate insolvency, the IBC architecture proposes a far larger role for the DRTs, hence increasing the burden on the court. The concerns with the effectiveness of the Indian judiciary are not unusual. Although tribunals were established to circumvent the lengthy procedures of civil courts, they have also failed to meet expectations.[94] The inefficiency is due to the 'number' of judges and the 'quality' of the process, in which a significant percentage of the judges' time is spent on administrative affairs, leaving less time for judicial judgements.[95]

As it is envisioned that individuals from various regions of the nation would be able to utilise the system, the quantity component gains more significance in personal insolvency. Even if 1% of personal loan accounts at banks in a district were to fail and less than 10% of them were to be placed under the IBC, the caseload of current DRTs would increase dramatically, according to Sane, 2017. This estimate is very cautious since it only covers credit given by the banking industry. As of June 30, 2017, there were already 1,09,518 outstanding cases at the DRTs, making the anticipated burden from personal insolvency cases a worry.

In addition to expanding the number of DRTs, the procedures inside DRTs must be examined. According to Datta (2016), a 'Tribunal Service Agency' must be established to offer administrative assistance to the Tribunals. This will result in the division of administrative and judicial tasks, enabling judges to devote more time to the latter.[96] These changes are essential if the DRTs are to be an effective adjudication body for personal insolvency.

Structure of institutions: IU

'Asset legibility' is a crucial issue in the implementation of any bankruptcy system, and personal insolvency in particular. It is highly challenging for a creditor or resolution expert to determine the precise type and worth of a debtor's assets in order to establish an agreeable repayment plan or liquidation value in the event of bankruptcy. A fundamental element of the BLRC's plan was the concept of an 'IU' that would serve as a repository for data on debt and default. In March of 2017, the IBBI announced rules about IUs. Since the regulations, just one IU has been formed: National e-Governance Services Limited (NeSL). It is of the utmost importance to comprehend the reasons behind the unwillingness of private businesses to build IUs and to amend the legislation in order to facilitate the establishment of such an industry.

Structure of institutions: Intermediaries

Individual debtors will be susceptible to biased advice about whether to file for bankruptcy, the filing procedure, and the resolution process, as well as in their interactions with creditors. There have been several cases of mis-selling in other areas of retail finance in India due to a mix of mismatched incentives resulting from high-pressure sales methods and lax regulation.[97] Such issues are likely to arise in the sphere of personal insolvency if not managed properly. The IBBI will need to rise to the issue of safeguarding consumer interests, which will include two key classes of intermediaries: insolvency professionals and credit counsellors.

IPs

Professionals in the insolvency field perform a crucial role in the IBC. As 'RPs', they oversee the whole resolution process in the event of corporate insolvency, and they serve as 'Liquidators' during liquidation. Due to the imbalance in the balance of power between creditors and debtors, the function of the IP is even more crucial in the event of personal bankruptcy. Several crucial choices about filing, drafting a plan, producing a statement of affairs, and negotiating with creditors, which will be key to the debtors' situation under the Code, are contingent on the honesty and effectiveness of the RP.

More than 4,000 IPs are now registered with the IBBI for corporate bankruptcy. They are governed by self-regulatory organisations known as the Insolvency Professional Agencies (IPA), which are governed by the IBBI.[98] There have been several obstacles in the operation of RPs in cases of corporate bankruptcy, including charges of political behaviour, problems about suitable timetables, as well as assaults on and kidnappings of RPs. When it comes to personal bankruptcy, it is probable that disagreements between the numerous parties to the debt contract and the RPs will rise. Even if the issues are relatively minor, they are likely to become more political if wrongdoing is uncovered.

The education and credentials of IPs, as well as their regulation, will need coordinated efforts on the part of the IBBI, with a particular emphasis on the issues that might emerge in personal bankruptcy. It is doubtful that the legislation governing corporate insolvency would be applicable to personal bankruptcy. For instance, the IBBI may need to weigh the pros and cons of a straight forward licencing system so that there are enough RPs to serve people throughout India vs a minimal certification criterion to assure service quality. Similarly, methods to reprimand a large number of professionals will need a capacity for implementation that may be lacking at the moment.

Credit and insolvency advisors

It is a difficult choice to file under the IBC. It is anticipated that debtors will need guidance on issues such as whether to apply for bankruptcy, where to file, what to expect in the procedure, how to locate the RPs when to anticipate a discharge, and the effect of the procedure on their credit ratings and future capacity to incur debt. Given the possible social stigma that may be connected to bankruptcy, it may be necessary to provide more assistance.

In a few of countries, this is accomplished via intermediaries known as 'credit counsellors' or 'debt-advisors'. In the United States, for instance, the BAPCPA mandates that a person undergo credit counselling from an accredited counselling service within 180 days prior to filing for bankruptcy. Additionally, the debtor must complete a post-petition financial management course. If therapy is not obtained, the lawsuit may be thrown. The Federal Trade Commission and the US Trustee Program at the Department of Justice regulate the agencies mainly. In the United Kingdom, 'debt advice' is voluntary. Multiple debt advisory agencies, regulated by the Financial Conduct Authority, provide assistance in investigating different insolvency resolution options. Individuals are urged to use these advisors in order to make educated choices. The application for debt cancellation in the United Kingdom (through a debt relief order, which is comparable to the fresh start in the IBC) must be submitted via such authorised intermediaries.

There is no mention of credit and insolvency advisers in the IBC. However, the IBBI draft rules highlight the necessity for debt counsellors, but do not provide any more information. It is difficult to get the laws right; for instance, Kilborn (2011) asserts that the BAPCPA amendments that mandated credit counselling also capped costs, resulting in 'ceremonial' counselling that lacks substance.

CONCLUSION

Credit markets are essential for economic growth. A well-functioning credit market provides for the smoothing of consumption and promotes entrepreneurship. The significance of insolvency laws in fostering the expansion of credit markets is crucial.

This paper discusses for the need of a personal insolvency legislation in India. It gives a concise summary of the unnotified personal insolvency rules in the IBC. The article identifies a number of policy challenges that must be addressed and argues that the effectiveness of the IBC is contingent on the design of subordinate laws and the creation of institutional infrastructure. Personal insolvency cannot have any impact without high-quality rules, changes in the institutional infrastructure, such as the IUs and DRTs, insolvency specialists, and bankruptcy consulting services.

According to Shah (2018), 'state capacity development necessitates sequencing, in which the ecosystem learns to cope with small issues before tackling large challenges'. The premise is that the reform process should constantly be cognizant of the load-bearing capability of public administration and that raising the complexity of the request too quickly might result in a conclusion that is out of balance.[99] These challenges are very pertinent in the context of personal bankruptcy, which is inherently complicated and subject to political meddling if errors are made early on. Before being operational for all persons, it would be prudent to implement the system for a select group of borrowers, such as firms or personal guarantors. Alternately, the IBC may be rendered operational in order to award debt relief via the fresh start procedure in a more methodical manner, prior to operationalizing the settlement and bankruptcy processes.

[1] 3rd Survey of Ministry of Small-Scale Industries (2001-2002). The Ministry of Small Scale Industries is now designated as Ministry of Micro, Small and Medium Enterprises.

[2] Report of the Bankruptcy Law Reforms Committee (BLRC), November, 2015.

[3] Sahoo M. (2021), "Next phase of IBC implementation should be personal insolvency", *The Indian Express*, 3 October.

[4] The way forward for personal insolvency in the Indian Insolvency and Bankruptcy Code, No. 251, 2019.

[5] *Ibid.*

[6] Supra Note 2.

[7] White M. (2015), "Economics of Personal Bankruptcy and Insolvency", CESifo DICE Report, ISSN 1613-6373.

[8] Anagol S. et al. (2017), "Understanding the advice of commissions-motivated agents: Evidence from the Indian life insurance market", Review of Economics and Statistics, 99.1, pp. 1–15.

[9] Supra Note 4.

[10] Supra Note 2.

[11] Supra Note 4.

[12] Supra Note 2.

[13] Supra Note 8.

[14] Malhotra V. (2009), "Rethinking the Regime Against Dishonoured Cheques in India".

[15] Khosla R. (2018), "The changing face of Indian retail borrowing", *Live Mint*, 20 August.

[16] Supra Note 8.

[17] Supra Note 2.

[18] Supra Note 15.

[19] Supra Note 2.

[20] Supra Note 15.

[21] *Ibid*.

[22] Supra Note 15

[23] Livshits I. et al. (2007), "Consumer Bankruptcy: A Fresh Start", The American Economic Review 97, p. 402.

[24] Ramsay I. (2017), "Personal Insolvency In The 21st Century: A Comparative Analysis of the US and Europe", 156 Hart Publishing.

[25] Kilborn J. (2015), "Reflections of the World Bank's Report on the Treatment of the Insolvency of Natural Persons in the Newest Consumer Bankruptcy Laws: Colombia, Italy, Ireland", 27 Pace Int'l L. Rev. 306, p. 45.

[26] *Ibid.*, p. 46.

[27] *Ibid.*, p. 47.

[28] *Ibid.*, p. 50.

[29] *Ibid.*, p. 53.

[30] *Ibid.*, p. 56.

[31] *Ibid.*, p. 61.

[32] *Ibid.*, p. 64.

[33] *Ibid.*, p. 67.

[34] *Ibid.*, p. 68.

[35] *Ibid.*, p. 70.

[36] *Ibid.*, p. 75.

[37] *Ibid.*, p. 77.

[38] *Ibid.*, p. 79.

[39] *Ibid.*, p. 80.

[40] *Ibid.*, p. 84.

[41] *Ibid.*, p. 86.

[42] Section 78, IBC.

[43] Section 3(10), IBC.

[44] Section 79(15), IBC.

[45] Chapter III, Part III, IBC.

[46] Section 99, IBC.

[47] Section 101, IBC.

[48] Section 102, 103 & 104, IBC.

[49] Section 108(3), IBC.

[50] Section 114, IBC.

[51] Section 116 IBC

[52] Section 121, IBC.

[53] Section 125, IBC.

[54] Section 126, IBC.

[55] Section 128 & 154, IBC.

[56] Section 155, IBC.

[57] Section 129-137 & 178, IBC.

[58] Section 94(6).

[59] Section 105(2)b) & Section 178, IBC.

[60] Section 79(19), IBC.

[61] Section 80, IBC.

[62] Section 82, IBC.

[63] Section 81(4), IBC.

[64] Section 83, IBC.

[65] Section 84, IBC.

[66] Section 84, IBC.

[67] Section 92, IBC.

[68] Section 92(5) IBC.

[69] Feibelman (2005).

[70] Section 110, IBC.

[71] Section 172, IBC.

[72] Section 178, IBC.

[73] Section 100(2), IBC.

[74] Section 114, IBC.

[75] Section 178(3), IBC.

[76] Supra Note 23.

[77] Sullivan T. et al. (2003), "Who Uses Chapter 13?" in J. Niemi-Kiesilainen et al., "Consumer Bankruptcy in Global Perspective", Hart Publishing, pp. 269-8.

[78] Eraslan H. et al. (2017), "An Anatomy Of U.S. Personal Bankruptcy Under Chapter 13", International Economic Review, Vol. 58, No. 3, pp. 671-702.

[79] Walter G. (2020), "Personal bankruptcy: Model structures and the fresh start", Working paper, Corvinus University of Budapest.

[80] *Ibid.*

[81]Supra Note 7.

[82] White M. (2007), "Bankruptcy reform and credit cards. Journal of Economic Perspectives", Vol. 21, No. 4, pp. 175–99.

[83] Zhu N. (2011), "Household Consumption and Personal Bankruptcy", The Journal of Legal Studies, Vol. 40, No. 1.

[84] Gropp R. et al (1997), "Personal Bankruptcy and Credit Supply and Demand", The Quarterly Journal of Economics, Vol. 112, No. 1.

[85] Fossen F. (2014), "Personal Bankruptcy Law, Wealth, and Entrepreneurship—Evidence from the Introduction of a "Fresh Start" Policy", American Law and Economics Review, Vol. 16, No. 1, pp. 269-312.

[86] Walter G. and Krenchel J. (2021), "The Leniency of Personal Bankruptcy Regulations in the EU Countries", Risks 9: 162, pp. 1-20.

[87]Draghici C. (2015), "Insolvency of Individuals in European Legislation - Great Britain", 2015 CONF. INT'l DR. 173.

[88] Graziano T. et al. (2019), "A guide to consumer insolvency proceedings in Europe".

[89] Draghici C. (2015), "Judicial Treatment of Personal Bankruptcy in the European Union", 2015 LAW Annals TITU Maiorescu U. 78.

[90] Supra Note 88.

[91] Supra Note 7.

[92] The draft regulations on personal insolvency were published by the IDBI in December, 2017. While these regulations provided the details for a broad process to be followed, they were not accompanied by a broad objective and goals that the regulations' wished to achieve.

[93] World Bank's 2014 report provides a comprehensive analysis of the various choices regarding a personal insolvency regime.

[94] In the *L. Chandra Kumar case*, the SC lamented that Indian tribunals function insufficiently since there is no authority in charge of supervising and fulfilling their administrative requirements.

[95] The Damle & Regy report of 2017 informs about the shortfall in the number of judges in the NCLT in the context of the increasing case load from the IBC.

[96] As discussed in the report of FSAT Task Force led by Jt. N.K. Sodhi, in 2015, to provide administrative services to tribunals in the financial sector.

[97] See Anagol & Kim (2012); Halan, Sane & Thomas (2014); Sane & Halan (2017) for examples pertaining to consumer protection problems in the insurance and mutual fund industries in India.

[98] Existing professional organisations such as Institute of Chartered Accounts of India (ICAI), Institute of Company Secretaries in India (ICSI) and Institute of Cost Accountants of India (ICWAI) have been given the licence to perform as IPAs.

[99] Rai (2018) makes this argument in the context of the design of a privacy law.

10 CONCEPTUALISING IMPLEMENTATION OF THE INSOLVENCY AND BANKRUPTCY FUND

- Deepanshi Gupta

EXECUTIVE SUMMARY

The Insolvency and Bankruptcy Fund (Fund), administered by a Government-appointed Administrator, is specified to be made under section 224 of the Insolvency and Bankruptcy Code 2016 (IBC/Code). However, neither the Code nor the Bankruptcy Law Reforms Committee (BLRC) has shed much light on the sources, utilisation, administration and governance of the Fund. The current design of the Fund renders it difficult to receive contributions voluntarily due to a lack of incentives for contributors, limited utility and an ambiguous legal framework. This leaves elbow room for discussion and deliberation over the same to actualise its purposes and benefits. The rescue of viable businesses and closure of unviable ones are broader socio-economic objectives that ameliorate the sufferings of stakeholders. Accordingly, this paper attempts to throw some light on this topic to help enable a legal framework to govern the Fund.

Keywords: IBC, Insolvency Resolution, Fund, Sources, Utilisation, Administration, Section 224

INTRODUCTION

National laws are shaped by many influences. National insolvency laws, including private international law rules on insolvency, follow the same path. Only here, the influence of economic theories (and of law and economics, during the last decades) is even stronger. Many insolvency laws around the world have copied or transplanted or received foreign ideas or rules. This is something that first happened during the nineteenth century, when civil and commercial Codes were created in Europe and, after that, countries in other parts of the world, usually former colonies of European countries, tried to form their own legal systems, unavoidably influenced by their former colonizers. It also happened through the judicial system of the English colonies, which applied common law and equity, in order, to either fill the gaps of the local laws or form legal systems like the English.[1]

Section 224 of the Code provides for the formation of the Fund for the purposes of insolvency resolution, liquidation and bankruptcy of persons under the Code. It is administered by a Central Government-appointed Administrator.

Section 224 specifies four sources of funds to be credited to the Fund, namely —

(a) the grants made by the Central Government for the purposes of the Fund;

(b) the amount deposited by persons as a contribution to the Fund;

(c) the amount received in the Fund from any other source; and

(d) the interest or other income received out of the investment made from the Fund.

The current design of the Fund does not incentivise contributions to it and provides very limited ways of utilising the amounts contributed. This is because firstly, contributions to the Fund are voluntary and may be made by the Central Government in the form of grants and by any person who voluntarily wants to make such contributions. Receiving contributions voluntarily may be difficult in practice and certain incentives or mandates may be required to enable regular contributions.

Secondly, the purposes for which the Fund will be utilised are limited. Section 224(3) only allows persons who have contributed to the fund to withdraw it, to the extent of their contribution (principal amount along with interest thereupon), for making payment to workmen, protecting the assets of such persons, meeting the incidental cost during the proceedings. This limits the possible utilisation of the Fund.

Consequently, the Ministry of Corporate Affairs (MCA) has recently proposed to amend section 224 to allow the Central Government to prescribe a detailed framework for contribution to and utilisation of the Fund. Based on a study of similar comparable funds created by the Central Government and regulators, this framework may capture and detail various sources for contribution to the Fund. It may also capture amounts lying in the Companies Liquidation Account of the Companies Act, 1956 or the Companies Liquidation Dividend and Undistributed Assets Account under the Companies Act, 2013. Similarly, specific and wider uses of the Fund may also be identified. For instance, the Fund can support some expenses of resource-strapped insolvency proceedings, such as payment towards workmen's dues, carrying forward avoidance proceedings, etc.

RESEARCH OBJECTIVES

This paper aims at:

- Giving more clarity over the purpose of the Fund.
- Suggesting sources of funds or contributions to be made to the Fund
- Suggesting utilisation of funds
- Suggesting the administrative mechanism in as much as relates to the appointment and eligibility of the Administrator
- Analysing provisions over the same in an international paradigm to enable a comparative study
- Providing a framework of the legal provision under section 224 to regulate the Fund.

RESEARCH METHODOLOGY

It is a theoretical analysis of the study. Various reports published by regulatory bodies, legislation of foreign jurisdictions, primary data of IBBI, and other internet sources have been consulted to understand and analyse the issue of the Fund.

RESEARCH QUESTIONS

Considering little has been said about this Fund and the call for elaborated provisions by the MCA in its recent circular, this paper deliberates upon the following research questions:

- Who shall establish and administer the Fund?
- How will the Administrator be appointed?
- Who can contribute to the Fund and under what circumstances? How will the contributors be incentivised?
- How and for what purposes can the Fund, and surplus thereof, be utilised? Can any person other than the contributor withdraw from the Fund?
- Analysis of similar/ parallel provisions in foreign legislations
- What can be a proposed framework for revamped section 224?

I. Who shall establish and administer the Fund?

The purpose of the Fund is for the insolvency resolution, liquidation and bankruptcy of persons under the Code. This has a wider scope of interpretation. Thus, it implies the purpose of rehabilitation and revival of businesses in India. It denotes that the Fund must be utilised for the betterment of the stakeholders of the insolvency resolution process.

The Fund may be compared with the funds set up for the promotion and protection of investors, namely, the Investor Education and Protection Fund (IEPF) established by the Central Government under section 125 of the Companies Act, 2013 read with Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016 or the Investor Protection and Education Fund (IPEF) established by the Securities and Exchange Board of India (SEBI) under section 11 of the Securities and Exchange Board of India Act, 1992 read with SEBI (Investor Protection and Education Fund) Regulations, 2009. It is administered by the IEPF Authority set up by the Government or SEBI under the guidance of an Advisory Committee, as the case may be.

Further, to promote and protect the welfare of the consumers via research and training programming and initiatives for consumer literacy and awareness, the Department of Revenue, Ministry of Finance has established a Consumer Welfare Fund under the Central Goods and Services Tax Act, 2017. It is operated by the Department of Consumer Affairs, Ministry of Consumer Affairs, Food & Public Distribution in accordance with the Central Goods and Services Tax (CGST) Rules, 2017.[2]

Considering the above similarity in purpose and vision, the framework of IEPF can be a base guide to establish the framework of the Fund. In this light, the Fund may be established by the Central Government or the Insolvency and Bankruptcy Board of India (IBBI). Likewise, it may be administered by either IBBI or an Administrative Authority appointed by the Central Government, either individually or collectively. Considering the purpose and objective of the Fund, it is advisable to provide for collective administration of the Fund.

It is necessary to assess if the Fund is functioning and being administered with proper due diligence and in compliance with legal procedures. To assess the same, an annual audit is inevitable.

II. How will the Administrator be appointed?

Section 224 specifies that the Administrator of the Fund is required to be appointed by the Central Government. On those lines, the Administrator may either be an individual or a body. From the administrative point of view, a body or committee being appointed as an Administrator seems more suitable. Such a committee may have a Chairperson along with a Chief Executive and the requisite number of members. This administrative body shall also play the role of a fund manager of the corpus under section 224. Administration and fund management shall be done by qualified professionals having the necessary knowledge of the relevant fields.

III. Who can contribute to the Fund and under what circumstances? How will the contributors be incentivised?

Currently, the contribution to the Fund is voluntary. It may remain voluntary for any person to contribute and allows him to withdraw to the extent of contribution to meet expenses of a proceeding under the Code. However, it shall be broadened to include:

- contributions even without the intention of withdrawing, and
- withdrawals even without contribution.

Contribution to the Fund may come from various sources ranging from grants by Governments to donations to disgorgements. However, it is an indisputable fact that the corporate insolvency resolution process (CIRP) itself may generate certain profits during the moratorium period. For instance, in the CIRP of Essar Steel, monthly measurement and monitoring led to the generation of the largest profits during CIRP under the Code.[3] Since profits during CIRP are generated due to the supportive framework of the Code, the resolution applicant shall not be allowed to reap those benefits at the cost of the existing stakeholders of the corporate debtor (CD). Accordingly, the profits yielded during the CIRP period shall be contributed to the Fund.

Furthermore, wherever possible, the contributions shall be incentivised to encourage contributions from different stakeholders. Incentives may be in form of tax benefits or relaxation of compliance requirements, etc. One incentive can be in form of fulfilment of the compliances pertaining to corporate social responsibility (CSR). This will encourage contributions from corporates in lieu of their CSR activities. However, it puts forth a question as to how CSR is linked with insolvency proceedings.

The objectives of the Code, i.e., promotion of entrepreneurship and balancing of interests of all stakeholders signify that when a company goes into liquidation, it is not only the company but also its stakeholders who bear the brunt of it. They can be considered as part of an organization's social accountability. Insolvency involves various stakeholder groups, namely:

a) internal stakeholders: managers, owners (shareholders) and employees; and

b) external stakeholders: creditors, customers, suppliers, society, state, banks, the court conducting bankruptcy proceedings.

Therefore, assisting a corporate in its insolvency resolution is not only the economic objective but is also in public (stakeholders') interest.

Employees of liquidating firms are likely to lose income and the non-pecuniary benefits of working for the firm, making bankruptcy costly for employees. Therefore, an attempt to save work positions in an enterprise at risk of bankruptcy is mostly aligned to the CSR concept.[4] In the case of corporate insolvency, employees' and pensioners' claims are social claims in the sense that they contribute to the social support and social fabric of countries in dealing with a more vulnerable segment of the population. Hence, despite being allotted the priority status in the creditors' list as having economic claims, there is every chance that the employee will not receive any payments for their claims. Accordingly, the company insolvency and satisfaction of employee claims, that range from wages, health and disability benefits to the issue of pension commitments, entail corporate social responsibility.[5] Considering the high-potential impact, the above elucidation justifies the inclusion of insolvency resolution as a CSR activity.

In this sense, the proposed framework elucidates the possible sources to the Fund, with specified incentives for contributors.

IV. How and for what purposes can the Fund, and surplus thereof, be utilised? Can any person other than the contributor withdraw from the Fund?

At present, section 224 allows it to be used or withdrawn only by persons who have contributed to the fund, to the extent of their contribution, for making payment to workmen, protecting the assets of such persons, and meeting the incidental cost during the proceedings. However, this limits the applicability and use of the Fund. Further, if only a contributor can withdraw, it puts forth several questions:

a) What is the purpose of establishing a Fund, as in this scenario the contributor can himself save or invest it to be used later?

b) Why should the State bear the costs of administering a Fund that can be utilised only for specific persons and not by the general public?

c) Why should a person contribute to the Fund in absence of any incentives?

The aforementioned questions make it clear that non-contributors should also be allowed to utilise the Fund in accordance with the conditions and procedure, as may be prescribed. Further, the existing section does not clarify how shall the surplus arising out of the investments made by the Fund be treated. Henceforth, the proposed framework takes into account these aspects.

V. Analysis of similar/ parallel provisions in foreign legislations

Several countries have acknowledged the need for safeguarding the interests of employees in an insolvency process. This is because the monetary loss is recoverable with time, but the hardships faced by the insolvency of their employers not only render them jobless and financially impaired but may also leave dark imprints. The guarantee mandate of the European Union requires that its member states establish guarantee funds that provide for a minimum level of payment for employee claims. Insurance guarantee schemes provide last-resort protection to consumers when insurance companies are unable to fulfil their contractual commitments. They protect people against the risk that claims will not be met if their insurer becomes insolvent.[6]

Two International Labour Organization (ILO) Conventions (1949 and 1992) and one ILO Recommendation (1992) specifically address worker claims in the event of enterprise insolvency. ILO Conventions are legal instruments, which on ratification create legal obligations and lay down the basic principles to be implemented by ratifying countries. ILO Recommendations are not open to ratification but can supplement a convention by providing more detailed guidelines on how they could be applied in legislation, policies, or practice.

Article 11 of the Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173), ratified by 21 countries to date, and Protection of Workers' Claims (Employer's Insolvency) Recommendation, 1992 (No. 180) establish two ways in which workers can make wage claims:

a) Assigning privilege to their claims so that they are paid out of the assets of the insolvent employer before non-privileged creditors can be paid their share.

b) Their claims shall be guaranteed through a guarantee institution when payment cannot be made by the employer because of insolvency.[7]

Several countries have a preference system for giving privileges to employees and workers. For instance, the Chinese Enterprise Insolvency Law provides that for bankruptcy distribution, workers' wages, labour insurance premiums and other workers' claims shall be paid with first priority.[8] Further, China engages in systematic retraining and job referral services as an aid to workers recovering from job loss due to insolvency. The Colombian Civil Code establishes the preference and order in which creditors must be paid.[9] Similarly, Nepal, Singapore, etc. also carry provisions for preferential or priority regimes with respect to the claims of employees instead of any designated funds for the purpose.

However, the problems associated with limited priority systems as inadequate to protect employees' compensation claims and guarantee funds as potentially creating inappropriate incentives, can be addressed by implementing a combined wage priority and guarantee fund system. A guarantee fund can be designed to pay employee claims immediately when the resources are most needed. The claim is then subrogated and a statutory priority to recover the amount of the claim means that the fund's costs are partially covered by the insolvent firm that caused the pay-out. A healthy mix of priority/preference claims systems and some form of guarantee fund or insurance could be an appropriate mechanism to protect employee claims during insolvency. Those systems that offer only one form of protection tend to under-protect employee claimants in terms of their relative risks associated with firm insolvency. However, the optimal mix of priority and guarantee systems depends a great deal on the economic and social structure of each country, on the composition of the workforce, on the financial stability of the sectors in which corporate activity is most concentrated and on the availability of other social safety nets. Guarantee funds and insolvency insurance schemes for wage protection are means of protecting employee wage claims during insolvency. Numerous jurisdictions have chosen to create wage guarantee funds or comprehensive insurance systems that are aimed at redressing the problems faced by employees in realizing their wage claims.[10]

Several countries have thus opted to establish such guarantee funds which are comparable to the existing Fund of India. There are not many examples of Funds for insolvency and bankruptcy purposes. However, guarantee funds with similar purposes inclining towards employees' protection are prevalent across major economies. Such Funds are elucidated below:

(i) **Austria -** Austria's Insolvenz-Ausfallgeld-Fonds is funded primarily through a premium payable by employers on their annual unemployment insurance contribution, which is payable pursuant to the Labour Market Policies Funding Act. In addition, it receives recoveries from the employee claims it has paid out, through recoveries from the insolvent estate, interest payments on the fund's assets, and from fines imposed on employers (S. 16 of the Insolvency Wage Protection Act, 1977). Although not funded by state revenue, the fund is subrogated to the claims of employees.

(ii) **Germany -** It offers a different model of a combined system. The Insolvency Code of 1994 ranks employees with unsecured creditors on a *pari passu* basis. Rather than a wage preference for employee wage claims, it has an 'industry-funded' wage protection fund for wage claims during insolvency. The employers' associations require payment from enterprises, the share depending on the total sum of wages of all socially insured employees, including quarterly advance payments and one final payment. This method of funding ensures adequate capitalization. The statutory provisions create the fund.[11] There is, however, the possibility of using a social welfare plan for employees that face severe disadvantages due to a firm's insolvency, whereby employees are awarded first priority in insolvency, with a limitation to one-third of all assets.[12]

Following are some of the mixed or combined systems having both wage priority and guarantee funds for treating insolvency claims (particularly wage claims).

(iii) **Japan -** Article 308 of the Japanese Civil Code treats an employee's wage and retirement payment claims as preferential claims. Besides, the government-backed/ government-affiliated funds, in different incarnations, have played a significant role in company restructurings in Japan since the early 2000s. Currently, the fund is established in form of a company named 'Regional Economy Vitalization Corporation of Japan' (REVIC). REVIC, a state-owned organisation, facilitates work-outs by co-ordinating the procedures applicable to lenders and providing financing to debtors.[13] Although restructuring support for small to middle-sized companies is at the forefront of REVIC's mandate, it can assist large-sized companies with the approval of the responsible minister. Its track record of success has generated wide recognition in Japan for the use of public funds for the rehabilitation of companies in distress. For instance, with the assistance of REVIC, the rehabilitation of Miyazaki Car Ferry not only kept people employed at the company but also kept in service its ferry routes that are a lifeline for the economy of *Miyazaki Prefecture*, enabling the reliable shipment of regional products.[14] However, it has also been criticised as the support provided by the government-backed rehabilitation funds has artificially propped up failing businesses to the detriment of competition and innovation as a whole in the debtor's industry. Accordingly, academicians have pressed the need for continued monitoring and collection of data to truly determine their success.[15]

(iv) **Denmark** – Its wage protection fund (Lønmodtagernes Garantifond) for wage claims during insolvency, created in 2005, is employer/industry-funded. The Fund provides relief to workers and, at the same time, avoids the distressed company's limited cash flow being used as security for the mandatory guarantees for wages that could jeopardize a successful restructuring and prevention of job loss.

(v) **Dominican Republic** - For overdue salaries and wage claims in case of insolvency, the guarantee will be set up as an insurance policy contracted by the employer with an insurance company and notified to the Labour Ministry. This guarantee should be funded in a way similar to other insurance policies and specifically, it should be funded by the employer. It is to be noted that it has not been implemented yet due to the fact that pursuant to Article 738 of the Dominican Labour Code, such Guarantee was to be ruled by means of a Tripartite Agreement among the Dominican State, the workers and the employers. To date, no such agreement has been reached.[16]

(vi) **Finland -** It has established a Wage Guarantee Fund in 1993 which is funded by all employers collectively, with each employer contributing 0.05% of employee wages. It is administered by the Uusimaa ELY Centre (Central Government).

(vii) **France -** Complementary to the priority system, France has guaranteed insurance for wage claims called Assurance de Garantie des Salaires. The Assurance de Garantie des Salaires is funded by employer contributions. All employers are liable for guaranteed insurance for wage claims, pursuant to section L.143-11-1 of the Labour Code. This structure ensures that the system is sufficiently funded. It covers the sums owed for work within a limit calculated according to the length of employment. There is also a compulsory insurance fund called the AGS.

(viii) **Ireland -** Certain limited claims of employees and the Irish Revenue Commissions have priority status ranking above the claims of holders of floating charges and the unsecured creditors. The Insolvency Payments Scheme of Ireland protects the former employees of companies that have become legally insolvent, with a limit of eight weeks and that have become due in the 18 months prior to the date of insolvency or employment termination, and with gross weekly wage being capped at ∈ 600.[17]

(ix) **Israel -** The National Insurance Law sets an arrangement in section 182 parallel to preference and super-priority regimes, according to which the National Insurance Institute is liable for wage claims that were approved by the trustee/liquidator.

(x) **Italy -** A special public fund, the CIG, is used to protect employees' income. It is financed by companies and the state and is administered by the National Institute of Social Insurance. All claims that have arisen during the previous three months of the employment relationship and within the last 12 months before application are covered.

(xi) **Korea -** Pursuant to Article 17 of the Wage Claim Guarantee Act of Korea, the Minister of Labour establishes a wage claim guarantee fund to apply to wage claims paid by the government instead of employers who have failed to pay owed wage amounts. This fund is established with financial resources consisting of recovered amounts by the exercise of subrogation right by the Minister of Labour, charges from employers, borrowings from financial institutions (FIs), and profits accruing from the management and operation of the fund.

(xii) The Netherlands - In cases of bankruptcy, employees' pay, and unpaid premiums constitute debts that are paid directly out of the estate with preference over the claims of other creditors. The employees have to claim the benefits from the Employee Insurance Agency (UWV), which itself carries a preferential status in order of priority of payments by the insolvent company.[18] There is no minimum duration of the employment relationship in order to be eligible. Part-time and fixed-term workers are also eligible, alongside employees with permanent contracts. Domestic civil servants that usually work fewer than three days a week are excluded from the pay guarantee regulation. Costs of the UWV are covered by companies, employees, national government.[19] It involves national government and public employment services for administration.

(xiii) Spain - Under the Spanish Insolvency law, the special insolvency state fund (FOGASA) is addressed to workers whose employer has been declared insolvent or bankrupt, or who had to stop paying wages for certain economic reasons. This guarantee, covering wages, bonuses and fringe benefits as well as financial employee participation that arises up to one year before the insolvency, becomes active only if there are not enough assets available. It is managed by the guarantee institution FOGASA of the Ministry of Employment and financed by employer contributions.[20] FOGASA funds a certain portion of wage dues on the basis of the daily National Minimum Wage. In terms of severance pay, FOGASA covers an amount acknowledged by a court sentence or resolution of the labour authority. In the first four months of the year 2021, a total of 169.5 million euros have been paid, of which 99.7 million euros responded to compensation and 69.8 million to salaries.[21]

(xiv) Thailand - The wage guarantee fund in Thailand is known by the name of the Employees' Provident Fund, created under the Labour Protection Act, 1998. It is funded by both employer and employee contributions. These sources of funding are sufficient for the Provident Fund's needs and benefits available under the Provident Fund include unpaid wages not exceeding 60 times the amount of the monthly payment.[22]

The above examples clearly depict the favourable position for employees in these countries. The existing section 224 is also on similar lines when allowing utilisation of the Fund for payment of workmen dues. However, it is prone to misuse if strict restrictions based on income criteria are not imposed; it is imperative to mention that not all employees can be under the purview of this Fund. Employees with handsome pay have more capacity to take haircuts than first-level employees, wage workers or labourers. With this spirit, income criteria must be specified for employees to be eligible to get their claims settled with the help of the Fund. Further, the Fund of Australia and the United Kingdom are closer to what India aims to achieve with an 'Insolvency Fund'.

(xv) Australia - In addition to the limited current priority over unsecured claims, the Australian insolvency system has a wage protection fund, thereby providing a relatively high degree of protection for employees during insolvency. Section 305 of Australia's Bankruptcy Act, 1966 deals with the payment of expenses by the Commonwealth. It is intended to facilitate the proper carrying out of the trustee's statutory and fiduciary duties. Funding may only be approved if the Minister or the delegate is satisfied that the amount in the estate of the bankrupt, the debtor or the deceased person are or may be insufficient to meet the costs of proposed proceedings or inquiries. An approval for Commonwealth funding of an activity may be subject to any conditions the Minister or delegate thinks fit (including conditions as to taxation, amount of counsel fees and reimbursement).[23]

Funding may be approved where:

(a) either the trustee has reasonable prospects of a successful outcome in proceedings, or the trustee should defend an application for a review of a decision; or

(b) the actions of the bankrupt or debtor give rise to the inference that the bankrupt or debtor is intentionally breaching their obligations or duties under the Act; or

(c) a significant question of law has arisen that requires resolution.

Funding is ordinarily not be approved for instituting proceedings unless:

(a) the trustee has approached creditors, or exhausted alternative opportunities for litigation funding (funding will generally not be provided merely on the basis that creditors have refused to provide cash or indemnities);

(b) the delegate is satisfied that undertaking the litigation is consistent with the Performance Standards for Trustees in Schedule 4A of the Bankruptcy Regulations;

(c) the delegate is satisfied that it would be appropriate to commence the litigation; and

(d) the trustee has obtained legal advice on the proposed proceedings.

Funding is provided to a trustee under Part X of the Act only in exceptional circumstances, due to the voluntary and commercial nature of personal insolvency agreements, the disclosures required by the debtor, and the preliminary investigations that need to be made by controlling trustees prior to creditors voting on the proposal.[24] Funding for inquiries to locate a bankrupt who cannot be located will ordinarily be limited to $500 for local inquiries and $800 for Australia-wide inquiries (inclusive of GST). A direction is not ordinarily given unless the trustee has taken reasonable steps to locate the bankrupt.

(xvi) United Kingdom - The Insolvency Regulations 1994 require Official Receivers and Insolvency Practitioners to pay into the Insolvency Services Account (ISA) at the Bank of England money received by them in the course of their administration of bankruptcies and compulsory liquidations. Voluntary Liquidators may also deposit funds into the ISA. The regulations also provide for payments from the ISA of disbursements, expenses and distributions to creditors and contributors in company liquidations (regulations 7, 8, 22 and 23). The ISA is administered by the Estate Accounts Services of the Insolvency Service.

By virtue of section 403 of the Act, when the Secretary of State has excess cash in the ISA[25] the excess amount is remitted to Commissioners for the Reduction of the National Debt (CRND) for investment in the Insolvency Services Investment Account (ISIA). ISIA is maintained by CRND and when the balance in the ISA is insufficient to meet demands, CRND makes good the shortfall from the ISIA. Under paragraph 16 of Schedule 8 to the Act, income earned on these investments is drawn down by the ISA to pay its liabilities of interest to insolvent estates and the associated tax is paid directly to HM Revenue & Customs (HMRC) by ISIA. Section 408(1) of the Act enables HM Treasury to make payments from the Consolidated Fund to the ISIA to meet any shortfalls in the investment account. Investments are realised to make repayments to the ISA to meet the demands in respect of bankrupts' or companies' estates.[26]

Section 407 of the UK Insolvency Act, 1986 deals with unclaimed dividends and undistributed balances and requires the Secretary of State to pay into the Consolidated Fund out of the ISA so much of the sums standing to the credit of that Account. For the purpose of this section, the sums standing to the credit of the ISA are deemed to include any sums paid out of that account and represented by any sums or securities standing to the credit of the Investment Account.

The Fund is utilised for various purposes pertaining to the administration of winding up and bankruptcies. Under regulation 7(1) of the Insolvency Regulations 1994, the liquidator shall be repaid all necessary disbursements made by him, and expenses properly incurred by him, in the course of his administration to the date of his vacation of office. Pursuant to regulation 8(3), in the case of a voluntary winding up, where the liquidator requires to make payments out of any money standing to the credit of the company in the ISA by way of distribution, the Secretary of State provides for it accordingly. As per regulation 9(8)(b), funds may be utilised for the immediate purposes of the winding up. Under Part 5, it may provide for the remuneration of the Official Receiver.[27] It may also be utilised for payment of Payment Protection Insurance (PPI) claims of bankruptcy estates.

A tabular representation for comparative analysis of related funds in foreign jurisdictions:

Sl.	Country	Related Fund	Sources of fund	Uses of fund	Administrator
1.	Japan	Guarantee Scheme + REVIC	Funded by the shareholders of the company, i.e., Deposit Insurance Corporation of Japan, and the Norinchukin Bank	Coordinate the creditor arrangement process and facilitate agreements on haircuts; purchases loan receivables with management guarantees and organize all financial debts	Managed in collaboration with FIs, etc.
2.	Denmark	Wage protection fund	Employer/ industry-funded	Outstanding wages and related compensation claims to employees	-
3.	Dominican Republic	The guarantee will be set up as an insurance policy contracted by the employer with an insurance company	Funded in a way similar to other insurance policies; by employers	Wage claims	Managed by insurance company. Accountable to Labour Ministry.
4.	Finland	Wage Guarantee Fund (national pay security system)	Employer's contribution to unemployment insurance.	Covers all claims that have become due within the three months before applying for the guarantee, irrespective of the duration of the employment or the type of contract.	Uusimaa ELY Centre (Central Government)
5.	France	Insurance Fund (Assurance de Garantie des Salaires)	Employer contributions	Covers the sums owed for work within a limit calculated according to the length of employment	Official Receiver
6.	Ireland	Insolvency Payments Scheme		Claims of employees	
7.	Israel	National Insurance Institute		Severance pays and wages	Trustee/ Liquidator

Sl.	Country	Related Fund	Sources of fund	Uses of fund	Administrator
8.	Italy	CIG	Financed by companies and the state	Employees' income	National Institute of Social Insurance
9.	Korea	Wage claim guarantee fund	Payments made by employers; Charges paid by employers; Borrowings from FIs; Revenues from the operation of the Fund; Other revenuesre covered amounts by the exercise of sub rogation right by the Minister of Labour; Profits accruing from the management and operation of the fund	wage claims; expenses incurred in relation to assistance from a certified labour consultant; provide employers with loans necessary to pay overdue wages; repay borrowings and interest accrued thereon; make contributions to the Korea Legal Aid Corporation, limited to support for legal aid services for workers with overdue wages, etc.; carry out projects for wage claim guarantee, manage and operate the Fund.	Minister of Employment and Labour
10.	Netherlands	Wage guarantee fund	Companies; Employees; National government	Claims of employees with the exclusion of certain employees	Managed by UWV Accountable to National government
11.	Spain	FOGASA	Contributions by employers	Covers wages, bonuses and fringe benefits as well as financial employee participation that arises up to one year before the insolvency.	
12.	Thailand	Wage guarantee fund in Thailand called the Employees' Provident Fund	Funded by both employer and employee contributions	Covers unpaid wages not exceeding 60 times the amount of the monthly payment	
13.	Australia	Wage Protection Fund; Payment of expenses by the Common wealth	Commonwealth	Insolvency expenses	Approvals by the Administrative Appeals Tribunal
14.	United Kingdom	ISA	State sources & voluntary contributions;	Income earned on investments is used to pay interest & tax to	Managed by Estate Accounts Services of The

Sl.	Country	Related Fund	Sources of fund	Uses of fund	Administrator
			Official Receivers & IPs pay the money received by them in the course of their administration of bankruptcies and compulsory liquidations; Estate monies; CRND invests money into ISIA;From realised investments, when needed to make repayments to ISA to meet the demands in respect of bankrupts' estates.	individual estates; Meet the demands in respect of bankrupts' or companies' estates; Repayments to Liquidators & trustees of necessary disbursements made and expenses properly incurred in the course of their administration; Payment of dividends to creditors in respect of debts owed to them and distributions to contributories in company liquidations; PPI claims dues of bankruptcy estates.	Insolvency Service. Accountable to the Parliament.
15.	Austria	Insolvenz-Ausfallgeld-Fonds	The premium payable by employers on their annual unemployment insurance contribution; recoveries from the employees' claims it has paid out; recoveries from the insolvent estate ;interest payments on the fund's assets;fines imposed on employers	Wage claims	Federal Minister of Economics and Labour
16.	Germany	Wage protection fund	Industry-funded	Employee claims; social welfare plan for employees	

Source: Original (Self-Compilation)

VI. Proposed framework

Section 53 of the Code creates a waterfall mechanism that obliges payments to be made in the order of priority specified therein. After the first priority given to the insolvency resolution process costs (IRPC) and liquidation costs, workmen's dues during the 24 months preceding the liquidation are ranked *pari passu* with secured debts, followed by dues to employees other than workmen. This clearly signifies that, like labour laws, the Code has also demarcated between workers and employees.

However, employees may also be not much better off than workers and this demands a change in our approach to catering to the woes of both workers and employees. To prevent misuse of the provision by high-paid employees, a maximum limit on the annual income of the employees needs to be prescribed as an eligibility criterion.

Further, despite being ranked higher the claims of employees and workers may remain unpaid and they may have to take a haircut. This worsens the woes of unemployment of both workers and employees because, unlike other creditors like FIs, etc., they do not carry the financial capacity to bear the brunt of haircuts.

The utilisation of the Fund shall not be restricted to the claims of employees and workers but shall also be extended towards other purposes of social welfare.

In this light, Section 224 may be amended as follows:

Section 224: Insolvency and Bankruptcy Fund.

(1) There shall be formed a Fund to be called the Insolvency and Bankruptcy Fund (herein referred to as the "Fund") for the purposes of insolvency resolution, liquidation and bankruptcy of persons under the Code.

(2) There shall be credited to the Fund the following amounts, namely—

a) the amount[28] given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

b) donations given to the Fund by the Central Government, State Governments, or any other institution for the purposes of the Fund;

c) the amount deposited by persons as a contribution to the Fund on a voluntary basis;

d) contribution in lieu of corporate social responsibility obligations;[29]

e) when no claimants are there in liquidation proceeds or realisations from avoidance transactions, such unclaimed money shall be credited to the Fund;

f) the amount disgorged by any person, pursuant to the direction issued under clause (4) of section 220 of the Code or otherwise;

g) the monetary penalties received by Insolvency Professionals, Insolvency Professional Agency or promoters or directors of a corporate debtor under the order of the Disciplinary Committee;

h) the component of interest on the amount lying in Companies Liquidation Account under the Companies Act, 1956 or Companies Liquidation Dividend and Undistributed Assets Account under the Companies Act, 2013 pursuant to the reason of inability to pay debts in compulsory liquidation and voluntary liquidation;

i) any amount received as donations by taxpayers in lieu of tax deduction under section 80G of the Income Tax Act, 1961;[30]

j) any amount received as investment in schemes of the Fund in lieu of non-taxable income on such investment;[31]

k) funds so recouped under clause (6) of this section;

l) a corporate debtor, whose insolvency has been resolved under this Code, shall contribute to this Fund a percentage of the amount as may be notified by the Central Government, irrespective of the fact that he did not utilise this Fund;

m) the interest or other income received out of the investment made from the Fund;

n) Such other amount as may be prescribed; and

o) if necessary for the operation of the Fund, it may borrow from FIs or other funds at the cost of the Fund.

Explanation to sub-section (2)

One may also contribute without any intention of withdrawing.

Explanation to clause (l) of sub-section (2)

The contribution shall be compulsory for persons who use or get any benefit from the processes under the Code. The manner and mode of contribution shall be as may be specified by the Central Government. For example, a financial creditor may be required to contribute ₹ 100 for every ₹ 1 crore recovery by him from a resolution or liquidation process.

(3) The Republic of India works on the principle of social welfare and this Fund may be utilised for the social welfare activities within the ambit of insolvency and bankruptcy law. The Fund may, therefore, be utilised for all or any of the following purposes:

a) A person who has contributed any amount to the Fund, once his application for insolvency resolution under this Code is admitted by the Adjudicating Authority, may make an application to the Administrative Authority for withdrawal of funds not exceeding the amount contributed (and interest accrued thereon) by it, for:

   (i) making payments to employees, protecting the assets of such persons, meeting the incidental costs during the proceedings or such other purposes as may be prescribed.

   (ii) meeting expenses of their resource-strapped insolvency proceedings,

   (iii) carrying forward avoidance proceedings,

   (iv) facilitation of fresh start,

   (v) any other expense as the Administrative Authority of the Fund may deem fit.

   Provided that any non-contributor may also utilise the fund for the purposes above-mentioned in the sub-clauses (i) and (iii), once his application for insolvency resolution under this Code is admitted by the AA, by making an application to the Administrative Authority in this regard.

b) Claims of organisations for a social cause or national defence may be settled via this Fund, subject to the discretion of the Administrative Authority;

c) For advocacy and awareness activities, research and publications;

d) For conducting a forensic audit, where it is considered necessary by the Insolvency Professional in the public interest and funds are not available with the corporate debtor;

e) For meeting salary, allowances and other expenses of the office of Administrative Authority;

f) For meeting expenses of the governments relating to the creation of infrastructure of insolvency and bankruptcy in the country;

g) For providing interim finance to persons undergoing insolvency resolution process under the Code, from a date as may be notified by the Central Government.[32]

h) For any other purpose, as may be identified by the National Company Law Appellate Tribunal or the Supreme Court of India.

Explanation to clause (a)(i) of sub-section 1

1. While making payments to workmen or employees, the following conditions must be satisfied:

   (i) The income of the employee does not exceed the amount specified by the Central Government.

   (ii) Only those workers' claims may be satisfied from this Fund which has been accepted by the resolution professional during CIRP.

   (iii) Workers whose claims are guaranteed by another fund are to be excluded.

2. For the purposes of this section, employees include workmen.

(4) To utilise the Fund for the purposes of clause (3), an insolvency professional responsible for the proceeding may file an application, with respect to such proceeding, to the Administrative Authority of the Fund in the form and manner, as may be prescribed under the rules. The Administrative Authority shall either approve or reject the application within seven working days from the date of application.

(5) Any surplus arising out of the investment made from the Fund shall be reinvested or utilised for the purposes of this Fund only.

(6) Any amount withdrawn or provided for corporate insolvency resolution process under clauses (3) and (4) shall be recouped to the Fund by the corporate debtor where either:

   (i) profits are earned during the corporate insolvency resolution process,[33] or

   (ii) the corporate debtor has been recovered or revived.

(7) The Central Government, in consultation with the chairman of IBBI, shall constitute authority for the administration of the Fund, by notification, with such members as prescribed under clause (8).

(8) The Authority appointed under clause (7) shall consist of:

   - Chairperson
   - Members who possess appropriate skills, experience and knowledge in finance and one or more fields of law, management, administration, research, corporate governance, technical operations.
   - Representatives of IBBI, MCA, and any other relevant regulator, ministry or body.

(9) The manner of administration of the Fund, appointment of chairperson and members, and holding of meetings of the authority shall be in accordance with such IBBI regulations as may be prescribed.

(10) The administrative authority, appointed under sub-section (7), shall be governed by such IBBI Regulations, as may be prescribed[34] and submit a quarterly report to the Governing Board of IBBI, in such manner as may be prescribed by IBBI.

(11) It shall be competent for the authority constituted under sub-section (7) to spend money out of the Fund for carrying out the objects specified in sub-section (3).

(12) The accounts of the Fund shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and such audited accounts together with the audit

report thereon shall be forwarded annually by the authority to the Central Government.

(13) The authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report provided by the Comptroller and Auditor-General of India to be laid before each House of Parliament.

CONCLUSION

The concept of insolvency fund had preserved under Indian laws with different names like Rehabilitation and Insolvency Fund under section 269 of the Companies Act, 2013 and section 441C of the Companies Act, 1956. However, it was replaced by the Fund with the advent of the IBC. Yet, the fund remains inoperative to date. The in-depth analysis of foreign jurisdiction signifies that the insolvency fund is not nascent to the world, rather operates for years for the benefit of stakeholders, especially workmen and employees, of the insolvent persons.

With this guiding spirit, this research has paved a supportive ground for legislators to establish an operative framework of the Fund. It has the potential to enhance the insolvency resolution processes, ameliorates the position of most affected stakeholders and supports a robust rehabilitation mechanism in the nation.

The scope of this paper leaves behind the applicability of the utilisation of Fund in case of insolvency resolution process of non-contributory financial service providers, which may require future research.

The author would like to extend a special thanks to Ms. Kokila Jayaram (DGM, IBBI) and Mr. Asit Behera (Manager, IBBI) for their continuous guidance, support, reviews, and valuable insights on this research study.

[1] Moustaira E. (2019), “Influences: Legal Transplants”, International Insolvency Law: National Laws & International Texts, Springer.

[2]Consumer Welfare Fund, Press Information Bureau, 2nd Feb, 2021.

[3] Case Study, IIIPI, “The Journey of Resolution of Essar Steel India Limited (ESIL) under IBC”, pp. 8-9.

[4] Bauer K. and Krasodomska J. (2015), “The premises for corporate social responsibility in insolvency proceedings”.

[5] Yury K.(2020), “Social Responsibility Aspects of Companies’ Insolvency”, Journal of Corporate Responsibility and Leadership.

[6] Review of insurance guarantee schemes, European Union.

[7] ILO (2020), “Protection of workers’ wage claims in enterprise insolvency”, May 18.

[8]Weiguo W. (2006), “The order of payment of workers’ claims and security interests under China’s new bankruptcy law”, April 28.

[9] Articles 2488 to 2511, Colombian Civil Code.

[10] Supra Note 7.

[11] *Ibid.*

[12] Omar P. (2008), “Widening the Insolvency Lens: The Treatment of Employee Claims”, International Insolvency Law: Themes & Perspectives, Ashgate.

[13] Restructuring and Insolvency in Japan: Overview.

[14] Restructuring and Insolvency in Japan: Overview, DBJ, 2018.

[15] Nihei Z. and Fujita M., “Japan’s Government-Backed Rehabilitation Funds Taking Stock of Over a Decade of Company Restructurings”, International Insolvency Institute, 16th Annual International Insolvency Conference, Tokyo, Japan, June 6, 2016.

[16] Fernández M. and Alcántara M., “Recent Developments in Dominican Insolvency Proceedings”, Emerging Markets Restructuring Journal.

[17]Insolvency Payments Scheme, Dept Of Social Protection, August 8, 2019.

[18] Expert Guide To Restructuring And Insolvency Law, CMS.

[19] Netherlands: Wage guarantee in case of insolvency , Article 61-68 (Chapter IV), EMCC, June 18, 2021.

[20] Insolvency guarantee fund, EMCC, Eurofound, August 3, 2021.

[21] The Government speeds up Fogasa payments to avoid new collapses due to the rise in files, Castellon Square, May 31, 2020.

[22] Supra Note 7.

[23] The provision of funding for trustees under section 305 of the Bankruptcy Act 1966, AFSA, January 4, 2021.

[24] Legal and Governance Guideline, Australian Financial Security Authority, January 4, 2021.

[25] Insolvency Act, 1986.

[26] Insolvency Services Account 2009-2010, London, July 26 2010.

[27] Insolvency Regulation 1994.

[28] It must be decided upfront by the Parliament.

[29] This will require an amendment in Schedule VII of the Companies Act 2013 to this effect, as either under clause (ix) of this Schedule or as another entry. A Proposed amendment under clause (ix) of the Schedule VII is as follows:

> "(ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; or any other fund set up by the Central Government for the revival of businesses in Indian economy and protection of the stakeholders thereof;"

[30] This will require an amendment in Section 80G of the Income Tax Act, 1961 to this effect through insertion of a new clause to this Section. A Proposed amendment under Section 80G is the insertion of a clause (iiihn) as follows:

"The sums referred to in sub-section (1) shall be the following, namely: —

> (a) any sums paid by the assessee in the previous year as donations to—
>
> (iiihn) Insolvency and Bankruptcy Fund as established under Section 224 of the Insolvency and Bankruptcy Code 2016."

[31] This would require an amendment under Section 80C of Income Tax Act, 1961 as an allowable deducation.

[32] For the initial years of operation, the Fund may not be utilised for the purposes of providing interim finance. However, it may be put to this use from a later notified date.

[33] Reasoning and intent behind such recoupment is mentioned in research question III of this paper.

[34] The Regulations may provide for the rules pertaining to inspection of the Fund and other related matters.

11 THE ROAD LESS TRAVELLED – ADVOCATING FOR SPECIAL SITUATION FUNDS AS A VIABLE SOLUTION IN THE INDIAN DISTRESSED ASSET MARKET

-Dhruv Kohli and Alankrita Pathak

EXECUTIVE SUMMARY

The Indian financial sector is struggling, and the stressed asset market is still approximately USD 150+ billion. While the amount recovered by asset reconstruction companies (ARCs) as a percentage of the total amount involved was substantially larger in the early years of their establishment, it has fallen below 30% in subsequent years, with the exception of a surge in 2017–18. Alternate Investment Funds (AIFs) are already allowed to invest in ARC security receipts and/or troubled company securities, but Special Situation Funds (SSFs) will also be allowed to purchase stressed loans. To aid in the settlement of stressed assets, some SSFs have also been granted extra exemptions/benefits over and beyond standard AIFs. This research aims to discuss the adoption of the SSF concept from international markets as well as the specific features of this type of investing. It is envisaged that such an adoption will prove to helpful in the context of the current distressed asset market of India.

Keywords: Distressed Assets, Reconstruction, Vulture Funds, SSF, ARC

INTRODUCTION

The pandemic has been described as an event having a more negative impact than the financial breakdown of the Great Recession in 2007–2009 due to enterprises, corporations, and firms experiencing unprecedented problems.[1] A number of economic, political, and social upheavals have undoubtedly been brought on by the coronavirus pandemic.

Federal Governments have made considerable adjustments to legislation and policy in an effort to combat the virus's onslaught. India in particular has been among the nations most severely impacted by the outbreak. The Indian Government concentrated on minimizing the negative economic impact through fiscal stimulus,[2] monetary policy,[3] and special programs geared towards a certain demographic or industry[4] after treating the urgent health issues brought on by the pandemic. Such initiatives have only received a tepid reaction from the relevant parties due to the significant amount of uncertainty associated with it.

The Indian Government's remarkable response to the epidemic was to halt the filing of insolvency proceedings by both creditors and debtors. This was primarily done to avoid firms being subjected to a torrent of insolvency actions as a result of the dampened economic activity.[5]

The role of Insolvency and Bankruptcy Code, 2016 (IBC/Code) in enabling credit distribution, restoring lender trust, giving debtors a practical escape path, and gauging an economy's general financial health is crucial. As businesses experience many challenges across all fronts during a recession, it takes heightened relevance and calls for a workable and long-lasting resolution structure.

It is significant to note that IBC was set up to foster credit in the country and completely change the structural framework of Indian insolvency procedures. Knowing the significance of IBC in India, it is essential to research the distinct components of a complete and unified Code. IBC does not mandate the resolution's content; instead, it tries to provide a procedure that aids debtors (usually business companies) in resolving bankruptcy. IBC has prioritized time-bound settlement above liquidation while changing the status quo of the ineffective bankruptcy law regime. Prior to IBC, several other legislations covered the debtor and creditors rights during insolvency. As a consequence, there were issues with the consistency and efficacy of the settlement process. Furthermore, traditionally, creditor privileges were limited. As a consequence of limited rights, there were more defaults and lower recovery rates, which meant that the creditors were reluctant in providing credit facilities. IBC seeks to: a) shorten resolution times; b) lessen losses to creditors in recovery; and c) increase levels of debt financing across a variety of debt instruments. It is clear that IBC has created a mechanism that has elevated the position of the creditor, so much so that it has resulted in a creditor-in-control mechanism.

For two reasons, speed is crucial to the bankruptcy code's operation.[6] First, while the 'calm period' can aid in keeping an organization afloat, important choices cannot be taken in the absence of complete clarity over ownership and control. Without strong leadership, the company is more likely to deteriorate and collapse. The likelihood that liquidation will be the sole option increases with the length of the wait. Second, due to the high economic rate of depreciation experienced by many assets, the liquidation value tends to decrease with time. If the company is sold as a going concern, creditors may often expect to get a good realisation. As a result, value is destroyed when delays lead to liquidation. Furthermore, delays reduce the realisation even in liquidation. Thus, the key to having a high recovery rate is locating and eliminating the sources of delay.[7]

The main goal of IBC was to promote credit throughout the nation. IBC reinforced creditors as well as provided incentives for unsecured creditors.[8] IBC's ultimate goal was to encourage resolution over liquidation. The developments during the pandemic have been detrimental to IBC. They somehow pushed businesses on the verge of bankruptcy to turn to liquidation.[9] This is where the importance of ARCs and SSF's comes in.

This paper first gives a general introduction of how the revaluation of mechanisms was ushered during the pandemic whereby the authors move on to discuss the evolution of the distressed asset resolution mechanism and how ARCs have come to occupy an important position in this. It then goes on to explain the working of ARCs in the wake of a new asset resolution mechanism, i.e., the IBC. Subsequently, a full-fledged analysis of SSFs has been done along with a comparative analysis in regard to ARCs. From there, the Indian distressed market as a whole is looked into and recommendations are provided therein.

ASSETS AND THEIR RECONSTRUCTION

The banking system of any nation forms a highly important part of its economic system. This is not only true for the Indian banking system but applies equally to all other banking system. Banks often provide the necessary capital which is required to kickstart industrial operations in any country. A banking system, with adequate capital giving capacity, helps in meeting with the demand capacity of the future.[10] In order to facilitate the growth of the economy, banks often lend the capital they possess with the expectation that the loans that are given would be returned back timely with the necessary interest. Issues arise when there is non-payment of the given loan, i.e., the loan becomes default. A loan is said to have become default when either the principal amount is not given or when the interest amount has not been received.[11] Within the Indian economic system, such default loans are termed as non-performing assets (NPAs). NPA creation is a major issue as they break the credit creation capacity of a bank.[12] Thus, NPAs are the problem of not only the banks, but they are the collective problem of the economy as a whole.

The Indian economy has been a victim of the vicious problem of NPA for the past many years. Between 2008 and 2017, the gross NPA of Indian banks increased from 2.3% to 9.7%.[13] Similarly, in 2019, the gross NPA of the Indian banking sector stood at $127 billion whereas at the same time, between 2016 to 2018, the NPA grew by around 4%.[14] At its peak, the NPAs in the Indian economy stood at 11.5% (2018) and 9.3% (2019).[15] Sector wise, it was the industry/corporate sector which saw the biggest rise in NPA. By September of 2019, the NPA share for this sector stood at a mammoth 17.4%.[16] Within the industrial sector, the largest chunk of NPA was taken by large industry, although it has decreased significantly from 25% to 18% over the period of March 2018 to September 2019.[17] In monetary figures, in 2019, the outstanding bad loans stood at around ₹ 3 lakh crore.[18]

In a nation like that of ours wherein capital requirement forms an essential part of economic growth, NPAs become a big hinderance. Successive regimes have time and again in coordination with industry pioneers tried to improve the NPA situation of the country through various different mechanisms. These included the establishment of the debt recovery tribunals (DRTs), the establishment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and the establishment of the ARCs in India. The present part of the paper seeks to elaborate on the evolution of the distressed asset resolution mechanism which has evolved in India over the past many years and how ARCs have come to occupy an important position in this. It would also aim at explaining the working of ARCs and the position they occupy in the wake of a new asset resolution mechanism, i.e., the Code.

Asset resolution mechanism in India

As a part of the asset resolution mechanism, DRT was the first apparatus established by the Government. The DRT was a statutory body that was established under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDB Act). The act and subsequently, the body were formulated on the basis of the report given by Narasimham Committee-1 (or the Committee on Financial System), which was constituted to look into the existing banking structure of the nation and suggest reforms for its upheaval. The DRT which was established by the Parliament was entitled to deal with loan recovery cases of only up to ₹ 10 lakh. They were however, authorized to establish 'Lok Adalat' which in turn could deal with cases wherein the recovery amount could go up to ₹ 20 lakh.

The DRTs had a promising start as a medium for asset resolution. In 2003-2004, around 79.1% of the total amount was recovered by the DRTs. However, with time the performance of DRTs as a mechanism for asset resolution saw drastic downfall. In the very next year (2004-2005), the DRTs could only recover 51.8% of the total amount, which was a stark reduction from the earlier percentage. The performance of DRTs kept on worsening and in 2019-20, they could only recover 4.1%. While the DRTs were established with the aim of speedy settlements, in reality, it was their over-stretched capacity and inadequate infrastructure that led to their failure.[19]

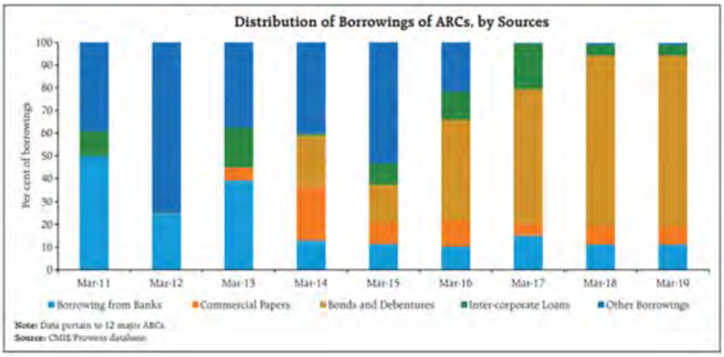
The next in line was the SARFAESI Act which was passed in 2002. The passage of the SARFAESI Act gave banks the power to auction off the borrower's property and enforcing their security and thus recover loans. Along with the SARFAESI Act, the Government also paved the way for the creation of the ARC.[20] The creation of both the SARFAESI Act and the ARC lies in the Narasimham Committee-2 report which was given in the year 1998, in the wake of an ever-high NPA standing at 15.7%.

ARCs

ARC was established as a special financial institution whose main task was to purchase NPA from banks at a discounted rate and restructure them and subsequently dispose them off at a higher price. ARCs would buy NPAs from banks by issuing security receipts (SR), bonds, or debentures.[21] ARCs issue SR to make payments rather than paying the entire acquisition cost upfront. Hope notes are another name for SR.[22] SR have both debt and equity characteristics, and their cashflows are volatile because they are backed by impaired assets. There was no investment requirement in the SR when ARCs were established. However, in 2006, the Reserve Bank of India (RBI) mandated that ARCs hold a minimum of 5% in SR. In 2014, the investment requirement was raised to 15%, and institutions other than banks were permitted to invest in them.

Functioning of ARC

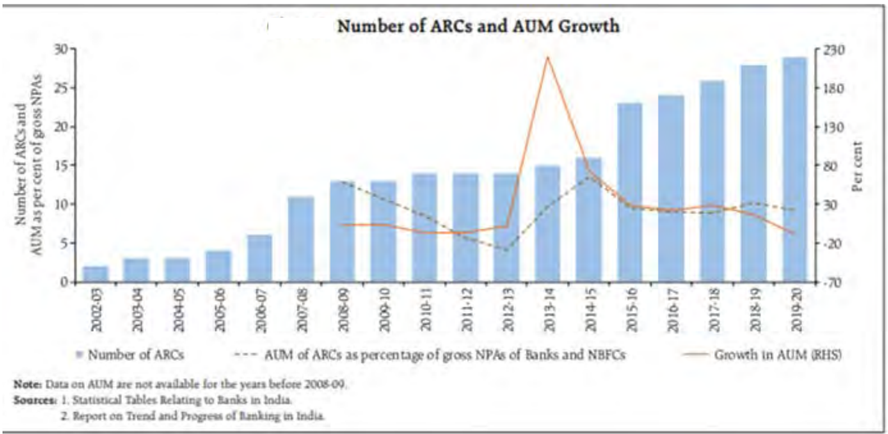
The major source of fund for an ARC is borrowing. Evidently, any constraints in raising capital may directly reflect in an increased reliance on borrowings by these companies.[23] Furthermore, the sources of funds for ARCs have largely been bank centric. As previously stated, the capital base of ARCs is largely made up of domestic sources, particularly banks and financial institutions, with foreign sources remaining limited. Over time, ARCs have moved away from bank borrowings and have inclined more towards bonds and debentures as a source of funding.[24]



ARCs use a waterfall structure in order to distribute the proceeds from the recovered NPAs. Legal and resolution costs are paid first in this structure. The balance is used to pay the management fee. ARCs typically charge a 1.5% management fee. This is a percentage of the net asset value (NAV) at the low end of the credit rating agencies' NAV range. Finally, SR shareholders are compensated. The remainder is divided in a 20:80 between ARCs and banks. The time frame for asset reconstruction or realisation is five years from the date of acquisition. The Board of Directors of ARCs may extend this period for an additional three years. There are several other structures/approached as well that exist through which the ARCs perform the task of NPA resolution. These include the portfolio approach, the existing promoter's approach and the arbitrage approach.[25]

In the context of the Indian market

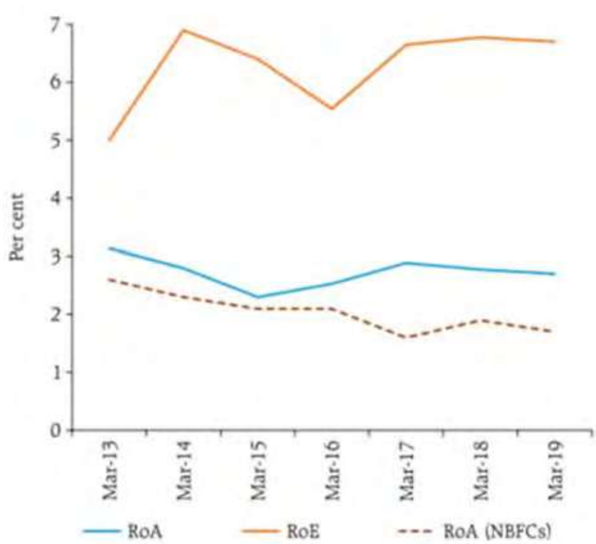
Ever since their inception, the growth of ARC in the Indian market has been a roller coaster ride. The first ARC that was established in India was Asset Reconstruction Company India Limited (ARCIL). There was a jump in the number of ARCs established in India in 2008 and then in 2016. Today, there are around 28 ARCs that are functioning in the Indian market. While there has been a growth in the number of ARCs that have been established in the Indian market, the same is not the case with the asset under management of these ARCs. Moreover, when the total volume of NPAs held by banks and non-banking financial companies (NBFCs) together is seen, it can be gauged that, there is a decline in the assets under management (AUM) of ARCs.[26]



As can be seen from the above chart, apart from the year 2013-2014, there hasn't been any growth in the AUM of ARCs. Reasons attributable for the same include excessive regulatory influence, inadequate legal procedure, price dispute between the banks/NBFCs and the ARC, lack of funds with the ARCs and most importantly, banks/NBFCs not selling the NPAs at the correct time.[27] In order to improve the functioning of ARCs in the Indian market, the RBI introduced a host of changes which led to increase in the year 2013-14. Subsequently, furthermore changes were introduced by RBI such as increasing minimum investment of ARCs to 15%, however, these changes rather than improving the functioning of ARCs have further led to a performance dip.[28]

The majority of ARCs earnings come from management fees, the difference between the recovery and acquisition costs of NPAs, and additional performance incentives provided by banks for early recoveries. When the assets are recovered, the trust's expenses are deducted first, followed by the management fee. The remaining funds are used to redeem SR. Apart from interest costs on the extent of their leverage, ARCs incur significant operational expenses related to the acquisition of NPAs and the fee incurred for trust valuation. Despite of the operational costs, ARCs have maintained a stable return on assets, which stands at close to 3% however, the return on equity has seen a decrease between 2014 and 2017.[29]

Trends in Profitability Ratios of ARCs



Report by the Indian Council for Research on International Economic Relations also point out that increased regulatory interference by the RBI in the functioning of ARC acted out as one of the foremost reasons for its dismissal performance. Between 2002-2014, the average return secured by ARCs stood between 20-30% however, ever since there has been an increased regulatory interference, this figure has gone down drastically.[30]

IBC AND ITS ROLE IN ASSET RESOLUTION

The year 2016 saw a major change in the Indian distressed debt market as it was, the year wherein the Government introduced the IBC. The IBC was a Code that aim at consolidating all existing laws and practices on resolution of stressed assets such as SICA, RDB Act, guidelines on sale of stressed assets, etc. IBC as a Code aims at maximising the value of assets of corporate entities and individuals who are about to undergo the insolvency process and by doing so, also aims to promote entrepreneurship and maximise credit facility, which can be made available to all the interested individuals.[31]

The basic aim of the resolution process of the IBC is to attempt, by depriving the former management of its powers and vesting them in a professional agency, to continue the corporate body's business as a going concern until a resolution process is drawn up, at which point the management is handed over under the plan so that the corporate body can pay back its debt and get back on its feet. All of this must be completed within six months, with a maximum extension of 90 days, or else the IBC is imposed, and the liquidation process begins.

Within the resolution process of IBC, one of the most important entities among all is that of the resolution applicant. The resolution applicant is the 'white knight' who comes to the aid of a corporate entity undergoing the insolvency process and makes an attempt at saving/reviving the company. Section 5(25) of IBC defines a resolution applicant as *'any person who submits a resolution plan to the resolution professional'*.[32] This definition apart from being too simplistic was also extremely similar to its American counterpart, i.e., section 1121 of the American Bankruptcy Reform Act, 1978. The effect of such a simple definition was that just like the American insolvency regime wherein the debtor or the existing management of the company was also permitted to put forth a resolution plan, even under the Indian regime, the existing board would have been permitted. This would result in the IBC adopting a 'debtor in possession' position. In the opinion of the Indian lawmakers, this would have been incorrect as the very management which initially led the company to insolvency should not be permitted to take advantage of their own faults. The parliament subsequently passed an amendment to the IBC in 2018, as a result of which section 29A was introduced in the act. Section 29A contained a list of persons who were not entitled to submit resolution plan. The provision banned a wide number of entities including those who were even remotely connected to an ineligible resolution applicant.[33]

The importance of section 29A and the objectives with which it was introduced has been time and again been explained by the apex court in decisions such as *Arcelor Mittal India Private Limited v. Satish Kumar Gupta*[34] and *Swiss Ribbons Private Limited v. Union of India*,[35] through which the court has re-affirmed the position that the main aim behind inserting section 29A of IBC was to prevent the backdoor of the management that led to downfall of the corporate entity and that this was done by adopting a purposive interpretation of the provisions.

ARC as a resolution applicant

As noted above, the primary purpose for which IBC was enacted was to bring a change in the asset management mechanism of India of which ARC since 2002 had formed a crucial part. The IBC regime allowed not only individuals but also institutions to be a part of the asset management system and this could be gauged from section 29A itself, which in explanation 1 states that a 'financial entity' would not fall under the definition of a 'related party'. Theoretically, the same meant that ARCs could function as resolution applicant under the new insolvency regime. Practically however, the same has not been the case.

In the case involving CIRP of Aircel Ltd. and its subsidiaries, among the parties which had submitted a resolution plan, one was an ARC (UV Asset Reconstruction Company Limited hereafter referred to as UVARCL). The committee of creditors (CoC) from all the plans available to them accepted the plan submitted by UVARCL and hence, an ARC emerged as a successful resolution applicant. Since the CoC approved its plan, UVARCL sought the approval of the RBI as under the guidelines issued by the regulator for ARC, an ARC is permitted to hold only 26% of the post-converted equity and only in some cases can they this limit be breached.[36] The RBI however, replied with a show-cause notice to UVARCL stating that by acting as a resolution applicant, they have violated the provisions of SARFAESI Act (specifically section 4) and the guidelines of RBI and asked them as to why their registration as an ARC shouldn't be cancelled. The RBI's notice was a display of a conflict between two conflicting provisions of SARFAESI Act and the IBC.

Section 9 of SARFAESI Act lists out certain acts which an ARC can undertake for purposes of asset reconstruction. Thus, the two businesses in which an ARC can indulge without any legal hinderance are asset reconstruction and securitisation.[37] For all other businesses, it has to undertake the approval of RBI.[38] The exception to this condition is given under section 10(1) wherein an ARC is allowed to act as a manager, agent or as a receiver. Reading the relevant sections (section 10(1) of SARFAESI and section 29A of IBC) along with the show-cause notice, the conclusion that can be drawn is that the regulator was of the opinion that business of being a resolution applicant didn't fall under section 10(1) of SARFAESI and hence, to act as a resolution applicant, approval was needed. This however, in the opinion of the author is erroneous as in the past even before UVARCL, there have been instances wherein ARCs have acted as resolution applicant. In the matter of *Maxim Infrastructure & Real Estate Private Limited,*[39] *Aparant Iron and Steel Private Limited*[40] and *Palm Lagoon Backwater Resorts Private Limited,*[41] ARCs have acted as resolution applicant.

The conundrum with regard to whether or not ARC can act as a resolution applicant under IBC was finally settled by the regulator itself as per a report dated October 11, 2022, RBI has allowed ARCs to act as resolution applicant under the provisions of the IBC.[42] This has been done however with certain conditions.

When one closely examines the recommendations, as well as the rationale and objectives (which focus on broadening the scope of their capital base, asset pool, debt resolution avenues, and so on), it becomes clear that the goal is to ensure that the ARCs are well equipped to operate in a commercially effective manner in order to achieve their debt resolution/revival/retrofit goals. While the report includes several important recommendations, it does not address issues such as the sale of ARCs (which is currently covered by an RBI circular), clarity on the requirement for meeting net worth criteria at the time of incorporation, and permission to purchase equity in companies other than its borrowers, to name a few.

Role of ARC's in CIRP and problems faced therein

ARCs as resolution applicant could prove to be extremely beneficial as:

a) No further fresh security to be created with assignment of existing debt to ARC.

b) Restructuring of existing debt into various instruments such as non-convertible debentures, optionally convertible debentures, equity, etc.

c) Lower stamp duty on assignment of debt.

d) Enhanced enforcement rights of ARCs compared to that of AIFs.

e) ARCs can pursue piece-meal sale/monetization of assets of the corporate debtor on approval of resolution plan over a period of time and pay lenders from sale proceeds.

There have been various instances in recent times wherein ARCs have functioned as resolution applicant. For instance, in 2020, Edelweiss ARC and a Goldman Sachs-managed distressed debt fund purchased more than 80% of Bilt Graphic Paper Products Limited debt from its lenders.[43] Similarly, Reliance Industries Ltd. along with JM Financial ARC Limited acted out as the resolution applicant for Alok Industries Limited wherein they paid close to ₹ 5,000 crore as a part of the resolution plan.[44] While ARCs have been acting in the resolution process under the new insolvency regime, there are various problems too that they have been facing. For instance, ARC functioning in India would need to augment capital worth ₹ 300 crore with themselves, if they have to act in the CIRP. While the principal aim behind this is to ensure that ARCs have sufficient funding, ARC experts wonder how all the 28 ARCs are to accumulate this.[45] Moreover, the overall efficacy of ARCs has also lowered and hence their efficacy specifically as resolution applicant also comes under doubt.[46] It's been more than 20 years ever since ARCs were introduced within the Indian economic system. With a slow start, ARCs did pick up some pace in the middle, however again they saw a downfall in their effectiveness. However, to ensure maximisation of ARCs within the IBC setup it is important to undertake certain key measures[47] or else, ARCs would not be able to achieve their intended purpose.

ALTERNATIVE INVESTMENT FUNDS: ALL ABOUT THEM

Venture capital, private equity, hedge funds, managed futures, and other types of investments are included in AIFs, which are pooled investment funds.[48] In layman terms, an AIF is a type of investment that is distinct from more traditional investment options like stocks, debt securities, etc. The term is specifically defined under regulation 2(1)(b) of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (AIF Regulations).[49] AIF can be established in the form of a company or a corporate body or a trust or a Limited Liability Partnership.

According to the Securities and Exchange Board of India (SEBI), these funds can be classified into three categories-

- Category I: Venture Capital Funds, infrastructure funds etc. which help micro, small and medium enterprises (MSMEs) and new businesses with high growth potential.
- Category II: Private equity funds, debt funds which invest in equity and debt securities. (Funds not described under category I and III)
- Category III: This includes such funds whose main aim is short terms returns.

SSFs has been introduced under Category I. An overview is provided further.

SSF's: A multi-faceted analysis

Stressed assets have long plagued India's financial system, necessitating a sizable capital infusion into banks, NBFCs, and other financial organizations a fortiori abovementioned.[50] Financial Institutions are unable to offer credit facilities in such situations to industries that would support India's overall economic development. It is noteworthy that by the end of the financial year 2021–2022, stressed assets held by Indian NBFCs, and mortgage lenders were predicted to have increased by 10–11%, with COVID-19 having an impact on nearly all of their asset classes.

In order to address these growing concerns, in its board meeting on December 28, 2021 (Board Meeting), the SEBI declared the establishment of the SSF as a new subcategory of Category I AIFs under the AIF

Regulations. As a result of the Board Meeting's decision, SEBI published the SEBI (Alternative Investment Funds) (Amendment) Regulations, 2022 (AIF Amendment) on January 24, 2022, introducing 'Chapter III-B - Special Situation Funds' as part of the AIF Regulations, which control SSFs.

According to AIF Amendment and the SSF circular, SSFs are Category I AIFs that: (1) can only invest in 'special situation assets' in accordance with their investment objectives; and (2), if they meet the IBC's eligibility conditions, can also act as resolution applicants.

Moreover, the AIF Amendment allows SSFs to make investments in 'special situation assets', which are described as the following:

a) Stressed loans that are available for acquisition in accordance with Clause 58 of the RBI (Transfer of Loan Exposures) Directions, 2021 (Transfer Directions), as amended from time to time, or as part of a resolution plan authorized by the IBC, or in accordance with any other RBI or Government of India policy issued in this regard from time to time; issued security receipts

b) SR issued by an ARC registered with the RBI.

c) Securities of investee companies:

    (i) whose stressed loans are available for acquisition in terms of Clause 58 of the RBI Master Directions (read with the June 7 Framework), or as part of a resolution plan approved under the IBC or in terms of any other policy of the RBI or Government of India issued in this regard from time to time.

    (ii) against whose borrowings, SR have been issued by an ARC registered with the RBI.

    (iii) whose borrowings are subject to CIRP under Chapter II of IBC; and

    (iv) who have disclosed all the defaults relating to the payment of interest/ repayment of principal amount on loans from banks/ financial institutions/ systemically important non-deposit taking NBFCs/ deposit taking NBFCs and /or listed or unlisted debt securities in terms of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and such payment default is continuing for a period of at least 90 calendar days after the occurrence of such default

    Provided that in case of sub-clauses (iii) and (iv) above, the credit rating of the financial instruments or credit instruments or borrowings of the company has been downgraded to 'D' or equivalent.

d) Any other asset as may be specified by the SEBI from time to time.[51]

Over category II AIFs, SSFs have some advantages. In addition, Category II AIFs have an investment cap and are not allowed to obtain 'loans' (but may only hold securities) consequently reducing its investible funds.[52] As long as the majority of their investment is in unlisted securities, Category II AIFs have the advantage of being able to invest in any security, regardless of credit rating or duration of default, as opposed to Category I SSFs, which are limited to the special situation assets discussed above.

Comparison with ARCs

As previously mentioned, ARCs are a typical entry point for foreign investment. Direct involvement in and control over the resolution of the stressed asset is a key benefit offered by SSFs (a role typically undertaken by the ARC trustee company).[53] Furthermore, under the Indian insolvency regime, SSFs are specifically intended to act as resolution applicants (bidders) in resolution processes and unlike ARCs, SSFs are not subject to strict regulations regarding the conversion of debt into equity, which makes it possible for the SSF to assume total control over the business and carry out an effective restructuring.

When compared to SSFs, ARCs are limited to using no more than 25% of the funds they raise for the reconstruction of the financial assets they have acquired, even though they are permitted to formulate schemes for doing so. On the other hand, an SSF is not constrained by these restrictions when providing financing for restructuring.

Presently, a foreign company or investor must purchase shares of the Indian company in order to acquire an Indian company through the IBC route. The subsequent acquisition of the entire shareholding by such a foreign company/investor will be made with the purchase consideration going toward paying off the current creditors. Foreign investors are not permitted to invest in debtor entities that are part of restricted industries (such as media companies or insurance companies). Such problems shouldn't concern an SSF whose sponsor and manager are Indian residents who own and govern them.[54]

In this case, it is particularly notable that SEBI, while allowing SSFs to acquire stressed loans, has in fact prohibited the acquisition of stressed loans from individual lenders, as stated in clause 58 of the Transfer Directions, which only allows the acquisition of loans in accordance with resolution plans that have been approved by the lenders in accordance with the RBI (Prudential Framework for Resolution of Stressed Assets) Directions, 2019[55] or the International Banking Code. Following these changes, it is anticipated that the RBI will update the Transfer Directions annexure to include SSFs. ARCs are currently limited to buying stressed loans that have been in default for more than 60 days or that are considered NPAs. In this regard, no such restrictions are applicable for SSFs.[56]

Besides that, a minimum lock-in period of six months is required for stressed loans that SSF purchases in accordance with clause 58 of the Transfer Directions.[57] The lock-in period, however, won't apply if the stressed loan is recovered from the borrower. Additionally, SSFs procuring the stressed loans must adhere to the same ongoing and initial due diligence requirements for its investors as those mandated by for ARCs in order to prevent regulatory arbitrage in respect to those requirements.

By allowing SSFs to act as 'resolution applicants' under the IBC, the SEBI has made it possible for SSFs to acquire both debt and securities, including shares of stressed companies going through an IBC corporate insolvency resolution process. Such provisions permit the SSFs to provide a thorough exit to the lenders and control the revival of the stressed company, without any restriction on investment concentration, in light of the fact that investment in special situation assets would necessitate extensive monitoring and supervisory support from the SSFs.[58]

In the past, credit funds with a stressed asset focus frequently invested in stressed loans through ARCs, with some of the funds acting as sponsors of the ARCs. However, the cost and complexity of such structures increase with the establishment of an ARC and the strict legal requirements imposed by the RBI. AIFs, on the other hand, are governed by the AIF Regulations, which give fund managers the most flexibility possible and promote investor investment.[59] It is commendable that SEBI decided to introduce SSFs as a sub-category under Category I AIF in order to address the problems with stressed loans. This move is anticipated to provide distressed companies with new sources of funding. Rich investors from developed markets might consider purchasing troubled loans with the goal of restructuring or recovering them. In order to prevent SSFs from acquiring stressed loans from their associates and investments from being made outside of India, the SEBI has also provided a number of safeguards. Additionally, the SEBI has given the SSFs a sufficient amount of time to try to resolve the stressed asset before exiting in the form of a six-month lock-in period.[60] Additionally, the exemption from the diversification requirements will guarantee that SSFs can be used as special purpose vehicles by both sophisticated investors with a high-risk tolerance and foreign investors who are looking to invest in the prohibited sectors of the stressed assets market.

When there is no way out for lenders, however, SSFs not being given the designation of 'secured creditor' for the purposes of the SARFAESI Act,[61] could prove to be a barrier for some investors. Contrarily, ARCs have a well-established resolution framework for recovering their investments because they are considered 'secured creditors', meaning that any security interest created in their favor can be enforced without the involvement of a court or tribunal. So, SSFs lack the asset reconstruction authority and unique benefits provided by securities laws (among other laws) that are available to ARCs.[62] In particular, SSFs would not have powers of outside court enforcement (which is considered as a key advantage otherwise available only to Indian banks, non-banking financial entities and ARCs).

The special situations fund or the vulture funds as they are often referred by investors all around the globe have been timely introduced in the Indian distressed debt market and are poised for growth. Such is the level of excitement among those who run SSFs that they are even ready to take cuts as high as 90% in order to acquire distressed asset in the Indian system and help banks and other institutions clean up their balance-sheets.[63] For Instance, German investor Deutsche Bank AG have increased their debt holding in India to almost ₹ 300 crore whereas Singapore based Broad Peak Investment have also increased their holdings to up to ₹ 100 crore.[64]

While the distressed debt market has been attracting both national and international investors which coupled with the latest introduction of SSFs as a resolution applicant, is surely going to attract a lot more investors, further steps should be taken in order to make sure that the environment is conducive enough for the vultures to act sufficiently. It should be remembered both by the Government as well as the regulator that as long as conducive environment is not present in India, the vultures won't be able to perform as efficiently as they are expected to be.

One of the first steps which the Government should consider taking is to review the existing taxing structure would be applicable on SSFs. As per the circular issued, SSFs are now considered as a part of Category-1 of AIFs. AIFs in Category I are funds with strategies to invest in start-up or early-stage ventures, social ventures, SMEs, infrastructure, or other sectors or areas deemed important by the Government or regulators as desirable on a social or economic level. Category-1 AIFs are currently provided with a tax pass through under the Finance Act, 2015 and any income apart from business income earned by category-1 AIFs is exempted. However, the issue that arises is with the taxation of the business income, which is taxed at fund level. The current taxation rate of the business income of category-1 AIFs stands at 42.7% after surcharge and cess. In opinion of the authors, such high level of taxation rate would deter foreign investors which have deep rooted funds from investing in the Indian distressed debt market.[65] High level of taxation can act as a major obstacle in the optimized performance of SSFs and thus, in order to ensure that SSFs have a successful application in the Indian market, it is imperative that the Government undertakes a comprehensive review of the same.

Another important point which should be kept in mind to optimize the usage of SSFs is that distressed debt investors in general and SSFs in particular invest in the distressed debt of any company so that they are able to establish their own control over that company. This has been a well-accepted principle in the international distressed debt market.[66] The Government along with the regulator should not repeat the mistake which was done at the time of introducing reforms in ARCs by which ARCs were prevented from establishing their long-term control. For SSFs to achieve their maximum potential in the Indian market, it becomes imperative that they are allowed to establish full control over the entity of which they buy the debt.

Another lesson which can be learnt from the American distressed debt market- as per a report published in 2021,[67] in the post-pandemic period, it was expected that the American distressed debt market would become a gold-mine for the investors. Instead, it has been observed that many of these investors have moved away from buying debt to providing loans to companies and institutions.

The reason for such a situation is the American Government and the federal reserve putting excessive liquidity in the market as a result of which, companies have cheap credit available at their disposal. In the Indian context, while it is necessary for the Government and the RBI to put liquidity in the market, they should keep a cap on it, so as to allow distressed debt investors (such as SSFs) to have something to invest into.

From the American situation itself, another important takeaway is that just like foreign markets, even in the Indian market, SSFs should be allowed to provide financing to those sectors or to those companies, who have been shunned away from the banks. In global distressed debt markets, players like SSFs are not only meant for prying on distressed debt but they also act as secondary sources of financing and have proved to be quite efficient. The Government should aim to create such environment wherein SSFs can function as a secondary source of financing themselves.

Under the current legal framework, SSFs do not possess special benefits under securities laws and other laws. They also do not have powers of outside court enforcement, which is often considered as a key element.[68] Owing to such restrictions, investors who would otherwise want to establish an SSF in the Indian market would be reluctant to do so. A review of such restrictions should take place and an attempt should be made to provide to SSFs equal benefits as given to other investors like ARCs.

THE INDIAN DISTRESSED DEBT MARKET: THE WAY FORWARD

While the introduction of SSFs as a resolution applicant would be considered as a welcome step by many, the Government however should not become complacent. An overall review of the Indian distressed debt market is what is needed right now in order to transform the Indian financial sector.

A recent Report by a market stalwart also suggests that the Indian authorities should look forward to developing the Indian distressed debt market as it will allow the banks to free up their existing balance sheets and would help in creation for new avenues of financing as well.[69] The creation of a dedicated market for distressed assets would also aid in corporate restructuring, the Report stated.[70]

The creation of a distressed debt market is not only necessary to solve the existing NPA issue which various Indian banks have been dealing with, it will also help in giving a boost to the Indian start-up industry. The Indian start-up industry is no more in a nascent stage, and this is evident from the increase in the number of start-ups that the country has seen in the past several years. The creation of distressed asset market would aid the start-up industry as it will create avenues of financing for many of them, who are able to secure financing from traditional sources.[71]

While there are several benefits of creating a dedicated market for distressed asset investing, certain steps however need to be taken in order to enhance the current system. One of the first reforms which the Government should urgently focus is to improve the time period for resolution of cases under IBC. In a recent report submitted before the Parliament,[72] it has come to the notice that in the year 2022 itself, the average time taken for resolution under IBC stood at 679 days which is a stark increase from the time period, as envisaged under the statute.[73] The extreme extension of time to complete the resolution process often erodes the value of bidders and creditors and also pushes otherwise viable entities into liquidation.[74] While dealing with distressed entities, sticking to a particular time frame becomes extremely important and hence, in order to improve the overall Indian distressed debt market, the time taken to complete a resolution needs to be seriously be brought down. Another way through which improvement in the Indian distressed asset market can be brought is by extending the ‘pre-pack insolvency process’ from MSMEs to all corporates.[75]

Additionally, the Indian insolvency regime works on the principal of ‘creditor-in-control’ wherein the debtor is removed entirely from the control of the company, once it comes for resolution. In the opinion of the authors, this might not be the best approach. As evident from our American counterpart, which follows a 'debtor' centric approach, entirely removing the existing management will not always help in reviving the stressed asset. The creditor centric approach also acts as an unattractive option for those investors who wish to come into an alliance with the existing management to turn around the asset.[76]

Another reason as to why the Indian distressed debt market lately has not been able to attract institutional investors would be judgments such as *Superna Dhawan v. Bharti Defence*,[77] which have indicated that resolution plans that do not envisage any infusion of new equity and/or envisage a 'turnaround and sale' model may not be considered compliant with the law.[78]

The Central Government should also consider granting investors who acquire debt from banks access to enforcement mechanisms such as the, SARFAESI Act and the RDB Act, as well as waiving stamp duty on the sharing of physical documents for record or due diligence, as well as on debt sales. Long-term, further liberalisation of conditions for acquiring distressed debt may be considered.[79] Tax issues with the IBC may also be considered as a factor which is prohibiting the growth of the Indian distressed debt market.[80]

Another way in which the growth of the distressed debt market can be ensured is by allowing investors such as SSFs to invest in debt securities, including defaulted debt securities. SSFs could invest across the entire corporate bond market, both pre-default (in corporate bonds) and post-default (in defaulted debt securities) would be better able to gain control of a distressed business by converting those bonds into a controlling stake of equity of the post-restructured entity and aid in the turnaround process.[81]

While the SSFs have been introduced in the Indian market, the Government however should also look to introduce some reforms with respect to ARCs, which will have to begin with answering the question that is how to regulate the ARCs-whether they are to be treated as bad banks or as stressed asset funds. There appears to be prima-facie contradiction on how they are to be treated which in some ways has also added in their poor performance. Answering this fundamental question is extremely important and this would have long term effects in the growth of a distressed debt market in India.[82]

The American model suggests that for a distressed debt market to take off, an effective corporate insolvency law and a vibrant high-yield bond market are vital.[83] The introduction of IBC in the Indian regime surely points towards development of an effective insolvency law however, India still needs an effective high-yield bond market. In this regard, the SEBI's operational framework for transactions in defaulted debt securities is a step in the right direction. Given the underlying political and economic realities, bank financing is likely to remain relevant in the Indian corporate credit market for the foreseeable future. Therefore, in order for distressed debt markets to function in India, the secondary market for corporate loans, both investment and non-investment grade, must be developed urgently.

DRAWING INFERENCES

AIFs can occasionally be used to fund ARCs. This idea proposes the establishment of an ARC to deal with NPA resolution and the AIF to deal with funding for asset accumulation. The cash gathered in the AIF is then used to buy the SRs issued by the ARCs. These AIFs are financed by family offices, high net worth individuals, or other investors. The advantages of an ARC—stressed asset resolution—and an AIF—pooled funding—are combined in a single entity known as an SSF.

The AIF Amendment is an innovative action by SEBI and will aid in luring investment towards special situation assets. The market is still waiting for the RBI to recognize SSFs as authorized transferees under the RBI Master Directions. Clarification on SSFs' ability to acquire loans as part of a resolution plan that has been approved under the IBC is also required. SSFs are expected to intervene in order to fully resolve all INR loans of a stressed borrower held by Indian banks and FIs (either alone or perhaps in collaboration with other purchasers).[84] The elimination of the diversification limits will encourage the creation of numerous AIFs for the purchase of stressed assets without the need to guarantee that such SSFs have access to a variety of deals. Hence, SSF's for sure can be a viable alternative to ARCs with respect to asset reconstruction.

[1]World Economic Forum (2022).

[2]Nivedita V. (2021), "Coronavirus stimulus package: Comparing India and rest of the world", *The Hindu Business Line*, December 6.

[3]Waghmare A. (2020), "Monetary policy taming COVID-19 to soften GDP fall says RBI", *Business Standard,* August 6.

[4] "Government Support Schemes", *TMF Group*, 2022.

[5]Johorey P. (2020), "Evaluating India's Covid-19 Insolvency Ordinance: Blanket Protections & Executive Wariness", *Oxford Business Law Blog.*

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

[7]Deb S. and Dube I. (2020) "Insolvency and Bankruptcy Code 2016: Revisiting with Market Reality", 63 International Journal of Law and Management, p.125.

[8] Supra Note 6.

[9] "Government's COVID-19 Insolvency relief may be a double-edged sword", *The Economic Times,* 2021.

[10]Balasubramaniam C. (2019), "Insolvency and Bankruptcy Code (IBC) - Implementation and Emerging Strategies for Industrial Revival in India".

[11]Agarwal S. (2020), "The Magic Broom of Banks to clear NPAs".

[12]*Ibid.*

[13]Kattadiyil B. (2020), "NOAH'S ARC: Analysing the role of IBC on ARC in NPA Alleviation" 9 IJMER 143.

[14]CRISIL, "Bolstering ARC".

[15] *Ibid.*

[16]Supra Note 13, p.144.

[17]*Ibid.*

[18]Supra Note 10.

[19]RBI Bulletin, "ARCs in India", April, 2021.

[20]*Ibid.*

[21]Section 7, SARFAESI Act.

[22] Bhagwati J. et al. (2017), "Can Asset Reconstruction Companies (ARCs) be Part Solution to the Indian Debt Problem?", Indian Council for Research on International Economic Relations.

[23]Supra Note 19.

[24]*Ibid.*

[25]Saleh G. (2021), "The Anatomy and Performance of Distressed Debt Funds: Asset Reconstruction Companies in India".

[26]Supra Note 19.

[27]Supra Note 11.

[28]*Ibid.*

[29]Supra Note 19.

[30]Supra Note 25.

[31] Supra Note 10.

[32]Section 5(25), IBC.

[33]Chugh B. (2020), "A to Z of the Insolvency and Bankruptcy Code", 22 June.

[34](2019) 2 SCC 1.

[35](2019) SCC Online SC 73.

[36]Kaur M. et. al. (2022), "ARCs as Resolution Applicants under IBC", *Mondaq,* 20 July.

[37]Section 10(2), SARFAESI Act.

[38]*Ibid.*

[39](2019) SCC OnLine NCLT 666.

[40](2019) SCC OnLine NCLT 28724.

[41]*R Velu v. Palm Lagoon Backwater Resorts Private Limited*, MANU/ND/0597/2020.

[42]RBI Circular dated October 11, 2022.

[43]Rebello J. (2020), "Edelweiss ARC, Goldman Co tighten grip", *The Economic Times*, January 14.

[44]"Lender Receive Money", *Financial Express*, April 28.

[45]Mohan R. and Abhijit (2022), "At the Crossroads", *Business Standard*, November 20.

[46]Gera I. (2022), "ARC need to rebuild", *Business Standard*, October 21.

[47]Edelweiss ARC, "Effective Implementation of Insolvency and Bankruptcy Code".

[48]Mukhopadhyay D. and Mohanty R. (2017), "Examining the SEBI (Alternative Investment Funds) Regulations 2012: A Capital Market Perspective of Hedge Fund Regulation in India", 38 Business Law Review, p.116.

[49]Regulation 2(1)(b), AIF Regulations.

[50]Outlook India (2022), "India Needs to Develop a Market for Distressed Assets, Says Report".

[51]AIF Amendment.

[52]Team TMS (2022), "What Are Alternative Investment Funds?", *Business Standard*, December 1.

[53]Vinod Kothari Consultants (2022), "Special Situation Funds", February 6.

[54] "Balance SSF Worries with a Pass-Through", *The Economic Times*, January 27, 2022.

[55] Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions, 2019.

[56] Supra Note 53.

[57]"SBI Details Regulatory Norms for Special Situation Funds", Economic Laws Practice.

[58]Desai N. and Sinha S. (2022), "Special Situation Funds", AZB & Partners, June 20.

[59]Supra Note 53.

[60]Supra Note 57.

[61]SARFAESI Act.

[62] "SEBI Seeks 'Secured Creditor' Tag for SSFs", *The Economic Times*, Feb 1, 2022.

[63]Dethe A. (2020), "Vulture Funds Find Gold Mine in India's Distressed Loans", *Economic Times*, February 10.

[64]*Ibid.*

[65]Coutinho A. (2021), "In a Sticky Situation: SEBI's SSF may run into tax wall", *Business Standard*, December 30.

[66]Cote C. (2021), "What is Distressed Investing", Harvard Business School, August 5.

[67]Oguh C. and Murugaboopathy P. (2021), "Cheap Money Pushes US investors from distressed debt to rescue financing", *Reuters*, August 12.

[68]Supra Note 58.

[69] "India needs to develop a market for distressed assets", *Financial Express*, February 14, 2022.

[70]*Ibid.*

[71]Wadhwa N. (2018), "The Start-Up Space Requires a distressed funds market in India", *Startup India*, May 18.

[72]Wankhade S. (2022), "Parliament Watch", *Bar and Bench*, December 14.

[73] Section 12(1), IBC.

[74] Singh Y. et al (2022), "The Distressed Assets Sector: Poised for Growth", *Lexology*, February 3.

[75]*Ibid.*

[76]Shroff S. and Prakash S. (2021), "Unlocking New Pastures for distressed investment in India", India Business law Journal, November 19.

[77] *Superna Dhawan and Ors. v. Bharti Defence and Infrastructure Ltd*., MANU/NL/0217/2019.

[78] Supra Note 76.

[79]*Ibid.*

[80] "The US and India Distressed Assets Market", *Withum*, July 4, 2021.

[81]Datta P. (2022), "The Evolving Indian Distressed debt market: Reading the tea leaves", IBBI's Annual Publication 2022: IBC- Idea, Impressions and Implementation.

[82]*Ibid.*

[83]Ellias J. (2021), "The Law and Economics of Investing in Bankruptcy in United States", SSRN 1.

[84]Behera D. et al (2022), "Special Situation Fund: An attempt to revolutionalize stressed asset space", 12 The National Law Review.

12 NEED FOR MANDATORY FORENSIC AUDIT AND WHISTLEBLOWING MECHANISM UNDER IBC

-Dr. B Charumathi and Beemamol M

EXECUTIVE SUMMARY

The paper discusses the issue of corporate fraudsters under the Insolvency and Bankruptcy Code, 2016 (IBC/Code). The implementation of the IBC in India has had a substantial impact on reducing credit risk and has helped the banking system by speeding up the process of converting non-performing assets (NPAs) into performing assets. However, the IBC has faced challenges with the classification of wilful defaulters and fraudsters. In some cases, corporate defaulters were declared as fraudsters or wilful defaulters during or after the resolution process. This paper identifies the relevant issues, such as lack of a proper whistle-blowing mechanism and the need for mandatory forensic audits under the IBC. The Report of the Association of Certified Fraud Examiners (ACFE) highlights the importance of the whistle-blowing mechanism in detecting fraudulent activities, and it is considered a successful mechanism in corporate governance. Hence, this study calls for policies on the whistle-blowing mechanism and mandatory forensic audit under IBC.

Keywords: Corporate Fraud, Forensic Audit, Whistle-blowing Mechanism, IBC

INTRODUCTION

Corporate fraud is a breach of that trust when management chooses to behave shrewdly in order to benefit certain stakeholders at the expense of others rather than working for the benefit of the corporation's stakeholders (Desai, 2020). The ACFE classifies fraud into three categories: asset misappropriation, corruption, and financial statement fraud (ACFE, 2020). According to the ACFE Report 2020, total losses incurred were more than $3.6 billion, and the number of frauds is tremendously increasing globally; due to different patterns, detection and mitigation has become difficult. Banking and financial services have become the most vulnerable industries to fraud, with an average loss of $1.546 million. Since the bank is the custodian of public money, when these custodians commit fraud, it will affect the whole banking system and the economy. IBC, one of India's greatest substantial economic developments, is said to have had a significant influence on credit risk reduction. The IBC combines and improves Indian legislation regulating the insolvency resolution process (Anant & Mishra, 2019). The implementation of the code affects lenders, financial institutions, organisations, and professionals alike, providing them with the option to operate as resolution specialists. Insolvent businesses are designed to be wound up faster, troubled firms are expected to be salvaged, and investors are intended to have a simpler exit (Anant & Mishra, 2019). The new law consolidates and amends the laws relating to the reorganisation and insolvency resolution of corporate persons, partnership firms, and individuals in a time-bound manner and for maximisation of the value of such person's assets as well as matters connected therewith or incidental thereto in order to promote entrepreneurship, availability of credit, and to balance the interests of all stakeholders (Anant & Mishra, 2019). It proposes to combine the laws now found in many statutes dealing with the insolvency of corporations, limited liability entities, unlimited liability partnerships, and people into a single statute. This unification would result in more legal clarity, making it simpler to apply standard, rational principles to all stakeholders who may be harmed by a firm collapsing or being unable to pay its debt (Anant & Mishra, 2019).

As the IBC is successfully conducting the corporate insolvency resolution process (CIRP) and helping the banking and financial institutions to get over their dead asset and provide a new life. The introduction of IBC and the Insolvency and Bankruptcy Board of India (IBBI/Board) has helped the entire banking system by giving a speed process of conversion of NPAs into performing assets. NPA management has been one of the bank's primary areas of concentration ever since the escalating NPA crisis that has plagued the Indian banking system for years. In such a situation, the Code's implementation may prove to be a significant step in lowering the NPA stress that is now piling up in the Indian banking system. Including cases transferred from the Board for Industrial and Financial Reconstruction (BIFR), the IBC has, directly and indirectly, assisted in the resolution of stressed assets totalling ₹ 3 lakh crore and disposed of about 50% (4400 to be exact) of the 9000+ cases it received in the last two years (Anant & Mishra, 2019). When we consider the corporate defaulter, recently, the banking industry has encountered many wilful defaulters or corporate fraudsters who have taken loans from the bank and diverted the same to their shell companies or for personal purposes. The Reserve Bank of India (RBI) has classified the wilful defaulters in their circular (Master Circular on Wilful Defaulters, 2014). The RBI has given instructions to classify the accounts as wilful defaulters based on their past behaviour, transactions and loan default amount. This classification is done by the committee from the bank by informing the defaulter.

The IBC allows the initiation of the CIRP against a corporate defaulter if it meets certain criteria specified in the Code. However, if a corporate defaulter has been declared a fraudster by the National Company Law Tribunal (NCLT), it will not be eligible to submit a resolution plan under the IBC. Section 35(1)(f) of the IBC specifies that a resolution plan may provide for measures to deal with any fraudulent or malicious activities by the corporate debtor (CD). Therefore, if a corporate defaulter has committed fraud, the resolution plan can provide measures to address such fraud. However, section 25(2)(h) of the IBC specifies that a resolution plan must provide measures to address any instances of fraud or avoidance transactions. If the corporate defaulter has been declared as a fraudster by the NCLT, it wil not be eligible to submit a resolution plan as it would not be able to meet this requirement. But in some cases, the corporate defaulters, who were neither wilful defaulters nor fraudsters, initially at the time of applying for CIRP, later, during or after the resolution process, were declared as fraudsters or wilful defaulters by the creditors. In that circumstance, how to address the same under IBC? There are many cases witnessed by the IBBI with respect to the same. On the other side, there were cases witnessed declaring the corporate defaulter as a fraudster by the stakeholder by blowing the whistle after the completion of the resolution process. As there is no proper whistle-blowing mechanism in the IBC, it is relevant to consider the same. According to the ACFE report to the nations, the whistle-blowing mechanism is considered the top most relevant mechanism to detect fraudulent activities globally (ACFE, 2020), which is also successful in the corporate governance mechanism to address the issues in the companies. Addressing the policies on whistle-blowing by the lenders' nominees during and after the CIRP should be considered.

Forensic accounting plays a crucial role in the detection and prevention of corporate fraud, especially in the context of insolvency and bankruptcy proceedings under the IBC. Some important sections related to forensic accounting and corporate fraudsters under the IBC are: Section 66: this section deals with the fraudulent trading or wrongful trading by the directors or officers of a company that is undergoing insolvency proceedings. Forensic accountants can be appointed to investigate any such fraudulent activities by the corporate fraudster. Section 69: this section provides for the attachment of the properties of the CD or any other person, including the corporate fraudster, who is involved in any fraudulent activities that have contributed to the insolvency of the company. Section 213: this section deals with the power of the Central Government to investigate the affairs of a company if there is a suspicion of fraud, misfeasance, or other wrongful activities. Forensic accountants can be appointed to assist in such investigations. Section 219: this section provides for the appointment of inspectors by the Central Government to investigate the affairs of a company. Inspectors may include forensic accountants, who can assist in the identification and investigation of corporate fraudsters. Section 235: this section deals with the prosecution of officers or employees of the company who have committed any fraud or other wrongful activities. Forensic accountants can provide evidence to support such prosecutions.

PUFE stands for preferential, undervalued, fraudulent, and extortionate transactions. It is a term used in forensic accounting to describe types of transactions that can lead to insolvency or bankruptcy of a company. Under the IBC, there are specific sections that deal with PUFE transactions. These sections include: Section 43 - preferential transactions: this section deals with transactions made by the CD within two years prior to the insolvency commencement date (ICD), which involves a transfer of property or payment to a creditor with the intention of giving them preference over other creditors. Section 45 - undervalued transactions: this section deals with transactions made by the CD within two years prior to the ICD, where the value of the consideration received is significantly lower than the fair market value of the asset. Section 50 - extortionate credit transactions: this section deals with transactions where the terms of the credit arrangement are excessively unfavourable to the CD, such as charging a significantly higher interest rate or demanding unreasonable terms. Section 66 - fraudulent transactions: this section deals with transactions made with the intent to defraud creditors or for any fraudulent purpose. Under the IBC, if any of these transactions are found, the Insolvency Professional (IP) or Resolution Professional (RP) appointed by the NCLT can take action to undo the transaction and recover the assets for the benefit of all creditors. The IP can also initiate legal proceedings against those responsible for the PUFE transaction. Forensic accounting plays a critical role in identifying PUFE transactions as it involves analysing financial records and transactions to detect any fraudulent or wrongful activities. Forensic accountants use their expertise to identify any red flags, such as unusual transactions, sudden changes in financial statements, or discrepancies in records, that may indicate PUFE transactions. The information obtained from forensic accounting investigations can then be used to support legal proceedings against those responsible for PUFE transactions.

Timely detection of the fraudulent activities of the corporate defaulter is important. Even though forensic accounting is conducted, the report from the forensic report is not conclusive with half-baked information. So, the timely detection of fraudulent activities can be possible through mandatory forensic auditing and the introduction of the whistle-blowing mechanism.

REVIEW OF LITERATURE

Whistle-blowing

Whistle-blowing is a –

> deliberate non-obligatory act of disclosure, which gets onto the public record and is made by a person who has or had privileged access to data or information of an organization, about non-trivial illegality or other wrongdoings, whether actual, suspected or anticipated which implicates and is under the control of that organization, to an external entity having the potential to rectify the wrongdoing (Jubb, 1999).

The whistle-blower is a term used to describe someone who works for or has previously worked for a company and who informs a third party or someone who has never worked for the company about wrongdoings within that company (Dasgupta & Kesharwani, 2010). In accordance with the party to whom the complaint is submitted, whistle-blowers may be internal or external. The complainant is known as an internal whistle-blower if they bring their allegations of misconduct to the attention of those within the company, such as the senior management. If the complaint is made to a third party outside of the firm, such as the government or another law enforcement body, the complainant is known as an external whistle-blower (Dasgupta & Kesharwani, 2010).

Because their actions are perceived as being disloyal to the company, whistle-blowers may suffer consequences from both the companies and their co-workers. Over the years, ethicists have asserted that a whistle-blower is not loyal to the organisation and that organisational loyalty and whistle-blowing are mutually exclusive. But how can the needs of the members of society at large, of which the offender is also a part, be met if everyone is loyal to the organisation in the sense that they would not reveal the organisational wrongdoings? Whistle-blowers are viewed as either hero who fights to defend the rights of society's citizens from wrongdoing done by organisations or as traitors or disloyal workers who act against the interests of their employer and the organisation in order to pursue personal benefit (Dasgupta & Kesharwani, 2010). Organizations regularly receive information showing impropriety, misconduct, or criminal activity. When an organisation either ignores or refuses to take the necessary corrective action in the appropriate conditions, either insiders or outsiders have the choice of raising the alarm. The term 'whistle-blowing' is not new, but the idea behind it is, particularly in the context of public and private businesses. Whistle-blowers may divulge the specifics of alleged wrongdoing to outside parties or to other persons within (for instance, to other members of the organisation) (to commissions, law enforcement agencies, the media or the groups concerned with the issues).

The Supreme Court ordered that, pending the passage of necessary laws, proper mechanisms be put in place to handle whistle-blower allegations. As a result, on April 21, 2004, the Union Government issued the gazette notification, also known as the Public Interest Disclosure and Protection of Informers (PIDPI) resolution. One of the difficulties experienced in fighting corruption in the Government and other organizations is the non-existence of adequate protection for whistle-blowers. Therefore, it was decided by the Government of India to enact separate legislation to provide protection to the persons reporting corruption, wilful misuse/abuse of power or the commission of an offence by a public servant. The Whistle-blowers Protection Act of 2011 establishes a procedure for investigating allegations of corruption and abuse of power by public officials and protects anybody who discloses misconduct in government agencies. The Whistle-blowers Protection Act, 2011, according to the Government, requires several changes before it can be implemented. So, the Whistle Blowers Protection (Amendment) Bill, 2015, is on the anvil. Enacting a Parliamentary Act is one solution, but this is not sufficient. Certain steps need to be taken at the organizational level.

RESEARCH GAP

When the corporate defaulter or the financial creditor (FC) or operational creditor files for CIRP, the defaulter will be declared as the defaulter with a clean forensic audit report. But when it comes to the case, during and after the resolution process, if any defaulter is declared as a fraudster by the banks, there is a need for a proper mechanism to address the same with proper law. In the cases of declaring corporate defaulters as fraudsters after the resolution process, it is important to update the law. However, if a corporate defaulter has been declared a fraudster by the NCLT, it may not be eligible for the resolution process under the IBC. Section 35(1)(f) of the IBC specifies that a resolution plan may provide for measures to deal with any fraudulent or malicious activities by the CD. Therefore, if a corporate defaulter has committed fraud, the resolution plan can provide measures to address such fraud. However, section 25(2)(h) of the IBC specifies that a resolution plan must provide measures to address any instances of fraud or avoidance transactions. If the corporate defaulter has been declared as a fraudster by the NCLT, it may not be eligible to submit a resolution plan as it would not be able to meet this requirement. But in some cases, the corporate defaulters, who were neither wilful defaulters nor fraudsters, initially at the time of applying for CIRP, later, during or after the resolution process, were declared as fraudsters or wilful defaulters by the creditors. Also, considering the cases like

Amtek auto, the whistle-blower has made an allegation about the fraudulent activities done by the corporate after completing the resolution process. Here comes the need for a proper whistle-blowing mechanism in the law. There is also a need to include a provision about who can be part of whistle-blowing mechanisms and how it should protect the blower within the IBC. This whistle-blowing mechanism can help to bring out many corporate fraudsters before and during the resolution process. Also, it should include the time period which can be considered regarding the whistle-blowing policies. Further, there is a need to regulate the forensic audits by the RBI and IBBI for corporate defaulters. RBI has made a mandatory forensic audit for the NPA accounts above ₹ 50 crore, and the IBBI made a mandated forensic clean report to do the resolution process. But there is no proper regulation to conduct the forensic audit for the defaulter and those who are detected as the fraudster during and after the resolution process. There is a need for more cooperation between RBI and IBBI for the better practice and procedure of resolution process of corporate defaulter who is declared as fraudster during and end of the resolution process.

RESEARCH QUESTIONS

Q1: Where is the proper whistle-blowing mechanism in IBC?

Q2: When to classify a corporate fraudster under IBC? Does IBBI need more cooperation with RBI?

Q3: Who will classify the corporate defaulter as a fraudster?

OBJECTIVES

a) To introduce a proper whistle-blowing mechanism in IBC

b) To determine the proper time to classify the corporate defaulter as a fraudster.

c) To identify the authority to classify the corporate defaulter as a fraudster.

WHISTLE-BLOWING CASE

Amtek Auto Limited

Profile

Amtek was founded in 1985 and is a leader in forging aluminium casting and machining for the engine, transmission, driveline, and chassis markets. Amtek serves sizable wallet shares of the biggest Tier 1 customer in the globe, including Sriram Pistons, Hitech Gears, Unimotion, Valeo, Maruti Suzuki India, Honda Motorcycle and Scooters, Tata Motors, Ford Motors, J.C. Bamford Excavators, Ashok Leyland, and Eicher. With 15 active units located throughout Haryana, Himachal Pradesh, Maharashtra, Madhya Pradesh, and Tamil Nadu, the company has built substantial engineering and manufacturing know-how.

Resolution process

The NCLT of Chandigarh completed the hearing and reserved its decision on July 9, 2020, bringing to a close the three-year-old insolvency procedure in the *Amtek Auto case*. The lawsuit, which was initiated in July 2017, saw several changes. One of the 12 significant businesses singled out by the RBI for bankruptcy proceedings was Amtek Auto. In addition to additional ₹ 12,500 crore owed by its group firms, including Castex, Metalyst, and Amtek Ring Gear, the corporation defaulted on ₹ 12,600 crore in financial debt. In addition, the serious fraud investigation office has been tasked by the Ministry of Corporate Affairs to investigate Castex Technology's financial situation. Liberty House, based in the UK, and Deccan Value Investors submitted proposals in the first round of bidding;

Liberty won due to a bigger cash component. Later, Liberty said that bidders were denied access to essential audit reports. It uncovered unfavourable data on asset values and determined that the liquidation value of assets was greatly exaggerated. It then decided against carrying out the resolution plan. Senior NCLT attorney Mr. Arvind Kumar Gupta said that the non-disclosure of several related party transactions and the retrospective write-down of ₹ 7,000 crore in fixed assets had caused the whole bankruptcy procedure to be delayed. The company's assets were decreased from ₹ 15,000 crore to ₹ 4,400 crore, including a write-off of fixed assets from ₹ 9,700 crore to ₹ 2,700 crore. Between July 24, 2017, the day the insolvency process began, and September 30, 2017, the day before the resolution plan was submitted, the asset value was written down by 70%, he said. The NCLAT ordered NCLT Chandigarh to liquidate Amtek in August, 2019. But vide several orders from September, 2019 to February, 2020, the Supreme Court halted the liquidation and instructed the RP to solicit new offers. US-based Deccan Value Investors LP, Mother Son Sumi, SREI, and Liberty all submitted offers for it. The liquidation value was decreased this time from ₹ 4,100 crore to around ₹ 1,500 crore, despite getting just ₹ 500 crore up front and the remaining ₹ 2,700 crore from future Amtek receivables, like tax refunds, the sale of non-core real estate, and other assets, the lenders accepted Deccan Value Investors' resolution plan in February, 2020. In response to the COVID-19 epidemic, Deccan Value Investors filed a petition with the Supreme Court asking for additional time to reconsider its offer. However, the Supreme Court dismissed the case. The timeline of the resolution process is as follows:

24-Jul-17	**24-Jul-17**: Initiation of CIRP
Jul 17	**27-Jul-17**: Appointment of Mr. Dinkar Venkatasubramanian as IRP and declaration of moratorium by NCLT **29-Jul-17**: Public Announcement inviting claims in terms of IBC
Aug'17	Constitution of the CoC and continuation of Mr. Dinkar Venkatasubramanian as RP by CoC **30-Aug-17**: Issuance of advertisement for inviting expression of interest for the corporate debtor with last date of submission as 11-Sep-17
Sep 17-Dec'17	Engagement with Prospective Resolution Applicants and submission of resolution plans (Last date for submission of plans 28-Dec-17)
Jan'18-Mar'18	Consideration of plans received and negotiation with Prospective Resolution Applicant(s)
Apr'18	Approval accorded by the CoC on Resolution Plan submitted by Applicant 1 and submission of the same for NCLT's approval by RP
Jul 18	**25-Jul-18**: Order passed by Hon'ble NCLT approving the Resolution Plan submitted by Applicant 1
Nov 18-Dec 18	Default by Applicant 1 in implementation of the Approved Resolution Plan. CoC sought directions from Hon'ble NCLT for next steps
Feb'19	**13-Feb-19:** NCLT advised that H2 bidder from the previous bidding process be given the first chance for resolution and granted additional 55 days for the purpose of calculating CIRP of 270 days and a further period of 10 days for serving notice to H2 bidder
May 19-Jul 19	Hon'ble NCLAT permitted the CoC to consider plans if filed by one or more persons. RP and CoC complied with the directions received
Aug'19	**16-Aug-19:** NCLAT did not consider extending/ excluding the period for starting a fresh process and directed NCLT to pass appropriate liquidation orders

Sep '19	**6-Sep-19:** Hon'ble Supreme Court stayed the liquidation proceedings pursuant to order passed by Hon'ble NCLAT **24-Sep-19:** Supreme court permitted the RP to invite fresh offers within 21 days and directed the CoC to take a final call within 2 weeks thereafter. RP and CoC complied with the order and invited plans.
Dec'19	**2-Dec-19:** Pursuant to the clarification application filed, Supreme Court recalled the order dated 13-Nov-19 & directed that the resolution plan must be submitted by PRAS within 30 days of the order and CoC to evaluate the plans within 3 weeks thereafter and place the same before Supreme Court. RP and CoC complied with the order and invited plans for consideration.
Jan 20	Consideration of plans received and negotiation with Prospective Resolution Applicant(s)
Feb 20	Resolution plan by Applicant 2 approved by CoC
Jun 20	**8-Jun-20:** Hon'ble Supreme Court relegated the matter to the NCLT to consider the same and pass appropriate orders within fifteen days from that day. Resolution Professional submitted the Application before Hon'ble NCLT for approval of the Resolution Plan. Hearings before Hon'ble NCLT conducted and concluded on 30-Jun-20
Jul 20	**9-Jul-20:** Resolution Plan by Applicant 2 approved by Hon'ble NCLT. Consequently, steps were taken for formation of Implementation and Monitoring Committee in terms of the Approved Resolution Plan comprising of one nominee from each of the 3 Key Lenders, nominee of the Resolution Applicant and the Insolvency Professional.

(Venkatasubramanian, 2021)

Whistle-blowing allegation of fraud

On May 23, 2022, a whistle-blower submitted a criminal complaint stating that top management of Amtek Auto had engaged in cheating, fraud, corruption, and the laundering of bank loans totalling ₹ 12,000 crore while reportedly conspiring with workers from numerous institutions (Financial Express, 2022). Mr. Arvind Dham, the company's promoter, 27 of its employees, RP Mr. Dinkar Venkatsubramanian, Partner Mr. Vivek Aggarwal, and Ernst & Young (EY), which produced a forensic audit report of Amtek Auto's transactions, were all named in the complaint, which has been forwarded to the Prime Minister's Office, the Central Bureau of Investigation (CBI) and the Enforcement Directorate. It further requested that anonymous IDBI Bank personnel be the subject of a criminal probe since they are accused of failing to recall loans in spite of violations of the requirements of a no-objection certificate that the bank granted in 2016. The complaint claims that Mr. Venkatsubramanian contacted Ernst & Young to evaluate the transactions that Amtek Auto had conducted between January 7, 2015, and July 24, 2017. Mr. Venkatsubramanian sought to ascertain whether any of these deals were advantageous or undervalued and whether any possible creditor fraud may have occurred. On March 13, 2018, the auditor issued his report. The lawsuit claims that even though the study only covered the years 2015 to 2017, it nevertheless showed 'glaring examples of cheating and syphoning off public cash'. It further claims that the forensic auditors neglected to collect and carefully review the balance sheets, account books, and banking records of these related firms in spite of abundant evidence that Amtek Auto had defrauded the Government through 127 connected organisations. The lawsuit alleges that upon receipt of the forensic audit report, the RP failed to use his independent judgement in informing investigating authorities of the economic offences perpetrated by Amtek Auto or in taking any action against the possibly connected parties. The complainant has requested that the CBI begin domestic bank account seizures of the Dham family, the 'benaamidars' mentioned in the complaint, and all parties that Amtek Auto may be associated with. Additionally, they have asked for an examination of the flow of money into foreign countries. Amtek

Auto was listed as one of the 12 big NPAs that must be resolved by the RBI via IBC. Amtek Auto owes its FCs ₹ 12,322 crore, according to records released during the settlement process. Castex Technologies and Metalyst Forgings, two of its group firms, owe lenders an additional ₹ 11,150 crore.

DELAYED FRAUD DETECTION

Case 1: ABG Shipyard

The debt-ridden company claimed in a Bombay Stock Exchange (BSE) filing that the NCLT authorised the start of ABG's liquidation and named Mr. Sundaresh Bhat as the Liquidator in an order dated April 25, 2019. In its order dated August 1, 2017, ordering the start of CIRP, the NCLT, Ahmedabad Bench accepted an application for the commencement of CIRP under section 7 of the IBC submitted by the FC, ICICI Bank Limited, in the matter of ABG Shipyard Ltd.

The company started the journey in the year 1985 by getting funds from 28 banks Andhra Bank, Indian Overseas Bank, Bank of Baroda, Laxmi Vilas Bank Ltd., Bank of India, Oriental Bank of Commerce, Canara Bank, Punjab and Sindh Bank, Central Bank of India, Punjab National Bank, Dena Bank, Deutsche Bank, The South Indian Bank Ltd., Development Credit Bank Ltd., Standard Chartered Bank, Export-Import Bank of India, State Bank of India, ICICI Bank Limited, State Bank of Patiala, IDBI Bank, State Bank of Travancore, IFCI Ltd., Syndicate Bank, Indian Bank and Yes Bank Ltd. (ABG Shipyard, 2016) in India and the Industrial Credit and Investment Corporation of India as a major funding bank. The company was the flagship company of the ABG group and was promoted by Mr. Rishi Kamlesh Agarwal, which focused on shipbuilding and repair. The firm had been operating for 16 years when the global financial crisis began to have an impact, and performance began to decline. Despite the company's poor performance, many banks actively extended loans to it until 2010. The State Bank of India attempted to restructure the debts via corporate debt restructuring in March, 2014; however, the firm failed to make the required loan repayment on time. The corporate account, which had a date of November, 2013, was labelled as NPA in July, 2016. A forensic investigation by EY LLP revealed that the firm had engaged in fraudulent operations between April, 2012 and July, 2017 that included 'diversion of cash, misappropriation, and criminal breach of trust' after the State Bank of India recognised it as a fake organisation in January, 2019. These 28 banks have granted three different forms of loans to ABG Shipyard, who then used the money to fund 98 shell businesses. The State Bank of India first complained in November, 2019 before adding more details in August, 2020. The CBI filed a lawsuit against ABG Shipyard and ABG International Limited on February 7, 2022, alleging that they defrauded the banks of the following sums. (ET Online, 2022).

The CBI issued a lookout notice for the ABG executives Mr. Santhanam Muthuswamy and Mr. Ashwini Kumar, as well as the founder Mr. Rishi Agarwal, on February 15, 2022. (ET Online, 2022). The Company was registered with both BSE and the National Stock Exchange, two stock exchanges in India. Additionally, the Securities Exchange Board of India (SEBI) conducted an investigation and submitted its report in 2019, stating the company, along with its promoter company, debited unreal purchases of ₹ 101 crore and diverted the funds from 2008 to 2014, leading to the overstatement of profit and assets. This complaint was received from the income tax department (SEBI, 2020). ABG Shipyard fraud, which involves financial statements fraud, asset theft, and corruption, is an obvious example of occupational fraud. The firm was slated for debt resolution under the IBC in July, 2017; however, it failed since no buyers were found.

Case 2: Bhushan Steel

One of India's top producers of primary and secondary steel is Bhushan Steel Limited (the CD or the company), now known as Tata Steel BSL Limited. In July 2017, the principal bench of the NCLT admitted the case of CIRP against the company under IBC. As required by the Code, the RP and his team continued the CD's business activities throughout the CIRP. The resolution process was also carried out by the RP and his team, and as a consequence, Tata Steel Limited's resolution plan was presented for approval of the NCLT. The resolution plan was accepted by the NCLT, and Tata Steel Limited, the victorious resolution applicant, immediately took over the CD.

The RBI designated 12 sizable accounts as being in default in June, 2017 and directed the lenders to submit an application for the start of CIRP. On this list, the company was recognised. The State Bank of India (applicant) filed the application against Bhushan Steel Limited before the NCLT on July 13, 2017, in accordance with section 7 of the IBC. By ruling dated July 26, 2017, the NCLT admitted the State Bank of India's application and designated Mr. Vijaykumar V. Iyer as the interim resolution professional (IRP). The committee of creditors subsequently voted at its initial meeting on August 24, 2017, to affirm the IRP as the RP. FCs and other stakeholders actively participated in the CIRP, which was completed within the time frames set forth by the Code and swiftly carried out in accordance with the agreed resolution plan.

Another scam by Bhushan Power & Steel Ltd (BPSL) in the amount of ₹ 3,805.15 crore has been reported by Punjab National Bank (PNB) to the RBI. The bank fraud involves a domestic exposure of ₹ 3,191.51 crore at the PNB branch in Chandigarh, a foreign exposure of ₹ 345.74 crore at the branch in Dubai, and an exposure of ₹ 267.9 crore at the branch in Hong Kong. The CBI first information report (FIR), which was filed on a suo-moto basis against the company and its directors, and the forensic audit investigation findings were the basis for the state-owned bank's claim that it was reporting the fraud to the RBI in accordance with regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. ₹ 3,805.15 crore in money was allegedly diverted from the banking system, according to the FIR. The bank said that in order to obtain funding from a group of banks, BPSL 'misappropriated bank funds' and 'manipulated books of accounts.'

SUGGESTIONS

This paper suggests the introduction of the whistle-blowing mechanism and mandatory forensic auditing under each of the sections of IBC.

Section 25(2)(h) - Resolution plan: This section requires a resolution plan to provide measures to address any instances of fraud or avoidance transactions. Whistle-blowers who report such instances may help in the detection and prevention of such frauds.

Section 44(2)(b) - Duties of Liquidator: This section requires the Liquidator to investigate the affairs of the debtor and report any suspected offences to the appropriate authorities. Whistle-blowers who report such offences may help the Liquidator in their investigations.

Section 213 - Investigation into Affairs of Company: This section provides for the investigation into the affairs of a company by the Government or the NCLT if it appears that the affairs of the company have been conducted with fraudulent intent. Whistle-blowers who report such fraudulent activities may help in initiating such investigations.

While the IBC does not have any specific provisions related to whistle-blowing mechanisms, it is possible to incorporate whistle-blowing mechanisms as part of the corporate governance framework of companies. The SEBI has issued guidelines for listed companies to establish a whistle-blowing mechanism for reporting instances of fraud, which may be relevant to insolvency proceedings involving listed companies.

CONCLUSION

It was evident from the *Amtek case* that there is no appropriate approach to identify the corporate fraudster before starting a resolution process. Additionally, there is no legitimate authority to label the defaulter a fraudster which was visible from the cases of *Bhushan steel* and *ABG shipyard*. Before beginning the resolution procedure, the IBBI must make sure the corporate defaulter is not a fraudster because it uses the same categorization as the RBI for wilful defaulters. The submission of the request for resolution procedure may be made contingent upon the auditor's clean report. Similar to the required forensic audit, the IBBI must allow time for whistle-blowers before proceeding with the RP and must assure their confidentiality and protection, as stated in the PIDPI. According to ACFE research, an organization's top fraud detection method is its whistle-blowing process. Therefore, the IBBI must introduce a mandatory forensic audit with a proper whistle-blowing mechanism under IBC.

BIBLIOGRAPHY

1) ABG Shipyard (2016), ABG Shipyard Limited, Annual Report, 2015-16.

2) ACFE (2020), "Report to the Nations - The Global study on occupational fraud and abuse".

3) Anant S. and Mishra A. (2019), "A Study of Insolvency and Bankruptcy Code and Its Impact On Macro Environment Of India".

4) Dasgupta S. and Kesharwani A. (2010), "Whistleblowing: A Survey of Literature", The IUP Journal of Corporate Governance, 9(4), pp. 1–14.

5) Desai N. (2020), "Understanding the Theoretical Underpinnings of Corporate Fraud", The Journal for Decision Makers, 45(1), pp. 25–31.

6) ET Online (2022), "ABG Shipyard Bank scam: The ABG Shipyard scam: Inaction on red flags as India's biggest bank fraud unfolded", The Economic Times.

7) Financial Express (2022), "Whistleblower accuses Amtek Auto promoters of Rs 12,000-crore fraud".

8) Jubb P. B. (1999), "Whistleblowing: A Restrictive Definition and Interpretation", Journal of Business Ethics, 21(1), pp. 77–94.

9) SEBI (2020), Final Order in the matter of ABG Shipyard.

10) Venkatasubramanian D. (2021), "CIRP of Amtek Auto Limited", Case Study published by IIIP ICAI, April, 2021.

13

BANK CRISIS MANAGEMENT AND RESOLUTION LEGAL REGIMES IN INDIA AND THE EUROPEAN UNION

-Dr. Ilias Kapsis and Dr. Neeti Shikha

EXECUTIVE SUMMARY

The paper contains a critical review of the bank crisis management and resolution legal regimes in India and the European Union (EU). The purpose of the review is to use the EU framework as a case study to infer lessons that India could use as it moves to update its own legal framework in this area. EU was selected because it adopted extensive reforms in its bank crisis management and resolution legal regimes following the global financial crisis (GFC) and the sovereign debt crisis in the eurozone during 2008-12. The two crises resulted in significant bank failures in EU and caused massive public interventions and costly bank bailouts. The post-crisis EU framework aims to create a special resolution regime for banks in order to improve the process of managing bank failures, while ensuring the avoidance of publicly funded bank bailouts, especially for systemically important banks (SIBs). The EU framework also incorporates the proposals of international standards setters especially of Financial Stability Board (FSB) for the resolution of banks. The EU experience from the implementation of the reforms could be useful to India, which has recently embarked on efforts to update its own legal framework for bank resolution. India is moving in this direction at a slower pace than EU due to the fact that India did not suffer significant bank failures during the GFC. The paper reviews critically the Indian and EU approaches to bank resolution and makes recommendations for improving these frameworks.

Keywords: Banks, Global Financial Crisis, Restructuring, Financial Stability, Insolvency, Systemic, Resolution, FRDI, European Union, India

INTRODUCTION

The crisis management and resolution of banks has been subject of ongoing discourse. The debate grew stronger post the GFC 2007-2009, which revealed significant weaknesses in the international pre-crisis regulatory architecture that led to major legal reforms in this area. India was not seriously impacted by GFC. The direct effect of the GFC on the Indian banking and financial system was almost negligible as the Indian financial market had limited exposure to riskier assets and derivatives.[1] Further, there was relatively low presence of foreign banks, which reduced the impact on the domestic economy.

However, the crisis did have knock on effects on the country, broadly, in three ways.[2] Firstly, there was a reduction in foreign equity flows, especially in the form of foreign institutional investors. This impacted the capital and forex markets and the availability of funds from these markets to domestic businesses. Secondly, the shrinking of credit markets overseas, which were popular to India's banks and corporates as a source of inexpensive credit, tightened the access to overseas lines of credit including trade credit forcing a switch to the more expensive domestic credit markets.[3] This increased the pressure on credit and liquidity in the domestic markets with knock-on effects. Thirdly, the fall in global trade and output had impact on consumption and investment demand. Also, India had a significant exposure to international trade with two-way trade (imports plus exports) being at 34.7% of GDP in 2007-08,[4] exposing India to the impact of the international economic downturn. The cumulative impact of all this was a slowing down of India's output and employment.

In the EU on the other hand, GFC had a major impact as it led to a large number of bank failures and significant economic fallout EU economy entered into recession for five quarters from the second quarter of 2008[5] driven by the drying up of interbank lending, bank deleveraging and the closing of credit lines in respond to the financial crisis. With the availability of lending severely restricted and causing snowballing effect on the rest of the economy, the economic output of EU took a significant hit. To prevent further damage to the financial sector the European Commission was forced to allocate between 2008 and 2011, 4.5 trillion euros (equivalent to 37% of EU GDP at the time) for state aid to financial institutions (FIs) across EU.[6] Measures included an increase in deposit insurance ceilings, provision of state guarantees for bank liabilities, and the recapitalization of banks being bailed out or wound down.[7] To address the economic fallout, EU agreed with member States, a range of fiscal measures including increased welfare funding, tax cuts, additional public investments, and other measures.[8] The EU efforts helped to stabilize the financial markets and pave the way for economic recovery but the high economic costs of public interventions resulted in a new crisis, this time around sovereign debt. The average government debt ratio climbed from around 60% of GDP before the crisis to 87% in 2014,[9] with some EU countries seeing levels of debt well above 100% of their GDP. The situation quickly escalated to crisis levels.[10] During 2010-11 Greece, Portugal and Ireland all received IMF bailouts, while Greece also received EU loans.[11] In May, 2012 Spain requested EU financial support as a result of the Spanish Government's efforts to deal with the collapse of the large bank Bankia and to support the Spanish banking sector.[12] Finally, in June, 2012, Cyprus, whose banks suffered significant losses from the restructuring of the Greek sovereign debt, requested EU bailout. The sovereign debt crisis also led to new problems for the financial sector as commercial banks had significant exposure to sovereign debts.[13] As a result, bank failures and the management of the consequences of the bank rescues for national economies remained an EU problem for a good part of the 2010s.

India was spared during the GFC, but the country still faces a serious challenge linked to the size of bad debts in its banks, where the official non-performing loan (NPL) ratio is 9.6 % and the ratio of 'stressed assets,' which also includes restructured loans, is 14 %.[14] This level of NPLs is very high, exceeding the level of non-performing loans reached in Greece, Portugal, and Italy during the crisis NPLs did not reach this level.[15] The relatively small size of the Indian banking sector may have spared the country for now from the kind of pain experienced in Ireland and Iceland during the GFC but as the country grows and its financial sector inevitably expands it is important to be aware of the risks and costs of bank restructuring especially in periods of industry-wide, systemic crisis, and to have in place mechanisms to address them.

GFC forced major rethinking internationally in regard to crisis management and resolution of banks. Urgent needs emerged to create mechanisms (internationally and domestically) to monitor systemic risks, to expand and improve regulation and supervision of banks, to resolve bank failures without resort to public funds and to prevent individual bank failures from escalating into systemic level events. Of equal importance was the need to develop effective mechanisms to be used pre-resolution to prevent bank troubles from escalating to threats to their solvency in order to avoid where possible the use of resolution with its associated high costs, with or without the use of public funds, and of disorderly bank insolvencies, which due to the significant interdependencies existing between banks, would increase the risk of systemic events. Preventing bank failures emerged as a first policy priority with the establishment of effective frameworks for the orderly winding down of banks, which were deemed beyond saving, as a second. In this context, an international consensus emerged that corporate insolvency laws were unsuitable to help achieve those objectives and the adoption of specialist resolution regimes was adopted instead as the preferred choice, at least for big banks. Finally, GFC revealed the need for regulators to focus on a small number but massive in scale banking groups, holders of significant assets and with significant presence in international financial markets or within national economies. The failure of these banks could threaten financial stability and whose rescue would require concerted international efforts by regulators. These institutions were branded 'too-big-to-fail' (TBTF) and 'SIBs'.[16]

The reforms that followed targeted all the above areas. Main elements of the reforms included the improvement of bank capitalization by revamping the Basel II rules,[17] the establishment of new bodies internationally and in the jurisdictions to monitor systemic risks,[18] the establishments of principles and mechanisms to improve cooperation between regulators with particular focus on the supervision of SIBs, the reform of the rules on prudential regulation and supervision of banks, the creation of new bank resolution legal frameworks and the protection of depositors.

India has joined the international efforts but at a slower pace than the EU, due to the issue being less urgent for the country. EU on the other hand, facing successive banking crises, was one of the first jurisdictions to introduce the internationally agreed post-GFC reforms and to put them into action. As such EU offers a good case study for considering the effectiveness of the post-crisis reforms. The lessons from the EU experience could be useful to India as it moves to improve its own regulatory framework for banks.

From all the post-GFC reforms this paper focuses on the crisis management and resolution rules for banks in India and EU. The purpose of the paper is to look at the current developments in this area in India and to use EU as a case study to extract conclusions and lessons from the application of the internationally agreed reforms that India could use as it moves to update its own legal framework in this area. India currently has not adopted many of the steps taken by other countries in this area, but there are plans for such an adoption. In 2017 the country's central government introduced the Financial Resolution and Deposit Insurance Bill (FRDI)[19] which was aiming to incorporate into Indian law many of the new international processes and practices on bank resolution and deposit insurance. The Bill was withdrawn in 2018 due to strong domestic opposition to several of its provisions but evidence emerged during 2022 that the Government could reintroduce the Bill with changes during 2023.[20]

On the other hand, EU has completed the relevant reforms in 2015[21] and has already in a fully-fledged framework on crisis management and resolution of banks and has acquired since considerable practical experience from its implementation. The biggest part of the paper will be allocated to the EU efforts and on the potential usefulness of EU experiences for India. The paper prioritizes the implementation of the framework on SIBs but all the main and rules principles are considered. The paper has three parts: the first part discusses how the Indian regulations describes SIBs and the principles that the central bank of the country i.e., the Reserve Bank of India (RBI) adopts to monitoring the function of these banks. The second part of the paper discusses the extensive EU framework for resolving SIBs. This part offers an insight into the strengths and weaknesses of the regulations in the EU. Finally, the third part advances the discussion on lessons that India can learn from the EU experience. Given that India is in process of developing insolvency framework for banks and FIs, the learnings from EU offers a way forward for regulators not only for developing insolvency resolution framework but also for addressing bank troubles early on. Before proceeding to the three parts, the paper analyses the concept of SIBs as developed by international regulatory bodies.

SIBs

SIBs fall into two groups: global systemically important banks (G-SIBs) and domestically systemically important banks (D-SIBs). Both types share as a common characteristic that they are different from ordinary banks because their failure can have a significant impact on the wider financial system, global or domestic. G-SIBs due to their far larger size and cross-border impact have received more attention in the post-GFC regulatory reforms but the main principles of financial regulation, supervision and resolution apply to both groups.

G-SIBs

The GFC led to the failure of a number of large global FIs with significant international presence which due to the size of these institutions threatened the stability of the international financial system and hit particularly hard several nations which had banks belonging to this group (US and UK among others). In the banking world, large banks with systemic significance are known as SIBs and are perceived as banks that are 'TBTF',[22] which leads to the expectation that Government support will be provided to these banks in time of distress to prevent broader financial collapse. SIBs are not a homogeneous group. They vary in areas of activity, size, complexity and systemic interconnectedness, and as such the risk they pose to financial stability also varies. However, these institutions have in common that their failure would cause significant disruption to the wider financial system and economic activity. The cost of a potential bailout of these institutions is very high, often exceeding the financial capacity of the individual countries or the groups of countries involved in the effort. Their insolvency due to their size and complexity and presence across several jurisdictions can be disorderly, and lead to great destruction of value as a result of the loss of franchise value and the fire-sale liquidation of assets. The dangerous consequences of the failure of these institutions results in a perceived expectation of Government intervention to prevent their failure in times of trouble. However, such support amplifies risk-taking, reduces market discipline, creates competitive distortions, and increases the probability of distress in the future.[23]

The emergence of G-SIBs has been the result of the rapid growth of globalization with the financial sector being one of the leaders seeking to finance trade, provide credit to businesses and states and provide new financial products and services to consumers across the world. The rapid financial globalization reflected in the over six-fold increase in the external assets and liabilities of nations as a share of GDP[24]—has been accompanied by the inevitable increase in financial interconnectedness between economies and businesses with banks serving as a critical conduit. Overall, countries have become more and more inter-linked with each other, particularly since the mid-1990s, as the asset liability management (ALM) strategies of their sovereigns, FIs, and corporations have become increasingly global in nature.[25]

Prior to the GFC the options available to the regulators to supervise the G-SIBs were limited and supervision was fragmented across national lines with limited cooperation between supervisors even if each G-SIB activities typically impacts many countries. When G-SIBs started failing during the crisis, the regulatory responses included a wide range of costly and poorly coordinated public sector interventions by affected countries, which aimed to restore financial stability. Both the financial and economic costs of these interventions, the market contagion and disruption caused and the associated increase in moral hazard meant that the existing supervisory arrangements and resolution mechanisms for G-SIBs were not fit for purpose.

The issue of moral hazard, the implicit market expectation that G-SIBs, due to their size and significance would be supported and their failure prevented by Governments received particular attention[26] and addressing it emerged as a key priority for regulators. In October, 2010, the FSB recommended that all member countries should have in place a framework to reduce risks attributable to Systemically Important Financial Institutions (SIFIs) in their jurisdictions.[27]

Compared to ordinary banks, whose regulatory framework was also updated, additional measures were put in place to reduce the likelihood and the severity of problems that emanate from the failure of G-SIBs.[28] Key priorities of the regulatory reforms included steps to improve the capitalisation and resilience of G-SIBs, to ensure their resolution in an orderly manner without exposing tax-payers to loss, while maintaining continuity of their vital economic functions, to prevent market contagion and to improve cooperation between national supervisors.[29]

The Basel Committee on Banking Supervision (BCBS) adopted a series of reforms to improve the resilience of banks and banking systems. New measures included increasing the required quality and quantity of capital in the banking system, enhanced risk coverage, introducing a revised leverage ratio to serve as a backstop to the risk-based regime, and introducing capital conservation and countercyclical buffers as well as a global standard for liquidity risk.[30] For G-SIBs these requirements were enhanced above Basel III levels.[31] The rationale for adopting additional policy measures for G-SIBs is based on the cross-border negative externalities created by them, which current regulatory policies do not fully address.[32] Two indicators in this category measure the importance of the bank's activities outside its home jurisdiction relative to overall activity of other banks includes cross-jurisdictional claims and cross-jurisdictional liabilities. The idea is that the international impact of a bank's distress or failure would vary in line with its share of cross-jurisdictional assets and liabilities. The distress or failure of a large bank is also more likely to damage confidence in the financial system as a whole.[33] The 'largeness' is measured in terms of total exposures used in the Basel III leverage ratio and its interconnectedness, among other factors.

In addition, the potential cross-border repercussions of a problem in any of the G-SIBs for the financial systems in many countries and for the global economy at large, make it impossible to address at national level and therefore a global minimum agreement is needed. Given that there is no single solution to the externalities posed by G-SIBs, there has been a multi-pronged approach adopted to address this. The policy objective has been to reduce the chances of failure of the globally SIBs and improve the global recovery and resolution frameworks.

The BCBS recommendations complemented those adopted by FSB which recommended the establishment of strong bank national recovery planning, the strengthening of the legal frameworks for bank resolution, the cross-border harmonisation of regulation and improved coordination between supervisors globally.

To identify SIBs, FSB in consultation with BCBS and national authorities, has been publishing since 2011 an annually updated list of G-SIBs.[34] The list is created based on a framework prepared by BCBS in November, 2011 (updated in July, 2013 and July, 2018[35]) for identifying the G-SIBs and the magnitude of additional loss absorbency capital requirements applicable to these G-SIBs.

BCBS developed a methodology based on an indicator-based measurement approach for assessing the systemic importance of G-SIBs. The indicators are calculated from data for the previous fiscal year-end supplied by banks and validated by national authorities. The indicators capture different aspects that generate negative externalities and make a bank systemically important and its survival critical for the stability of the financial system. The indicators included size, cross-jurisdictional activity, interconnectedness, lack of substitutability or FI infrastructure, and complexity the structure of such G-SIBs. This offered multi-dimensional analysis of institutions that constituted of systemic importance as compared to limited indicators available otherwise. The methodology included giving equal weight of 20% to each of the five categories of systemic importance indicators. For each bank, the score for a particular indicator is calculated by dividing the individual bank amount (expressed in EUR) by the aggregate amount for the indicator summed across all banks in the sample. The indicator-based measurement approach is based on a large sample of banks, which works as a proxy for the global banking sector. The banks with scores exceeding a cut-off level set by the BCBS are classified as G-SIBs.

The list of G-SIBs is divided into buckets' corresponding to the required level of additional loss absorbency. Loss absorbency concerns that capacity of banks to absorb losses both before and during resolution and is a crucial indicator of the resolvability of the bank, a critical step in the efforts of regulators to resolve the 'TBTF' problem[36] without exposing public funds to loss.[37] G-SIBs due to their significance and risks they pose to the financial system are required to have additional loss absorbency capacity compared to ordinary banks.[38] BCBS has published the assessment methodology and the additional loss absorbency requirement for G-SIBs.[39] The changes in the allocation of the institutions to buckets reflects the effects of changes in underlying activity of banks.

In the same year the Insolvency and Bankruptcy Code, 2016 (IBC/Code) was drafted, the FSB noted that there is a need to develop the macroprudential policy framework and in strengthening the regulation and supervision of non-banking financial companies (NBFCs) and housing finance companies (HFCs). On the macroprudential framework, this involves fleshing out institutional and operational arrangements, strengthening risk analysis and more closely linking it to decision-making, and enhancing public communication. On NBFCs and HFCs, this involves additional data collection and analysis, enhanced risk assessments, a regular review of the regulatory perimeter, and a more activity-based and risk sensitive framework for these entities. All of these tasks are not unique to India, reflecting challenges faced by many other jurisdictions, and need to be considered as part of managing the transition to a more diverse and interconnected financial system.[40]

For the resolution of banks, ordinary and SIBs, FSB published in 2011 the 'Key Attributes of Effective Resolution Regimes for Financial Institutions' containing the core elements of an effective resolution regime. The documents were updated in 2014.[41] Principles of this significant document are discussed later in this paper.

D-SIBs

After the adoption of a framework for G-SIBs, BCBS turned to the adoption of a new framework for the regulation of D-SIBs. The BCBS finalized its framework for dealing with D-SIBs in October, 2012.[42] The D-SIB framework focuses on the impact that the distress or failure of banks will have on the domestic economy. As opposed to G-SIB framework, D-SIB framework is based on the assessment conducted by the national authorities, who are best placed to evaluate the impact of failure on the local financial system and the local economy.[43] D-SIBs can cause similar externalities at domestic level by playing an important role for the stability of the domestic financial system and the national economy compared to non-systemic institutions.[44] However failure of a D-SIBs cannot always exclude a cross-border spill-over and as such the framework for D-SIBs is complementary to that for G-SIBs.[45] The resolution frameworks for D-SIBs are based on the same principles as G-SIBs with some adjustments to reflect their more national focus.

The banks having systemic importance above a threshold will be designated as D-SIBs. D-SIBs would be segregated into different buckets based on their systemic importance scores, and subject to loss absorbency capital surcharge in a graded manner depending on the buckets in which they are placed. A D-SIB in lower bucket will attract lower capital charge and a D-SIB in higher bucket will attract higher capital charge.

In India, banks having a size beyond 2% of GDP will be selected in the sample.[46] For this purpose, latest GDP figure at market prices, released by Central Statistical Office, Government of India, will be used.[47] As foreign banks in India have smaller balance sheet size, none of them would automatically get selected in the sample. However, foreign banks are quite active in the derivatives market and the specialized services provided by these banks might not be easily substituted by domestic banks. It is, therefore, appropriate to include a few large foreign banks also in the sample of banks to compute the systemic importance.

THE LEGAL FRAMEWORK FOR BANK CRISIS MANAGEMENT AND RESOLUTION OF BANKS IN INDIA

The RBI has expanded the use of quantitative techniques and stress tests to gauge systemic risks, especially to the commercial banking sector, while the main findings (reflecting the contributions of various authorities) are reviewed by the Financial Stability and Development Council and published in the Financial Stability Report (FSR). The Report focuses on reviewing the nature, magnitude and implications of risks that have bearing on the macroeconomic environment, FIs, markets and infrastructure.[48] It carries stress tests to determine resilience of various sectors. Over the years, it has emerged as main driver for directing pre-emptive policy responses to emergent risks in the financial system. Experience shows that there could be varied institutional arrangements for macroprudential policy considering country-specific circumstances. [49]

RBI, being the central bank, undertakes the analysis of macroprudential framework and policy. The law mandates RBI to secure monetary stability,[50] but since 2004 it has voluntarily included financial stability as an additional objective in view of its contribution to the conduct of monetary policy and to price stability. [51] It carries out banking system stress tests mainly applying scenarios directly to banks' balance sheets. Valuation of the soundness and resilience of financial intermediaries by analysing their recent performance as reflected in offsite returns is one such way. Further, it provides an assessment of activity indicators, asset quality and capital adequacy of scheduled commercial banks.[52] It also examines the resilience against macroeconomic shocks through stress tests and sensitivity analysis.[53]

This approach is not full-proof and could be enhanced in various ways. First, models could be further developed to assess the impact of adverse macro scenarios on banks' borrowers – especially those most at risk – and then, in turn, how a deterioration in their balance sheets would feed back to banks' own balance sheets.[54] Currently, such approaches are adopted only for highly indebted corporates for instance those having high foreign currency maturity mismatches. There is need for authorities to continue to develop techniques that assess financial stability risks outside the banking sector and includes their linkages with other FIs, markets and the impact of external shocks on capital flows. It would also be useful to continue to increase the coverage and consistency of data on corporate balance sheets. At present, information on corporates' foreign currency hedging is collected by banks, which incur incremental provisioning and capital requirements for loans to entities with unhedged foreign exposures. [55]

However, focusing solely on domestic resident entities may lead to an understatement of overall group foreign exchange leverage and risks. Also, availability of data is a challenge. Usually, the corporate sector and macro data are available on an infrequent basis and the delay results in delayed policy response. Even the financial stability response within the RBI relies on quarterly (or less frequent) data in preparing the FSR, and lacks regular surveillance. The technology advancement and real-time data availability with financial market information can provide more timely data and thereby timely policy response.

Framework for regulating and resolving SIBs by the RBI

The RBI had issued the framework for dealing with D-SIBs on July 22, 2014. The framework mandates the RBI to disclose the names of banks designated as D-SIBs starting from 2015 and place these banks in appropriate buckets depending upon their Systemic Importance Scores (SISs). Based on the bucket in which a D-SIB is placed, an additional common equity requirement has to be applied to it. In case a foreign bank having branch presence in India is a G-SIB, it has to maintain additional CET1 capital surcharge in India as applicable to it as a G-SIB, proportionate to its Risk Weighted Assets (RWAs) in India i.e., additional CET1 buffer prescribed by the home regulator (amount) multiplied by India RWA as per consolidated global group books divided by total consolidated global group RWA.

The principles developed by the RBI for regulating D-SIBs allows for appropriate national discretion to accommodate structural characteristics of the domestic financial systems. The principle allows the possibility for countries to prescribe additional requirements based on the specific features of the country and its domestic banking sector. The regulatory principles consider the higher loss absorbency (HLA) requirement for D-SIBs. There are in total 12 principles and these can be applied to consolidated groups and subsidiaries as well. National authorities may apply them to branches in their jurisdictions in accordance with their legal and regulatory framework. The RBI aims to implement these principles in combination with a strong peer review process. The 12 principles can be broadly categorised into two groups: the first group that includes principles 1 to 7 focuses mainly on the assessment methodology for D-SIBs. The second group comprising principles 8 to 12 focuses on HLA for D-SIBs.

National authorities should establish a methodology for assessing the degree to which banks are systemically important in a domestic context. The assessment methodology for a D-SIB should reflect the potential impact of, or externality imposed by, a bank's failure.

Bank resolution under the FRDI Bill

FRDI Bill establishes a single unified framework for resolving certain categories of financial service providers (FSPs) in distress.[56] Further, it seeks to provide deposit insurance to consumers of certain categories of financial services and a mechanism for designation of SIFIs by the Central Government for resolution.[57]

There are essentially two authorities involved throughout the process of resolution of specified service providers[58] namely, Resolution Corporation[59] which exercises the core resolution powers and is the resolution authority and the other is the appropriate regulator,[60] which is a financial service regulator of the respective specified service provider and assists the Resolution Corporation in the process leading up to resolution.

The resolution procedure under the provisions of FRDI can be broadly divided into two stages namely pre-resolution stage and the resolution stage.

According to clause 36 of the FRDI Bill, every specified service provider, based on objective criteria,[61] can be classified into one of the categories of risk to viability i.e., low, moderate, material, imminent or critical. Various attributes such as adequacy of capital, assets and liability, asset quality, capability of management, earnings sufficiency, leverage ratio, liquidity of the specified service provider, sensitivity of the specified service provider to adverse market conditions, compliance with applicable laws, risk of failure of a holding company of a specified service provider or a connected body corporate in India or abroad etc. are to be taken into account.[62]

The Bill provided that any specified service provider, classified in the category of material or imminent risk to viability shall submit a restoration plan to the appropriate regulator and a resolution plan to the Corporation within ninety days of such classification under section 36.[63]

Further, it provided that the Corporation may create a bridge service provider by incorporating a company for the purpose of resolving a specified service provider, with the aim of eventual resolution and that the shares of the shares of the bridge service provider can be entirely held by the Corporation.[64]

Also, the Corporation may, in consultation with the appropriate regulator, if it is satisfied that it necessary to bail-in a specified service provider to absorb the losses incurred, or reasonably expected to be incurred, by the specified service provider and to provide a measure of capital so as to enable it to carry on business for a reasonable period and maintain market confidence, take an action under this section by a bail-in instrument or a scheme to be made under section.[65] The major reason for the public's backlash towards the FRDI Bill was due to the lack of understanding and apprehension towards the misuse of insured deposits.

International Association for Deposit Insurance (IADI) Core Principles for Effective Deposit Insurance Systems, as referred to in the Key Attributes Assessment Methodology for the Banking Sector, a timely pay-out is a pay-out made to the depositors within seven working days and if not, then a credible plan must be in place in the jurisdiction to reach this seven-day pay-out target within two years. The erstwhile FRDI bill did not comply with this. India must ensure compliance with this provision, among others. From the perusal of the Bill, the process of initiation of the insolvency process against the FSPs is unclear. Even though the insolvency process against the FSPs is to be initiated only on an application filed by the appropriate regulator[66](RBI),[67] it is uncertain, under what circumstances, the appropriate regulator can file the application with the National Company Law Tribunal (NCLT). The international standards require that there should be clear standards or suitable indicators of non-viability to help guide decisions on whether firms meet the conditions for entry into resolution. Countries have attempted to define SOAR[68] and PAIRS[69] risk assessments to identify the non-viability of a failing financial firm. It is desirable that the regulations clearly define them so that the respective authority has the power to step in timely before the financial firm becomes balance sheet insolvent. There are several other gaps that exist in the proposed FRDI Bill that Government had recalled but has expressed its desire to reintroduce with tweaks.

It is beyond the scope of this paper to delve deep into what should be the ideal framework for the insolvency measures of banks. What the paper proposes is that the focus should be on creating robust pre-insolvency framework for banks.

The pre-insolvency resolution options

Currently India has following pre-insolvency resolution options for banks:[70]

a) **Corporate debt restructuring**- This scheme is designed for lenders to voluntarily restructure the debt of their companies where the banks accept a moratorium on interests of the portfolio and extended period for principal repayments.

b) **Strategic debt restructuring**- This scheme is used by lenders to convert their debt into equity in order to take control of the distressed companies and sell their stake to realize value.

c) **Prudential Norms on Income Recognition, Asset Classification (IRAC) and Provisioning pertaining to advances**- This requires banks to ensure adequate levels of provisioning on assets and to have a transparent mechanism. As per this, there is requirement of policies for lenders on resolution of stressed assets. These norms also require detailed policies on various signs of financial difficulty, providing quantitative as well as qualitative parameters, for determining financial difficulty as expected from a prudent bank. In order to enable lenders to frame respective policies for determination of financial difficultly, the framework provides for a non-exhaustive indicative list of signs of financial difficulty.[71]

d) **Scheme for Sustainable Structuring of Stressed Assets** (S4A)- The framework under S4A scheme is used to convert large project debt into sustainable and unsustainable components with the latter then being converted into equity to sell to a new owner. This Scheme provides that lenders may upgrade and reverse the associated enhanced provisions after one year of satisfactory performance of the loan. Further, it makes incumbent on banks to make disclosures in their annual financial statements on application of the Scheme for Sustainable Structuring of Financial Assets.[72]

e) **IBC**- The IBC outlines separate insolvency resolution processes for individuals, companies and partnership firms. The objective of the code is to resolve the cases in a timely manner within 180 days (extendable up to 270 days).

f) **RBI Guidelines on Early Warning Signals** (EWS)- The objective of EWS is to identify the risks associated with a potential fraudulent account at a nascent stage, which can help the lenders take preventive action on an account to be declared a fraud.[73]

THE EU CRISIS MANAGEMENT AND RESOLUTION FRAMEWORK

In order to understand the extensive EU framework for crisis management and resolution of banks it is important to understand first the context in which EU regulators operate.

The current situation of the banking sector in the EU

During the past three years EU faced three major crises with potentially significant implications for its financial system: the first crisis concerned the consequences of the health crisis cause by COVID-19 pandemic. Europe was one of the hardest hit regions and European Governments were forced to respond by imposing significant restrictions in social and economic activity in their territories. Social distancing rules and lockdowns placed significant strains on the European economies.

The European financial system, unlike in 2007 when GFC hit, was well prepared and weathered the crisis without major problems. Part of the success was attributed to their superior levels of capitalization compared to the financial crisis. According to Ana Botín,[74] President of the European Banking Federation, at the start of the COVID-19 pandemic in 2020, the European banks had a capital ratio of 15% on average and a short-term liquidity ratio of over 150%. These levels of capitalization and liquidity were more than double of those that European banks had at the start of the financial crisis. In addition to the higher levels of capital and liquidity the European banks benefitted from the massive economic stimuli provided by European Governments to support the economies during the pandemic. The EU played a significant role in coordinating policies and mobilizing financial resources. As a result, the European banks did not experience significant deterioration in the quality of assets under their control during the COVID crisis.

In 2021, the economic recovery in Europe helped to improve the financial outlook of European banks even further, but a new threat in the form of high inflation, as a result of the supply-chain disruption caused by the pandemic and other factors emerged as a new threat to the financial stability. 2021 ended with inflation hitting multi-year highs and interest rates rising as a response. The situation deteriorated further in 2022 due to the Russian invasion of Ukraine, which resulted in big rises in energy prices in Europe, which pushed inflation to even higher level. Interest rates continue to rise as the European Central Bank (ECB) has been trying to control inflation increasing the risk of recession in Europe during 2023, while stock market volatility and high energy prices increase economic pressures on households and the economy.[75]

Despite the volatile political and economic environment, the European banks and European regulators have declared that the current levels of bank capitalization and the results of the resolvability assessment indicate that banks are in position to ensure effective defence of financial stability.[76] EU regulators have become so confident that they have declared their intention to eliminate the 'TBTF' problem associated with SIBs by 2024.[77] By that time regulators expect that all major EU banks will have achieve resolvability levels.[78] In addition, after the financial crisis they claim that they have built a comprehensive regulatory and supervisory regime, which is equipped with tools and processes for effectively dealing with failing banks, without the need to resort to bank bail-outs using taxpayers' funds, a method broadly used during the last financial crisis, which is deeply unpopular in Europe. Whether they will succeed or not remains to be seen.

Bank supervision and regulation in EU

The European policy for the banking sector, since the creation of the European Economic Community (EEC) and the Common Market by the Treaty of Rome in 1957 provided for the creation of a single market for financial services, a process linked to the achievement of the free movement of capital[79] one of the 'four freedoms' on which the EU single market is currently based (free movement of goods, services and people are the other three). To build that single market, a process which lasted for several decades, EEC pursued the liberalization of financial services by taking steps to remove national barriers while seeking to harmonize the financial laws, regulations and administrative provisions of Member States. The harmonization process relied on the principles of:[80] a 'single banking license', which would provide to a financial institution that was granted licence in one EEC country a 'passport' to conduct business in all other EEC countries; 'mutual recognition', which required each Member State to recognize the regulatory standards of other Member States; and 'home country control', which required that the country of origin in EEC of the financial institution, would have the main responsibility for the supervision of that institution with the host countries playing complementary role.[81] The single market in financial services was officially completed in 1992 and the EU focus shifted to the new big European project, which was the creation of the single European currency, the euro, which was launched in 1999. In the same year the European Commission published its Financial Services Action Plan[82] for the purpose of improving the single market in financial services, which, as the Commission acknowledged, remained segmented with businesses and consumers deprived access to cross-border financial institutions. New action was also needed to address the structural changes caused by the introduction of the euro.

One of the significant developments that followed was the publication in 2001 by the Committee of Wise Men of the Lamfalussy Report on the Regulation of European Securities Markets.[83] The Report recommended a four-level approach to improve the regulatory process in financial services in order to make it quicker and more effective.[84] The recommendations were adopted in the European Securities markets and also in the rest of the financial services sector. Other reforms also followed until 2005. The main aim was to advance European integration in financial services, improve regulation and build an effective supervisory architecture.

However, the EU legal architecture prior to the GFC was suffering from several significant flaws. The first flaw was that the creation of a single market for financial services and the efforts for further legal integration in the sector were not accompanied by the creation of pan-European regulatory and supervisory authorities. Supervision of banks remained the responsibility of national authorities. For large banks with significant cross-border activities national supervisors were expected to share information and coordinate their supervisory actions.

The second flaw was that the harmonization of financial regulations within the single market was not complete. What had been achieved was only partial harmonization, with the common EU directives providing to EU Members States options in the enforcement of the agreed common rules. Even where the rules left no options to national authorities, issues of interpretation to the law prevented a single legal approach.[85] In regard to failing banks, for those operating primarily at the national level, national laws were applicable but for the increasing number of banks with significant cross-border activity there was no EU-wide legal framework. Different supervisory, crisis management and resolution tools as well as different company and insolvency laws existing across member states prevented effective coordination and created legal complications as national laws had different approaches e.g. in regards to the rights of creditors, the protection of depositors, the transfer of assets or the management of insolvency processes.[86] The absence of agreement on burden-sharing for the financing of the public support to the bank when it was needed further complicated the efforts of a common approach, which ended up being very ad hoc.[87] As a result, prior to GFC, the EU regulatory landscape was largely fragmented with national laws continuing to play a significant role.

A third flaw which was not EU's alone but an acknowledged failure of regulators across the world, was the absence of an early warning system and of a proper review of systemic risks in the financial sector.[88] This absence along with the other EU-specific weaknesses compounded EU losses when GFC hit.

It was clear that the EU needed a new approach to financial regulation, which would result in more centralized regulatory architecture, with EU taking from Member States the main responsibility for the regulation and supervision of banks, especially those with significant cross-border activity. EU also undertook to create a funding mechanism for dealing with the resolution of banks.

GFC also revealed the need for better policy coordination among regulators at the international level with standard setting bodies such as the BCBS assuming more prominent role. EU undertook more responsibilities in the representation of EU member states in these bodies and in the implementation of internationally agreed standards within the EU.

A new group of experts led by Jacques de LarosieÌre was appointed to make recommendations for a new approach to financial supervision. The LarosieÌre Report published in 2009 made a wide range of recommendations including the proposal to transfer to EU law the responsibility of drafting the core rules and principles of financial regulation limiting the discretion of national authorities.[89] The Report also recommended the creation of a European System of Financial Supervisors (ESFS), which would coordinate the supervision of banks at national level.[90]

EFSF was introduced in 2010 and included three new European supervisory authorities (ESAs): the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA). The new authorities were granted more powers in regard to setting out the relevant regulatory standards and coordinating their implementation at national level. However, the new authorities did not become fully-fledged, centralised financial supervisory authorities.[91] Day-to-day supervision has remained a responsibility of national authorities but their discretion and powers to act autonomously have been significantly reduced.[92] EFSF also includes a European Systemic Risk Board (ESRB), a new body with responsibility to monitor systemic risks. For large cross-border banks the LarosieÌre Report recommend the strengthening of colleges of supervisors which would assume the supervisory responsibility.[93]

The above recommendations were aimed at addressing the two flaws identified above. For the problem of the increasing number and cost of bank failures EU used a different mechanism which was the creation in 2014 of the Banking Union, which rests in two pillars with plan for a third. The Single Supervisory Mechanism (SSM) which was enacted in 2014 and the Single Resolution Mechanism (SRM) which was enacted in 2015.

SSM comprises the European Central Bank and the national supervisory authorities of the participating countries. ECB assumes the responsibility for the direct micro-prudential supervision of EU Banks that are 'not less significant'[94] in the euro area. These are the most important banks in EU and their number at consolidated level, as of December 21, 2022, was 113.[95] The significance of a bank is determined by a number of factors such as the bank's total assets (they exceed 30 billion euros), the bank's significant cross-border activity, the receipt by a bank of public financial support, the significance of the bank for the EU economy or a specific EU country and where a bank is one the top three banks of a particular EU country.[96]

For all other banks, national supervisors will carry out direct day-to-day supervision.[97] However the national authorities act as 'delegates' of the ECB and have to report to the latter. Also, ECB reserves the discretionary power to designate any other bank as significant and to take control of direct supervision from the national supervisors.[98]

SRM aims to establish a common approach for dealing with failing banks for the purpose of safeguarding financial stability while minimizing the cost of bank rescues for European taxpayers. A third pillar, includes the creation of a EU-wide deposit guarantee scheme (DGS), which would ensure protection of depositors across the Union. This has not been completed yet.

In addition, to resolve the problem of the diversity of banking regulations across its member states and to support its new centralized approach, EU created 'a single rulebook' for banks by passing a series of EU laws, which limit the ability of member states to act autonomously. The 'single rulebook' includes harmonized prudential rules, which cover *inter alia* capital requirements,[99] bank recovery and resolution[100] and national deposit guarantee schemes.[101]

Finally, GFC's spread across the world and the global reach of many banks revealed the need for action at international level. In this area EU efforts concentrated on coordinating European countries participation in international standard setting bodies such as the BCBS, FSB and G20.

EU law and systemically important institutions

SIBs in the EU are referred to as 'systemically important institutions' (SIIs). The EBA is the EU body responsible for issuing guidelines, which is used by regulators for the identification and assessment of SIIs. The EBA methodology for identifying global SIIs (G-SIIs) follows closely the BCBS's one for G-SIBs.[102] As a result, the EU list of G-SIIs identified by EU member states has been since 2014 identical to the list for G-SIBs identified by the BCBS.[103] EBA assessment of SIIs also follows closely the BCBS guidelines.

D-SIBs are referred to in EU as 'other systemically important institutions' (O-SIIs). The term concerns banks that are systemically important either at member state or union level and EBA has developed guidelines for their identification and assessment[104] based on the BCBS guidance of D-SIBs.

The EU approach to bank failures

GFC manifested clearly to EU policy makers that a new approach was needed aimed at creating a special crisis management and resolution legal regime for EU banks. The new regime would not abandon completely the application of corporate insolvencies framework. However, when EU regulators determine that the application of such framework could risk harming the public interest and cause market instability, different rules would apply. This is due to the fact that insolvency laws do not fully consider the need to avoid market disruptions which could harm financial stability or the need to maintain essential services and protect depositors.[105] In addition, insolvency proceedings are lengthy and involve complex negotiations and agreements with creditors especially when reorganisation is needed. At the end, shareholders and creditors also suffer losses.[106]

The European Commission's view, which reflects a wider international consensus after GFC, has been that resolution, should be used as an alternative to corporate insolvencies primarily for SIBs. Resolution, just as insolvency, will result in the restructuring or winding down of the bank and will impose losses on shareholders and creditors, but it will also safeguard financial stability and will limit the loss to taxpayers from bailouts and other support.[107]

Further, the special resolution regime for bank failures raising public interest concerns would have liquidation of assets as the last resort. Instead, the resolution process would first aim to ensure the continuity of critical bank functions, restore the viability of parts or all of the bank and maintain financial stability. Corporate insolvency rules would apply only if the bank cannot be made viable.

The current EU framework was developed following the guidance provided by the FSB in its Key Attributes of Effective Resolution Regimes for Financial Institutions.[108]

The Single Resolution Mechanism

The legal framework for the recovery and resolution of credit institutions and investment firms can be found in the Bank Recovery and Resolution Directive (BRRD)[109] which was adopted in 2014 (Directive 2014/59/EU). BRRD was amended in 2019 by Directive 2019/879[110] as regards the loss-absorbing and recapitalization capacity. BRRD was further amended in 2022 by the 'Daisy Chain' regulation[111] which introduced targeted adjustments aimed at improving the resolvability of banks**.**

In addition. the EU Single Resolution Mechanism Regulation 806/2014[112] (SRMR), which was also adopted in 2014 aimed to introduce for the first time a Single Resolution Mechanism (SRM). SRMR such as BRRD, was amended in 2019.[113]

SRM comprises the Single Resolution Board (SRB), a body responsible for the resolution of large banks in EU and a Single Resolution Fund (SRF)**,** which is used to finance the resolution process, and which is financed by the financial sector.

a) The recovery plans

The EU legal framework requires, as a first step, efforts to prevent the bank failure by designing crisis prevention measures. Recovery plans are used to ensure that banks and investment firms *'...consider in advance which corrective actions they could effectively take in situations of stress to restore their financial and business viability'*.[114] The process requires banks to submit recovery plans to the relevant resolution authority (national authority or the SRB), detailing the *'...measures to be taken by the institution to restore its financial position following a significant deterioration of its financial situation'*.[115] EBA provides guidance and recovery plan indicators, which aim to help banks *'...to monitor and respond to the emergence and evolution of a stress situation'*.[116] The plans must be updated annually or when there are materials changes in the situation of the bank (e.g. change in the legal structure, business or financial position). Significantly, recovery plans should not assume access to public funds, and they should include details about when and how the bank will use central bank facilities and should identify the qualified assets that will be used as collateral.[117]

The supervisory authorities will review the plan to determine if its implementation *'...is reasonably likely to maintain or restore the viability and financial position of the institution or of the group'*[118] taking also into account the preparatory measures already taken or planned. The authorities will also consider if the plan *'...is reasonably likely to be implemented quickly and effectively in situations of financial stress and avoiding to the maximum extent possible any significant adverse effect on the financial system'*.[119]

For groups, the usual type of entity involving SIIs the recovery plan will concern the entire group, will be headed by the parent company in the EU and will include actions at both parent and subsidiary level.[120] Group plans are submitted to the 'consolidating supervisor', which is usually the 'home' supervisor (EU country where the bank is registered and licensed) or the appointed lead supervisor.[121]

For SIIs the 'minimum requirement for own funds and eligible liabilities' (MREL) and the 'total loss absorbing capacity' (TLAC) are included to the list of indicators.[122] Recovery plans should take into account scenarios not only specific to the banks or groups drawing the plans but also those covering situations of broader market stress.[123] These requirements highlight the emphasis of EU regulators to ensuring that the implementation of the recovery plans will not adversely affect financial stability.

A particularly challenging issue concerns the determination of the indicators whose presence will trigger the actions determined in the plan and the decision to take those actions. BRRD requires that these indicators should be included in the recovery plan, that they could be quantitative or qualitative and they should be easy to measure.[124] However, BRRD leaves to the bank the decision to take recovery action where an indicator has not been met or to refrain from action when an indicator has been met. In all cases the relevant authority should be notified.[125]

The recovery plans are submitted to the supervisory authority which in EU is separate from the resolution authority. The latter is consulted during the review of the plan and may make recommendations.[126]

b) The resolution plans

These are drawn by the relevant resolution authorities and contain the resolution options in case of failure or near failure of a bank. For banks which are subject to the SSM, the plans are drawn by the SRB in consultation with the ECB and the national authorities.[127]

The resolution plans are developed after a thorough analysis of the bank's legal, financial and operational structures and other critical elements and seek to prepare responses taking into account various scenarios of failure of the specific bank.[128] The scenarios also include conditions of wider market distress. As with recovery plans, the resolution plans should not assume any extraordinary public financial support besides what is already prescribed, any central bank emergency liquidity assistance and any central bank liquidity assistance provided under non-standard collateralization, tenor and interest rate terms.[129] Resolution plans are very detailed including the resolution tools that will be used in each potential scenario, the details of the plan execution, timeframes financing and other critical information.[130]

An important part of the resolution plans concerns an assessment of whether the bank is 'resolvable' without assuming extraordinary public financial support or central bank liquidity support. An individual bank is resolvable if it is 'feasible' and 'credible' for the resolution authority 'to either liquidate it under normal insolvency proceedings or to resolve it by applying the different resolution tools and powers' avoiding wider market instability.[131] A group is resolvable if resolution authorities can visibly and credibly '*...either wind up group entities under normal insolvency proceedings or [...] resolve group entities by applying resolution tools and powers*' without adversely affecting financial stability.[132] Group resolution plan will normally require involvement of more than one resolution authorities as the group may have operations across different countries. SRB leads in the design of the resolution plans for banks regulated under SSM.

A potential controversial issue concerns the requirement that banks should take action to remove impediments to the bank's resolvability. The controversy emerges from the fact that the affected bank will have to make some changes in its business model (e.g. divest assets or cease activities in certain areas) or financial position (e.g. amend existing inter-group financial arrangements) to remove the impediments which have been identified as part of a scenario-based resolution plan. Hypothetical scenarios for the future may be confirmed by reality or not, but the banks are required to act promptly to remove impediments to resolution, once such impediments have been identified in the scenario-based exercise.[133]

Banks have the right to propose their own measures to address the identified impediment, but these could be rejected if they are not deemed satisfactory.[134] Resolution authorities could then propose their own alternative measures.[135]

If the bank is part of a large group, the latter may be able to address the risk of the bank's resolution by providing intra-group financial support to that bank. Such support could be acceptable by regulators if it can be effective in preventing the bank failure and does not put at risk the financial viability of the entire group or its ability to meet its regulatory obligations.[136] The impact of any assistance on financial stability will have to be considered. Also, to maintain a level playing field in the market, there is the expectation that the assistance will be repaid by the receiving bank. The relevant agreement between the group and the affected bank will have to be submitted to the resolution authorities for review and approval.

In the case of banking groups an important aspect of resolution planning includes the resolution strategy with two options being considered: the Single Point of Entry (SPE) where only one entity of the group, usually the group's parent enters into resolution (resolution entity) and Multiple Point of Entry (MPE) where more than one group entities enter.[137] SPE has the advantage that apart from the resolution entity all other group entities (subsidiaries) stay out of the resolution process even if they remain members of the group. All group losses are upstreamed to the parent entity from the subsidiaries while capital takes the opposite direction from the parent to the subsidiaries to ensure their continuing operation and viability.[138] SPE helps to avoid a number of problems such as the increased complexity of the resolution process if subsidiaries are dragged in, the wider a market disruption caused by the spread of the crisis from the parent to its subsidiaries and the markets where the latter operate, the 'abandonment' of subsidiaries by the parent and the involvement of multiple resolution authorities from different states when the subsidiaries are located outside of the home country of the parent.[139] Under SPE the resolution authority responsible will take the lead and resolution efforts will concentrate on the parent. On the other hand, SPE by seeking to ensure adequate capitalization of subsidiaries, 'locks -in' financial resources of the group restricting their use by the group.[140]

Under MPE resolution strategy there is more than one resolution entity and thus more than one resolution group may exist within the banking group.[141] The two or more resolution groups may become legally separated and resolved by different resolution authorities, which may apply different resolution frameworks. Such strategy is more suitable for large groups with significant international operations is countries and regions with different legal frameworks for resolution.

c) The pre-resolution regulatory intervention stage

Before the occurrence of events that would trigger the bank resolution process, other events may trigger an early intervention by regulators. The latter prefer to avoid the resolution stage by acting in the earliest signs of bank trouble to try to resolve the problem. Early interventions are handled in EU by the regulators and not the resolution authorities.

Early intervention would be triggered by the occurrence of events specified in EU legislation. These include the rapidly deteriorating financial condition of the bank, including deteriorating liquidity situation, increasing level of leverage, rising NPLs or concentration of exposures.[142] The deterioration may not have yet reached a level where the regulatory thresholds for liquidity, leverage and capital have been breached triggering the resolution process, but this may be likely to occur in the near future.

The action taken during the early intervention stage will depend on the individual circumstances of the bank and the cause of the emerging problem. Regulators may require implementation of measures listed in the recovery plan, may request from the bank management to draw up plans to overcome the problem within a specific timeframe, convene a meeting of shareholders, request the removal or replacement of members of the bank board identified as responsible for the problem, and other measures.[143]

d) The resolution stage

The timing of the transition from the early intervention to the resolution stage depends on the individual circumstances. Initiating the resolution process is a very important stage because of the impact of the relevant decision on the bank assets, the bank's creditors, the depositors and in the case of SIIs potentially the wider market stability. The body responsible for initiating the resolution process in EU is the SRB but the exercise of this power is subject to legal conditions which must all be met:[144]

a) a determination that the institution 'is failing or is likely to fail' has been made by the competent authority, after consulting the resolution authority or by the resolution authority after consulting the competent authority;

b) having regard to timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector measures...would prevent the failure of the institution within a reasonable timeframe;

c) a resolution action is necessary in the public interest.

Importantly the determination of whether the bank 'is failing or likely to fail' is left to the 'competent authority', that is the supervisory authority, which for SIIs is the ECB. The central bank is deemed to be better placed to make the determination due to its its role as the day-to-day bank supervisor.[145] In this sense and given the significance of the determination, it is evident that ECB's influence on the SRB's decision to initiate the resolution procedure is critical[146] and that therefore the ECB holds the main power.

The legal standard for failure or likely failure of a bank includes situations where the bank will '*infringe the requirements for continuing authorization in a way that would justify the withdrawal of the authorization*' such as when the losses incurred by the bank will deplete all or significant part of its own funds.[147] It will also be met where the bank's assets in the near future will likely be less than its liabilities[148] or if in the near future, the bank will be unable to pay its debts or other liabilities as they fall due;[149] or where the bank will require extraordinary public financial support (through state guarantees or capital injections).[150]

In regard to the case where the bank needs extraordinary public support, EU law establishes an additional option which is known as 'precautionary recapitalization' and which could be provided without triggering the bank resolution process. Precautionary recapitalization can be used only if one of the other triggers of bank failure above are not in existence. If they are then the bank will enter the resolution process. Precautionary recapitalization may be used for example where the bank has failed stress tests or has been unable to raise adequate capital from private investors.[151]

Precautionary recapitalization is subject to a number of conditions:

a. It is provide' in order to remedy a serious disturbance in the economy of a member State and preserve financial stability;[152]

b. It consists in 'an injection of own funds or purchase of capital instruments;[153]

c. The price and terms of the recapitalization should not 'confer an advantage upon the institution;[154]

d. It 'shall be confined to solvent institutions;[155]

e. It is 'conditional on final approval' under State aid rules;

f. It is of a 'precautionary and temporary nature;[156]

g. It must be 'proportionate' to remedy the consequences of the serious disturbance in the economy;[157] and

h. The measure shall not be used 'to offset losses that the institution has incurred or is likely to incur in the near future.[158]

Overall, precautionary recapitalization is an early, temporary and with limited scope measure aimed at ensuring the continuity of bank operations, whose disruption could cause serious disturbance in the economy.[159]

The other condition for initiating resolution with significant and potentially wider dimension is the requirement the resolution action to be necessary in the 'public interest'. The concept of public interest, as discussed later in the paper, is highly contentious even if SRMR provides relevant guidance[160] which is that the resolution procedure is necessary to achieve the resolution objectives, the resolution procedure is proportionate and that winding up the bank through normal insolvency procedures would not be able to achieve the same objectives.

The aims of the resolution process include:[161]

a. to ensure the continuity of bank critical functions;

b. to avoid significant adverse effects on financial stability, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline

c. to protect public funds by minimizing reliance on extraordinary public financial support;

d. to protect depositors and investors;

e. to protect client funds and client assets.

The EU aims reflect the relevant FSB guidance in its Key Attributes.[162] The main principles governing bank resolution have been set out[163] as follows:

The shareholders of the bank will bear first losses followed by the bank's creditors.[164] Creditors will bear losses in accordance with the order of the priority of their claims.[165] Creditors of the same class are treated in an equitable manner unless the regulation provides otherwise.[166] Creditors will not incur greater losses than they would have been incurred if the entity had been wound up under normal insolvency proceedings.[167]

The management body and senior management of the bank under resolution will be replaced unless their retention is necessary for the achievement of the resolution objectives.[168] The management body and senior management of the bank under resolution shall provide all necessary assistance for the achievement of the resolution objectives.[169] Natural and legal persons will be made liable, subject to national law, under civil or criminal law, for their responsibility for the failure of the institution under resolution.[170] Covered deposits are fully protected.[171]

For group entities resolution authorities will act in such a way that minimizes the impact on other group entities and on the group as a whole.[172] The authorities will also seek to minimizes the adverse effect on financial stability in the Union and its member states, in particular in the countries where the group operates.[173]

e) The resolution tools

The EU framework proposes four resolution tools that can be used in the resolution process.[174] Three of them reflect long regulatory practice: the sale of business tool, the bridge institution tool, the asset separation tool. Before GFC, and still in some cases, public funds and bank nationalization (temporary or permanent) were used to finance the resolution scheme. However, the spiraling costs for taxpayers of the bank bailouts during GFC helped to build an international consensus in favor of private contributions to the resolution of the banks. This took the form of a fourth tool, that of bail-in.

The resolution tools can be used either individually or in any combination but the asset separation tool can be used only together with another resolution tool.

i. Sale of business

The sale of business to a third party is a common practice in banking rescues. EU law requires[175] that the purchaser is not a bridge institution. The transfer must be made on commercial terms.[176] However given that the transfer takes place within short timeframes and involves the resolution authority which acts as the broker of the deal and which seeks to achieve also other resolution objectives beyond the transfer itself (e.g. to maintain financial stability), the whole transaction cannot be deemed strictly commercial.[177] The urgency usually involved in the process, especially when the institution involved is systemically important, makes challenging for resolution authorities to meet the legal requirements of transparency, non-discrimination of any potential purchaser, transaction in market prices and other related ones.[178] Another significant issue concerns the impact of the sale on the shareholders of both the acquiring and the acquired bank who due to the urgency of the matter and the swift completion are given very limited (if at all) say. Ensuring the continuity of critical bank functions and protecting financial stability takes precedent in that case over the rights of shareholders and creditors.

ii. The bridge institutions

This tool is used in the case where a suitable purchaser for the failing bank cannot be found quickly. It involves transfer of the failing bank to a bridge entity owned partly or wholly by public authorities[179] which will manage the business until a suitable purchaser is found. The transfer of the failing bank to a bridge entity helps to prevent the initiation of insolvency procedures and insulates it from private claims. The bridge institution pays for the acquisition and the process overall is subject to the same principles as the sale of business.

iii. Asset separation

This tool is used when a decision is made to separate the 'good' bank assets (e.g. deposits, performing loans) from the non-performing ones (e.g. NPLs).[180] The bad assets are acquired by asset management vehicles. This tool allows the 'good bank' to continue operations and recover while the management vehicle with manage the non-performing assets (NPAs) and prepare them for sale or wind down. The vehicle will seek to maximize the value of these assets before their sale but it is very difficult in practice to find purchasers willing to pay high price for NPAs. However, the management vehicle is under no pressure to sell the bad assets immediately or in any specific timeframe, which could help to improve the performance of these assets or wait for better market conditions before pursuing their sale.

iv. Bail-in

It emerged as an alternative tool to bank bail-outs, which are expensive, carry moral-hazard and face significant popular opposition. Empirical evidence supports the view that during GFC many banks that faced near collapse could have been fully recapitalized using bail-in.[181] It is based on the notion that the private sector should share the burden of a bank failure by absorbing bank losses and contributing to the recapitalization of the bank. The 'private sector' in this case includes the bank shareholders and a range of junior and unsecured creditors.[182]

It can be the result of voluntary action by the bank facing capital adequacy issues or could be imposed by regulators either as a resolution tool (alone or in combination with other resolutions tools) or outside of resolution such as when a bank has failed a stress test.[183]

When imposed by regulators, the process does not require consent of affected creditors and shareholders. The process will result in the resolution authority writing down certain types of debt obligations or convert them into equity. Insured deposit liabilities are normally excluded along with secured liabilities and liabilities to other institutions.[184] As a result, bank shareholders and unsecured creditors bear the main burden.

In particular, the process sacrifices the shareholders first, by cancelling or diluting their capital to help recapitalize the bank.[185] Second, additional tier one instruments are converted into ordinary equity and are also, in certain circumstances, subject to deduction below their face value. Tier 2 is converted into ordinary equity next with deductions being smaller.[186] Other subordinated debt and other eligible liabilities, based on ordinary insolvency hierarchy, follow.[187] The conversion must not leave creditors worse off than under normal insolvency procedures. A number of liabilities are excluded from the bail in including covered deposits, social security and tax liabilities, remuneration owed to employees and pension liabilities.[188]

According to EU law,[189] the bail-in tool may be applied for any of the following purposes:

a. To recapitalise a bank that meets the conditions for resolution to the extent sufficient to restore its ability to comply with the conditions for its authorization and to continue to carry out the activities for which it is authorized

b. to convert to equity or reduce the principal amount of claims or debt instruments that are transferred:

    (i) to a bridge institution with a view to providing capital for that bridge institution; or

    (ii) under the sale of business tool or the asset separation tool

The bail-in tool will be applied for the purpose of recapitalization *'only if there is a reasonable prospect that the application of that tool, together with other relevant measures […] will, in addition to achieving relevant resolution objectives, restore the entity in question to financial soundness and long-term viability'*.[190]

EU has made use of bail-in in cases of bank restructuring during the sovereign debt crisis of the eurozone. The application of the tool has been controversial for a number of reasons (discussed in more details later) but its adoption reflects the wider consensus within EU and outside of it that private sector should contribute to the cost of bank restructuring.

The SRB

It is the resolution authority for significant and cross-border groups. SRB is involved well before the resolution stage and well before a bank reaches crisis level. SRB develops with regulators, ECB and the banks the resolution plans which prepare responses to various negative scenarios. SRB handles the resolution of entities and groups directly supervised by the ECB and cross-border groups.

The Single Resolution Fund

The Single Resolution Fund (SRF) is used to finance the implementation of resolution tools if financial aid is needed. The fund is controlled by the European Commission[191] even if it belongs to SRM. The use of the fund aid is conditional upon the Commission's deciding that the aid is compatible with the internal EU market. The fund is financed by bank contributions which are raised at national level but are then pooled at EU level following an agreement between EU national governments on the transfer and progressive mutualization of those contributions.[192] This step was essential not only to support financial stability but also to limit the link between the perceived fiscal position of individual member states and the funding costs of banks and undertakings operating in those member states.[193] This link is further broken by a different rule that the decisions taken within the SRM would not impinge on the fiscal responsibilities of the member states[194] unless the public financial support is 'extraordinary'. In most cases though decisions that involve the use of the Fund or of a deposit guarantee scheme will not have fiscal impact or impact on the budgetary sovereignty of the member states.[195]

Taking these steps EU seeks to ensure that the member states will not be overburdened by the cost of financing of failing banks and that there will be no return of the sovereign-dept crisis in the future.

Deposit guarantee schemes

The EU efforts to complete the Banking Union with creation of a common system for deposit protection – the European Deposit Insurance Scheme (EDIS) have not been successful. The creation of EDIS was aimed to complement the SSM and SRM, the two other Banking Union Pillars. Currently EU member states run deposit guarantee schemes (DGSs) at national level. DGSs aim to protect small depositors and contribute to financial stability by acting as buffer mechanisms in periods of financial crisis.[196] The Commission's proposal[197] was that the creation of EDIS would result in the progressive transfer to it from DGSs of funds and of the management of deposit payout events. EDIS would increase the resilience of the financial system of EU by removing and important link between banks and their home sovereign and by offering EU depositors better protection from large but local bank crises which would challenge the ability of DGSs with the more limited resources to bailout the depositors. The EU failure to achieve its goal was due to opposition by rich EU countries especially Germany to the mutualization through EDIS of deposit insurance which would generate moral hazard by making peripheral EU countries, which are more susceptible to financial crises reliant on wealthier EU countries for the bailout of depositors.[198] As a result while insurance protection of depositors is provided in all EU member states, it is resourced and managed locally.

The EU recovery and resolution regime: Discussion.

Unlike other industries where the failure and exit of an inefficient and uncompetitive company is a sign of market health, which rarely attracts significant public attention with the broader market and consumers rarely take notice as competitors move quickly to seize the opportunity and fill in the created market gap, bank failures can raise wider alarm. This is due to the strong financial interdependence and complex relationships existing between them, which can turn, in appropriate circumstances, even the failure of a mid-level bank into a systemic market event. In this context preventing bank failures where possible has been accepted by regulators as a battle worth fighting for even if such an approach challenges the free market orthodoxy. Even where a bank cannot be saved in its current form, the resolution processes aim first to preserve the parts that can be saved and use the winding out of the bank as the very last resort.

EU, as demonstrated in the previous sections, by building comprehensive regulatory and supervisory frameworks to address bank failures has fully subscribed to the above principle and international consensus as demonstrated in relevant FSB and BCBS guidance. The EU framework provides for advance planning and proactive engagement of regulators with banks on matters of recovery and resolution hoping to prevent a repetition of the GFC and sovereign debt crises which caused serious economic harm and endangered the European integration project. The purpose of the framework is to avoid where possible, the bank entry into the resolution stage but if this is unavoidable and purpose is that entry to be 'timely and early' before the bank is balance-sheet insolvent and before all equity has been fully wiped out.[199]

The EU framework though has not escaped heavy criticism targeting many parts of it as well as the effects of its application on both individual banks and the financial sector in particular. For instance, the EU framework has been blamed for resulting in the prohibition of public intervention in the banking sector, the fire sale of banks and the subsequent concentration of banking capital;[200] for a 'one-size-fits all' approach to bail-in rules and the unfair treatment of shareholders and creditors in the bail-in process; for disregard by the centralized single resolution mechanism of the differential impact of the resolution decisions on national markets; and many other issues. While the criticism is not fully unjustified it does sometimes underestimate the gravity of the challenges that bank failures, especially those of bank institutions, pose for regulators and resolution authorities. It also underestimates the difficult balance that resolution authorities have to find between an array of competing economic and political interests associated with bank failures. Under such conditions it could be argued that the EU resolution framework, despite its significant weaknesses is a step in the right direction. More detailed discussion on those issues follows in the next sections.

What has EU framework achieved so far

The EU framework is a significant step forward as it has addressed significant weaknesses identified by the literature, regulators and the EU itself in the review that followed the GFC. EU needed not just a specialist framework for crisis management and resolution of banks separate from that for corporate insolvencies, but also a framework which would offer clarity about the resolution tools to be used and the procedural steps that will have to be taken before and after the resolution stage has been triggered. The framework also makes clearer the allocation of responsibilities between the central (EU level) and state level authorities and proposes a clearer hierarchy between the two by demonstrating a preference for more centralized control of the process. However, this hierarchy is not used in all bank cases but only large banking groups including SIBs. The resolution process, which is controlled centrally by SRB is exceptional with the norm being that banks will be sent to insolvency and be managed at national level using national laws.

The creation of SSM and SRM also ensures better supervision and resolution of SIBs, which it transforms the national supervisory and resolution authorities to national agents of EU. The creation of the SRF lifts the financial burden of bank bailouts from the shoulders of national governments. These are significant achievements from an organisation which is neither a unitary nor a federal state.

On the other hand, the new framework has not been able to address all the identified issues, partly because EU has still failed to achieve complete legal integration (e.g. not all EU Member States are members of the Banking Union and SRM, even where it applies, has not resulted in centralised control of all EU banks), and partly because the many of the new rules seek to resolve issues which for objective reasons are hard to resolve.

Weaknesses and challenges of the EU framework

One of the key challenges for conducting accurate and realistic assessments of the bank's resolvability and for drawing up credible and feasible resolution plans is the existence of high quality, complete and timely bank data. The issue has been highlighted regularly by the SRB, which has reminded banks that failure to provide such data would be considered as failure to comply with their legal obligations to share information and the issue could be declared as an impediment to resolvability[201] but the issue remains. In addition, even after the data is provided the analysis of the bank's resolvability relies on a mix of quantitative and qualitative data. Qualitative assessments are harder to measure, and the issue combined with the hypothetical scenarios on which resolution plans are based could cause complaints by the bank, especially if the resolution plan requires from them to implement significant and costly changes to their business model.[202]

Another complication could arise from a potential disagreement between the national resolution authorities involved in the resolvability assessment and in the drawing up of the resolution plan. All national resolution authorities concerned are obliged by EU law to work together.[203] Even in the important bank cases involving SIBs, where normally SRB takes the lead in designing the plan, it still has to consult with the European Central Bank and the national resolution authorities, which may not agree with the SRB decisions and assessment outcomes if they think that they do not reflect the situation in their respective countries. If the disagreements are not resolved, often with the mediation of European Banking Authority (EBA), dissenting national authorities could end up creating a separate plan applicable to their respective jurisdictions. Disagreements are not a purely theoretical potential. In 2018, EBA was asked to mediate in a dispute between SRB and Banca Nat'ionala a Romaniei on a group resolution planning process.[204]

The application of normal insolvency rules remains the default position for most banks of the Union. The normal insolvency rules cover banks which are not deemed significant to be subject to ECB supervision and the SRM but also potentially significant banks (e.g., by assets threshold), whose application of SRM jurisdiction will not be used because SRB determined that it was not in the public interest to resolve them. These banks will also be subject to normal insolvency procedures. The implication here is, first, that the preference to a specialist insolvency regime for banks does not apply to all banks, which means that, given the vast difference in the available options between resolution (a range of tools available) and insolvency (liquidation as the main option), banks with similar business characteristics could be subject to radically different treatment. While the different treatment is clearly stated in various parts of the SRM framework and is not a surprise, it is the decisions about which banks should be subject to resolution and which to insolvency that can cause confusion and criticism. Even if SRB has issued guidance on how to assesses public interest,[205] evidence from its practice show that SRM's approach differs from that of the NRAs when they make the similar assessment for banks at national level.[206]

The issue has additional importance due to the fact that the banks not subject to SRM will be dealt with by national insolvency rules which are not harmonized.[207] Some EU countries have bank-specific insolvency regimes while others do not.[208] However, insolvency rules generally appear to make easier the use of public support than resolution procedures, which aim to reduce the use of public funds.[209] The latter issue has given rise to arguments[210] that the EU resolution framework is more restrictive than the international standards. Critique also points to the requirement of a minimum amount of private contribution through creditors' bail-in (8% of total liabilities) before the bank can use SRF funds as another example of EU restrictions.[211] Finally, the potentially easier use of public funds under insolvency rules apart from creating different insolvency treatment of banks across member states (as the level of public funds commitment could also vary depending on the economic conditions in each country) it could also endanger a key principles of the EU resolution regime that the creditors of banks going through resolution would not suffer more losses than the losses suffered under insolvency.[212] The use of public funds may reduce the losses of creditors in some insolvency cases.

Further, the Single Resolution Mechanism is very complex as its operation involves multiple EU bodies and institutions, including the top ones (Council, the Commission and the ECB) along with representatives of member states. The decision of the SRB on the resolution scheme must be submitted and approved by the Commission and the Council.[213] SRB itself is made up of independent experts and representatives of the national resolution authorities. In this complex multi-agency, multi-layered architecture with each agency representing different and often competing interests, it is easy to see that the whole decision-making process is cumbersome with the final resolution outcome likely being the result of internal institutional compromises[214] rather than of an objective, evidence-based assessment of the situation. The EU decision-making processes, due to the Union made up of 27 member states and the strong political and independent nature of its institutions, are generally complex and slow. For that weakness EU paid a heavy price during the GFC where it failed to reach internal consensus and to act swiftly to prevent the escalation of the crisis. The post-crisis new architecture is supposed to have incorporated the lesson of the need to create a centralised structure which adopt decisions expeditiously and EU law has some provisions for it. For example, SRMR requires that the Commission and the Council give their approval (or object to) the SRB resolution scheme within 24 hours from its submission to them.[215] All procedural steps for the adoption of the resolution scheme must be concluded within 32 hours. Given the multi-agency involvement how realistic is this timeframe for a meaningful scrutiny of the proposed scheme and the adoption of a 'proportionate' response to the resolution objectives remains an open question.[216]

A significant absence from the entire resolution process is that of the bank shareholders and creditors who will learn about the fate of the bank and their property rights in it from the EU authorities without their input in the decisions. The protection of their rights is not a priority in the process even if SRMR and MRRD make reference to compliance of resolution processes with human rights.[217] The decisions of EU bodies are subject to judicial review, and affected parties can bring their case before EU Courts, but the review will take time and will have little consequences for the resolution process, which will shape shareholders' and creditors' rights profoundly and immediately.[218]

The 'hostility' towards the shareholders and creditors is not to be found only in the EU framework. International standard-setters such as the FSB, in their guidance,[219] make implicitly clear that the private interests of these key shareholders are not a priority. The entire resolution mechanism prioritizes financial stability and cost reduction for the public sector.

In this context, the argument in part of the literature[220] that traditional insolvency procedures offer potentially more evidence-based, proportionate response, which serves shareholders' and creditors' rights better comes as no surprise.

EU seems to be even more willing to undermine these rights. A good example is the execution of the bail-in. EU has made extensive use of the new tool in the bank restructuring during the sovereign debt crisis of the eurozone. In the case of the Bank of Cyprus the bail-in implementation by the government of Cyprus, which was part of a condition for a 10 billion euros rescue package imposed the conversion of 47.5% of uninsured deposit in the Bank of Cyprus.[221] The application of the bail-in in this case was criticised. Other cases of implementation of the bail-in tool have also been criticised. Part of the problem is that the tool can be used not only during the resolution stage but also outside of it (for example, after failed stress-test of the bank). This combined with the wide discretion of regulators and the absence of consultation with the affected bank stakeholders, creates unpredictability about the outcome of the process and legal uncertainty in the market.

The selection of the resolution tools does not follow any specific order. A bank failing to pass a stress test may be subject to precautionary recapitalization instead of bail-in. Assets valuation during the implementation of the resolution tools can be another problem. The existence of adequate bail-inable liabilities as well as the definition of what constitutes bail-inable security is further issue.[222] EU law seeks to provide answers by requiring bank compliance with a minimum requirement of own funds and eligible liabilities known as 'MREL', which could be used in bail-in and by establishing that all liabilities are in principle subject to bail-in. MREL, which has the same objective as the TLAC, which is used by BCBS for G-SIBs, is emerging as a key metric of a bank's resolvability, as it indicates the level of the bank's ability to absorb losses and recapitalize in the case of failure.[223] The 2019 amendment of BRRD[224] imposed the harmonization of MREL with TLAC.[225] SRB expects that all SIBs will meet the MREL required threshold by the end of 2023,[226] which will allow the institution to declare the end of the too-big-to-fail problem in EU by that time.

However, the entire process is subject to the discretion of the resolution authorities which can exclude liabilities from the bail in. For banking groups with cross-border activity jurisdictional issues may emerge as certain jurisdictions especially outside of EU, may not be able to recognize the bail-in arrangement.[227]

Finally, the bail-in is not a panacea. It cannot resolve all issues causing a bank crisis. It can only restore capital adequacy, but it cannot address for example a liquidity crisis caused by a bank run situation. As such central bank's role in providing adequate liquidity remain essential for the recovery of a failing bank. Bail-in is only one of the available tools.

POTENTIAL LESSONS FOR INDIA

India is different from EU. It enjoys the status of a sovereign country that EU does not have and as such does not face the challenges of legal harmonization or opposition from sovereign states when passing legislation that EU faces.

Still EU due to the serious crises that it has faced in its financial sector during GFC and the sovereign debt crisis offers a good case study for issues relating to the dealing with financial failures, either at individual bank level and at systemic level. India has not faced challenges of such scale during the past two decades. Also, the post-GFC reforms proposed by the FSB and BCBS have been adopted by EU and many of these reforms have already been tested in real market conditions and crises, which offers useful lessons. The EU framework is by no means a role-model for the resolution of banks, but some of the experiences from its application cover issues faced by regulators also elsewhere, including in India, and as such they could be useful.

Some of these lessons are highlighted below:

First, the resolution of banks especially those with systemic significance, due to their complexity, would benefit from a more 'centralized approach' in its management. A central authority has better view of the market impact of a bank failure, can have better access to information and can mobilize more resources. A central authority can help streamline and monitor more effectively the design and implementation of the recovery and resolution plans. As such the decision of EU, which on this has followed international practice, to create in ECB a single supervisory body for SIBs and in SRB a single resolution mechanism for them is a positive steps and addressed a key weakness of the pre-GFC supervisory architecture and not only in EU. India's FRDI Bill seems to be following the same direction.

However, one of the problems of centralization is often the dependence of the central authority on regional authorities, whether they are independent from the centre or local branches of it, for implementing the central authority's decision, collecting and sharing market data and information with the latter and monitoring bank compliance.

Second, a 'close working relationship' between the centre and these local authorities is essential for success in this case. EU, historically, had difficulty to secure the cooperation of national authorities. The significance of the banking sector for both the central and local economies could complicate the co-operation. Local economic interests linked to the banks or other groups affected by the direction of a bank's resolution may use local authorities to seek to put pressure on the centre to change its decision. Local authorities and governments for example may be keener to use public funds to finance the implementation of bank's resolution than to use bail in. They may also seek to avoid bank asset separation and sale if the bank in question is deemed significant for the local economy. EU central authorities regularly encounter such pressures which are not idiosyncratic of EU. Indian central authorities could also face similar pressures. In EU, such disagreements are usually resolved through compromises between the center and the member states but not always. For example, the interpretation of the 'public interest' test of EU Law, crucial for deciding if the bank will proceed to resolution or will be sent to insolvency, is often different at national level compared to EU level. This does not always mean that local authorities are more narrowly focused and therefore less useful for restoring financial stability. It could be the opposite: the central authority being out of touch with the situation on the ground in certain areas and the impact of a bank failure there.

There are no easy solutions to this problem. The key lesson is that while centralization of supervision and resolution, which is promoted by EU and other international standard setters (e.g., FSB) helps to better deal with large banks it is no panacea.

Third, 'effective cooperation' and coordination between the central resolution authority and the other authorities supporting it is also important for collecting real-time (or close to it) and accurate market information. Drawing up effective recovery and resolution plans depends critically on the quality of the underlying data. The banking sector has also to contribute by submitting timely and accurately the required information.

A closely related issue concerns the realism of the various market scenarios which are used to determine the resolvability of a bank. These scenarios to be realistic must be based on market evidence and credible factual assessments. The process though in EU, as indicated in the preceding analysis, allows for other considerations. Some could argue for example, that the resolution process could be used by regulators not only to handle bank failures and systemic risks but also to shape the industry, something which is not a declared objective of resolution. The shaping of the industry can for example be instigated by a decision of regulators to broker the purchase of the troubled bank by a domestic competitor instead of a foreign new entrant. The decision will have an impact on the competitive situation in the market. A similar effect would emerge if the resolution authority favours recapitalization over liquidation of banks. While some market impact from any resolution decision is unavoidable, in EU and more often at national level, resolution authorities adopt resolution decisions that often protect national champions or large banks at the expense of smaller and medium banks. Medium banks especially seem to be falling in a grey zone of the resolution process as they are usually not big enough to be deemed significant (meeting the 'public interest' requirement) at EU or national level and as such they are not dealt with by resolution but by insolvency processes, which lead to their liquidation and elimination from the market. A lesson here is that resolution authorities should focus on the achievement of the resolution goals narrowly defined rather than use resolution to achieve other objectives. Also, more clarity must be provided about when resolution and insolvency will be used. It has been argued in the literature that the use of two options should be abandoned and that all banks should be subject to resolution to ensure consistency and to avoid unequal and unfair treatment.[228]

This view has merit, but the insolvency option, given the disregard of resolution for shareholders and creditors' rights may still be attractive in some cases. The insolvency procedures are well understood, and the law is well developed. The rights of these stakeholders are further degraded by the adoption and expansion in EU of the bail-in. The treatment of the rights of bank shareholders and creditors is an issue which requires more careful consideration by regulators. Even if financial stability and continuity of a bank's critical functions are deemed as highest priorities that the rights of these private stakeholders, it should not be forgotten that property rights, such as those of share and debt holders are fundamental human rights and as such they should enjoy protection.

Finally, the hard push for 'private sector contribution' to bank failures, mainly in the form of bail-in, should be done with caution. India already experienced serious opposition to the FRDI Bill which caused its 2018 withdrawal due to its bail-in provisions. With banks ever growing in size it is inevitable that public funds alone are not sufficient to finance bank resolutions, but unwise use of the bail-in tool could also cause problems.

CONCLUSION

EU battle-hardened experience on crisis management and resolution of banks can be a useful case study for India which is currently building its own legal framework in this area. EU experience indicates that the adoption and application of a framework in this area is not a simple process but requires several steps. The regulatory and supervisory architecture that will emerge will be complex and will have to be tested in real market conditions to prove its effectiveness. The test of the EU framework so far has demonstrated clear signs of progress towards achieving the policy goals., but EU has still a long way to go.

[1] Thorat U.(2009), "Impact of global Financial Crisis on Reserve Bank of India".

[2] *Ibid.*

[3] Subbarao D. (2009), "India - Managing the Impact of the Global Financial Crisis" Speech delivered at the Confederation of Indian Industry's National Conference and Annual Session 2009 in New Delhi on March 26, 2009.

[4] *Ibid*.

[5] Szczepanski M. (2019), "A Decade on from the Crisis, European Parliamentary Research Service", Briefing, PE 642.253.

[6] European Commission (2012), "New crisis management measures to avoid future bank bail-outs", Press Release, Brussels, June 6.

[7] Supra Note 5.

[8] *Ibid.*

[9] Szczepanski M. and Claros E. (2019), "A Decade on from the Financial Crisis: Key Data", European Parliamentary Research Service, Briefing, PE 640.145.

[10] Chiu I. and Wilson J. (2019), Banking Law and Regulation, Oxford University Press, p. 313.

[11] See also Hadjiemmanuil C. (2015), "Bank Resolution Financing in the Banking Union", LSE Law, Society and Economy Working Papers 6/2015.

[12] *Ibid.*

[13] *Ibid.*

[14] Bergeron D. et al., "Public Sector banking crisis in India", Oliver Wyman.

[15] *Ibid.*

[16] Discussed in more details later in this paper.

[17] See Basel III: International regulatory framework for banks.

[18] Most important development in this area was the establishment in 2009 of the Financial Stability Board by the G20 countries.

[19] Bill No.165 of 2017.

[20] FRDI is discussed in detail later in the paper.

[21] In 2015 Single Resolution Mechanism for banks as part of the Banking Union was enacted.

[22] Reserve Bank of India, Framework for Dealing with Systemically Important Banks.

[23] For further discussion, see Bank bailouts, interventions, and moral hazard Lammertjan Dam (University of Groningen and Center for International Banking, Insurance and Finance), Michael Koetter (University of Groningen, Center for International Banking, Insurance and Finance and Sveriges Riksbank) Discussion Paper Series 2: Banking and Financial Studies No 10/2011.

[24] Lane P. and Ferretti G. (2007), "The External Wealth of Nations Mark II", Journal of International Economics, 73(2), November.

[25] IMF, "Understanding Financial Interconnectedness".

[26] Basel Committee on Banking Supervision, Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement, July, 2013.

[27] Reducing the moral hazard posed by systemically important financial institutions FSB Recommendations and Time Lines.

[28] *Ibid.*

[29] See Financial Stability Board, Reducing the Moral Hazard Posed by Systemically Important Financial Institutions, 20 October, 2010.

[30] Basel Committee on Banking Supervision, Basel III: A Global Regulatory Framework for more Resilient Banks and Banking Systems, December, 2010.

[31] Supra Note 27, p.1.

[32] For more discussion see Bank of England (2016), "The Financial Policy Committee's Framework for the Systemic Risk Buffer", Basel Committee on Banking Supervision (2018), "Global Systemically Important Banks: Revised Assessment Methodology and the Higher Loss Absorbency Requirement".

[33] Laeven L. et al. (2014), "Bank Size and Systemic Risk, International Monetary Fund, Research Department", SDN/14/04, p. 6.

[34] In November, 2011 the FSB published an integrated set of policy measures to address the systemic and moral hazard risks associated with SIFIs. In that publication, the FSB identified as global systemically important financial institutions (G-SIFIs) an initial group of G-SIBs, using a methodology developed by the BCBS. The November, 2011 report noted that the group of G-SIBs would be updated annually based on new data and published by the FSB each November.

[35] Basel Committee on Banking Supervision, Global systemically important banks: revised assessment methodology and the higher loss absorbency requirement, July, 2018.

[36]See Financial Stability Board (2021), "Ending too-big-to-fail".

[37] Financial Stability Board (2015), "Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution", November 9. For more details on the resolvability of banks see later in this paper.

[38] *Ibid.*

[39] Basel Committee on Banking Supervision, "Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement".

[40] Financial Stability Board, "Peer Review of India".

[41] Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions".

[42] Basel Committee on Banking Supervision (2012) , "A Framework for Dealing with Domestic Systemically Important Banks".

[43] *Ibid* p.2.

[44] *Ibid* p.1.

[45] *Ibid.*

[46] Reserve Bank of India, "Framework for Dealing with Domestic Systemically Important Banks (D-SIBs)".

[47] *Ibid.*

[48] Reserve Bank of India, RBI releases First Financial Stability Report Says Limited Risk to Financial Stability, but Monitoring Required on an Ongoing Basis, Press Release, 25 March, 2010.

[49] More discussion on this can be found in Occasional Paper Series No 227/ July 2019, European Central Bank.

[50] The object clause of the RBI Act, 1934 states that "Whereas it is expedient to constitute a Reserve Bank for India to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in 2[India] and generally to operate the currency any credit system of the country to its advantage".

[51]Reserve Bank of India, Financial Stability Report, June, 2022.

[52] Reserve Bank of India, "Financial Institutions: Soundness and Resilience".

[53] *Ibid.*

[54] Supra Note 14.

[55] *Ibid.*

[56] Bill, Preamble.

[57] *Ibid.*

[58] As per section 2(34) of the Bill, "specified service provider" means a person as specified under the Second Schedule.

[59] Section 3. (1) provides that "*The Central Government shall, by notification, establish for the purposes of this Act, a Corporation by the name of the Resolution Corporation. The Corporation shall be a body corporate, by the name aforesaid, having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold or dispose of property*," For further information on Resolution Corporation, please see chapter 2 of the Bill.

[60] As per 2(2) of the Bill, "*appropriate regulator" means a financial sector regulator specified under the First Schedule, and includes financial sector regulators where the specified service provider is regulated by more than one financial sector regulator; and in that case such regulators shall, from amongst them, designate a lead regulator by entering into a memorandum of understanding, and in case of any disagreement, the Central Government may designate a lead regulator*.

[61] The objective criteria will be specified by the Resolution Corporation, in consultation with the appropriate regulator, in form of regulations.

[62] Section 36 of the FRDI Bill.

[63] Section 37 of the FRDI Bill.

[64] Section 50 of the FRDI Bill.

[65] Section 52 of the FRDI Bill.

[66] FSP Rules, Rule 5(a).

[67] Ministry of Corporate Affairs, Notification dated 18th November, 2019, S.O. 4139(E).

[68] Supervisory Oversight and Response System (SOARS).

[69] Probability & Impact Rating System (PAIRS).

[70] Alvarez and Marsal, "Developing An Early Warning Signal Solution For Loan Portfolio Companies".

[71] Reserve Bank of India, "Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances".

[72] Reserve Bank of India, Scheme for Sustainable Structuring of Stressed Assets - Revisions.

[73] Reserve Bank of India, Frauds – Classification and Reporting.

[74] Botín A. (2022), "The banks are not complacent", Interview, Supervision Newsletter, February 16.

[75] See European Central Bank , Financial Stability Review, November, 2022.

[76] *Ibid.*

[77] Singe Resolution Board (2022), "Resolvability of Banking Union Banks: 2021", July, 2022.

[78] Discussed in more details later in the paper.

[79] According to Article 61(2) of the Treaty of Rome '…'the liberalisation of banking and insurance services connected with movements of capital shall be effected in step with the progressive liberalisation of movement of capital'.

[80] Commission of the European Communities, "Completing the Internal Market", White Paper from the Commission to the European Council, Brussels, 14 June, 1985, para. 101-107 COM (85) 310 Final.

[81] "The EC Single Market in Financial Services", Bank of England Quarterly Bulletin 1993, pp.92-97.

[82] Commission of the European Communities, "Implementing the Framework for Financial Markets: Action Plan", Brussels, 11 May, 1999, COM (1999) 232 final.

[83] The Committee of Wise Men, "Final Report on the Regulation of Financial Securities Market", Brussels, February 15, 2001.

[84] *Ibid.*, Chapter 2. For an analysis see Gortsos C. (2015), "The Evolution of European Banking Law: From the Principle of National Treatment to the European Banking Union".

[85] See the findings of the The de Larosiere Group Report "The High Level Group on Financial Supervision in the EU, Brussels, 25 February, 2009.

[86] *Ibid.*

[87] *Ibid.,* pp. 32-37.

[88] Supra Note 85, pp. 39-42.

[89] *Ibid.,* pp. 27-29.

[90] *Ibid.*, pp. 46-48.

[91] Gortsos C. (2019), "The Single Resolution Mechanism (SRM) and the Single Resolution Fund (SRF): Legal Aspects of the Second Main Pillar of the (European) Banking Union", 5th Edition, April 30, p. 37.

[92] Supra Note 10, p. 290.

[93] *Ibid.*, p.43.

[94] Article 6 (4) of Council Regulation (EU) No 1024/2013 of 15 October, 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

[95] Source: European Central Bank, "Significance Assessment: 2022 at a glance – moving to 2023".

[96] Article 6(4) SRMR.

[97] *Ibid.,* See also Supra Note 10, p. 215.

[98] See Ventoruzzo M. and Sandrelli G. (2019), "O Tell Me The Truth About Bail-In: Theory and Practice", Working Paper N° 442/2019, March 9, p. 6.

[99] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012; Directive 2013/36/EU of the European Parliament and of the Council of 26 June, 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

[100] Discussed extensively below.

[101] Directive 2014/49/EU of the European Parliament and of the Council of 16 April, 2014 on deposit guarantee schemes, O.J. L173/149, 16.2.2014.

[102] European Banking Authority, Guidelines on the specification and disclosure of systemic importance indicators, Final Report, EBA/GL/2020/14, 4 November, 2020.

[103] *Ibid.*, p.4.

[104] See European Banking Authority, Guidelines on the criteria to determine the conditions of application of Article131(3) of Directive2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs), 16 December, 2014, EBA/GL/2014/10.

[105] For the European Commission's view on the matter see: European Commission "Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms", Brussels, 2012/0150(COD), 6.6.2012, COM (2012) 280 final, section 3.

[106] *Ibid*.

[107] *Ibid.*

[108] Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions". The framework was initially published in 2011 and was updated in 2014.

[109] Directive 2014/59/EU of the European Parliament and of the Council of 15 May, 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council Text with EEA relevance.

[110] Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May, 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC, PE/48/2019/REV/1.

[111] Regulation 2022/2036 of the European Parliament and of the Council amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institutions with a multiple-point-of-entry resolution strategy and methods for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities.

[112] Regulation of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Reso-lution Fund and amending Regulation (EU) No 1093/2010.

[113] Regulation (EU) 2019/877 of the European Parliament and of the Council of May 20, 2019 amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms.

[114] European Banking Authority, Guidelines on recovery plan indicators under Article 9 of Directive 2014/59/EU, 9 November 2021, EBA/GL/2021/11.

[115] Article 5(1) BRRD.

[116] Supra Note 111, p.5.

[117] Article 5(4) BRRD.

[118] Article 6(2)(a) BRRD.

[119] Article 6(2)(b) BRRD.

[120] Article 7 BRRD.

[121] Supra Note 10, p.622.

[122] MREL and TLAC are discussed in more details later in the paper.

[123] Article 5(6) and 7(4) BRRD.

[124] Article 9(1) BRRD.

[125] *Ibid*.

[126] Article 6(4) BRRD.

[127] For more details see Single Resolution Board, Expectations for Banks, March, 2020.

[128] Article 8 (12) SRMR. Also SRB *Ibid.*

[129] Article 10(3) BRRD.

[130] *Ibid.*

[131] Article 15(1) BRRD.

[132] Article 16(1) BRRD.

[133] Supra Note 10, p. 626.

[134] Article 17(3) BRRD.

[135] Article 17(4) BRRD.

[136] Article 23 BRRD.

[137] See European Commission Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institution groups with a multiple point of entry resolution strategy and a methodology for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities, Brussels, 27.10.2021 COM (2021) 665 final, p.2.

[138] Deloitte (2022) European Union's Resolution for 2022, 26 January, 2022.

[139] See König E. (2021), "Single Point of Entry - a resolution strategy addressing the home – host issue in Europe's Banking Union", April 22.

[140] *Ibid.*

[141] See European Commission's proposal.

[142] Article 27 BRRD.

[143] *Ibid.*

[144] Article 32(1) BRRD.

[145] See also, Zavvos G. and Kaltsouni S. (2014), "The Single Resolution Mechanism in the European Banking Union: Legal Foundation, Governance Structure and Financing" , pp.18-19.

[146] See also *Ibid*.

[147] Article 32(4)(a) BRRD

[148] Article 32(4)(b) BRRD.

[149] Article 32(4)(c) BRRD.

[150] Article 32(4)(d) BRRD.

[151] Supra Note 10, p.638.

[152] Article 32(4)(d) BRRD.

[153] *Ibid.*

[154] *Ibid.*

[155] *Ibid.*

[156] *Ibid.*

[157] *Ibid*.

[158] *Ibid.*

[159] For a further discussion see also European Parliament, Directorate General for Internal Policies, "Precautionary recapitalisations under the Bank Recovery and Resolution Directive: conditionality and case practice", Briefing, 5 July 2017, PE 602.084.

[160] Article 18(5) SRMR.

[161] Article 14 SRMR.

[162] See the FSB statement in the preamble of the Key Attributes for Effective Resolution Regimes for Financial Institutions, p.3.

[163] Article 15(1) SRMR.

[164] *Ibid.*

[165] *Ibid.*

[166] *Ibid.*

[167] *Ibid.*

[168] *Ibid.*

[169] *Ibid*.

[170] *Ibid.*

[171] *Ibid.*

[172] Article 15(2) SRMR.

[173] *Ibid.*

[174] Article 22(2) SRMR.

[175] Article 38(1) BRRD.

[176] *Ibid.*

[177] For an analysis and discussion see Supra Note 10, p.651.

[178] These are prescribed in Article 39(2).

[179] Article 39 BRRD.

[180] Article 42 BRRD.

[181] Conlon T. and Cotter J. (2014), "The Anatomy of a Bail-In" Journal of Financial Stability, Vol. 15, December, pp. 257-263.

[182] Supra Note 10, p.642.

[183] *Ibid.*

[184] Cranston R. et al. (2017), "Principles of Banking Law", 3rd Ed., Oxford University Press, 2017, p.182.

[185] Supra Note 10, pp.644-5.

[186] *Ibid.*

[187] *Ibid*.

[188] *Ibid.*

[189] Article 27(1) SRMR.

[190] Article 27(2) SRMR.

[191] Article 19 SRMR.

[192] Regulation 806/2014, Preamble para 19.

[193] *Ibid.*

[194] *Ibid.*

[195] *Ibid.*

[196] Gortsos C. (2016), "Deposit Guarantee Schemes: General Aspects and Recent Institutional and Regulatory Developments at International and EU Level", p. 3.

[197] European Commission Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, 24.11.2015, COM/2015/0586 final - 2015/0270 (COD).

[198] For an analysis see Mortágua M. & Solipa I. (2022), "Reviving financial markets – a critical assessment of the single resolution mechanism", International Review of Applied Economics, 36:3, 403-423, DOI: 10.1080/02692171.2022.2093339; Also Gortsos C.

[199] Supra Note 162, pp. 6-7.

[200] Supra Note 198, p.416; Supra Note 11, p. 11.

[201]See Single Resolution Board, 2023 Resolution Reporting.

[202] See the discussion of resolution plans earlier this paper.

[203] See the various provisions of BRRD and SRMR for resolution plans and decisions.

[204] European Banking Authority, Decision of the European Banking Authority on the settlement of a disagreement, 27 April 2018; See also Supra Note 10, p.629.

[205] See also König E. (2020), "To resolve or not to resolve: a public interest assessment fit for purpose".

[206] For a detailed discussion see Restoy F. et. al (2020), "Bank failure management in the European banking union: What's wrong and how to fix it", Occasional Paper No.15.

[207] *Ibid*.

[208] Baudino P. et. Al (2018), "How to manage failures of non-systemic banks? A review of country practices", FSI Insights on policy implementation, no 10, October.

[209] Supra Note 206, p.13.

[210] Restoy F. (2019), "How to improve crisis management in the banking union: a European FDIC?", July 4, p.2.

[211] *Ibid.*

[212] *Ibid*, p.4.

[213] Article 18(7) SRMR.

[214] Supra Note 145, p.29.

[215] Article 18(7).

[216] Supra Note 185, pp.182-3; Supra Note 11, p.18.

[217] See for instance recital 121 of SRMR which establishes the Regulation "…respects the fundamental rights and observes the rights, freedoms and principles recognised in particular by the Charter, and, in particular, the right to property, the protection of personal data, the freedom to conduct a business, the right to an effective remedy and to a fair trial and the right of defence, and should be implemented in accordance with those rights and principles".

[218] Supra Note 11.

[219] See e.g., the Key Attributes of Effective Resolution Regimes for Financial Institutions.

[220] Supra Note 98, p.81; Supra Note 184, p.183.

[221] Supra note 184, p. 181.

[222] Supra Note 98, pp. 28-29.

[223] SRB (2022), p.7.

[224] By Directive 2019/879.

[225] See Norton Rose Fulbright, Banking reform updater: Bank Recovery and Resolution Directive II, April, 2020.

[226] Singe Resolution Board, SRB publishes Resolvability Assessment and Heat-map, Press releases, 13 July, 2022.

[227] Supra Note 98, pp. 28-29.

[228] Supra Note 210.

14 IBC FOR MSMEs: HITS AND MISSES

- Dr. Isha Goel and Dr. Sunita Gupta

EXECUTIVE SUMMARY

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) has emerged as the apex economic legislation for resolution of insolvency and bankruptcy in the country. The micro, small and medium enterprises (MSME) sector is the keystone for economic and social development in India. In the context of MSMEs, the relevance and contribution of IBC needs to be evaluated. This paper explores the specific relaxations available to MSME sector under IBC and examines the measures available for their protection as a debtor and as a creditor. IBC as an economic legislation is still evolving based on empirical learnings. One of the latest amendments to IBC, is the introduction of pre-packs for corporate MSMEs. Through an in-depth literature review, various aspects of pre-pack framework introduced in India have been discussed and the utility of pre-packs for MSMEs has been analysed. The strengths and weaknesses of pre-packs in India have been identified and the opportunities and challenges they present have been examined. In light of the findings of this paper, in the end recommendations are made which can further help strengthen the IBC framework for MSME sector.

Keywords: IBC, MSME, CIRP, OC, Pre-packs, PPIRP

INTRODUCTION

The MSME sector is a keystone for economic and social development in India with a vital contribution to entrepreneurship, employment generation, industrial progress, exports, and inclusive growth. MSMEs are an economic powerhouse as they provide a livelihood to over 110 million people, and contribute over 30% to India's GDP. MSMEs also help in reducing regional imbalances and ensuring a more equitable distribution of national income and wealth by setting up units in rural and backward areas.

The Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act) was enacted to facilitate the promotion and development of these industries and enhance their competitiveness. Online registration for MSMEs has been provided through the Udyam portal wherein the registration process is free of cost, paperless, and on completion an e-certificate is issued. The micro sector with 630.52 lakh estimated enterprises accounts for more than 99% of total estimated MSMEs, the small sector with 3.31 lakh enterprises accounts for 0.52% and the medium sector with 0.05 lakh estimated MSMEs accounts for 0.01% of all MSMEs (Govt. of India, 2022).

Despite the importance of MSME units within the Indian economy, they face certain challenges specific to them. MSMEs are required to overcome obstacles relating to access to knowledge, availability of timely and adequate finance, access to skilled labour, etc. The MSME sector can expand and realize its true potential only when these impediments are removed. Realizing this need, the Government has taken various measures and policy initiatives for the growth and development of the MSME sector. The Ministry of MSME has implemented various schemes to provide financial and technological assistance, skill development, and training, to enhance the competitiveness of MSMEs (Govt. of India, 2022).

A revision in the MSME definition was announced in the Atmanirbhar Bharat package on May 13, 2020 to establish an objective system of classification and to provide ease of doing business. The new definition has done away with the difference between the manufacturing and service sectors and has added a new turnover-based criterion. Table 1 gives the new criteria notified by the Central Government which came into effect from July 1, 2020 (Govt. of India, 2020).

The Government in Budget 2022, has announced various schemes for MSMEs like an extension of the Emergency Credit Line Guarantee Scheme (ECLGS), revamp of Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE) scheme, the rollout of Raising and Accelerating MSME Performance (RAMP) programme, etc.

Table 1: Revised Classification of MSMEs

Classification	Criteria1	Criteria 2
	Investment in Plant and Machinery or Equipment	**Turnover**
Micro Enterprise	Should not exceed ₹ 1 crore	Should not exceed ₹ 5 crore
Small Enterprise	Should not exceed ₹ 10 crore	Should not exceed ₹ 50 crore
Medium Enterprise	Should not exceed ₹ 50 crore	Should not exceed ₹ 250 crore

(Source: Based on Govt. of India, 2020)

Since MSMEs constitute a significant part of the global economy, they are also among the largest commercial users of insolvency systems. However, MSME insolvencies cannot be treated at par with other corporations as MSME insolvencies face unique challenges and issues. MSMEs are often financed through owner's funds and informal sources and can be over-dependent on a few customers which can lead to severe distress in unfavourable times. Due to their low bargaining power, MSMEs face problems in recovering delayed payments and enforcing legal provisions available to them under MSMED Act (RBI, 2019). Many corporates buy from MSMEs on credit basis and often unscrupulous practices are used to avoid paying on time. The MSME sector remains under stress from customers on one hand, and suppliers on the other. While customers express their inability to pay on time, suppliers push for advanced or early payments. In such a situation, an economic crisis can hit MSMEs particularly hard, with receivables getting delayed on one hand, and drying up of available credit on the other. Consequently, they may face cash management issues and face illiquidity which can easily turn into insolvency.

The World Bank Group (2017) has noted that most jurisdictions regard MSME insolvencies at par with other corporate entities despite MSMEs' unique attributes. An effort in the direction of reducing the legal obstacles encountered by MSMEs for their liquidation or re-organization, UNCITRAL in 2021, adopted the legislative recommendations on insolvency of micro and small enterprises. The recommendations take into account the unique features of micro and small enterprises (MSEs) and the specific needs and circumstances of their financial distress (UNCITRAL, 2021).

In India, the IBC has emerged as the apex economic legislation for the resolution of insolvency and bankruptcy. Recognising the special concerns of MSMEs pertaining to the insolvency regime, various committees have been constituted by the Government and sectoral regulators to look into concerns of MSMEs pertaining to the insolvency regime. The Reserve Bank of India (RBI) constituted the Expert Committee on MSME with a mandate to undertake a comprehensive review of the MSME sector and highlight issues and suggest solutions for the economic and financial sustainability of MSMEs. The Insolvency Law Committee (ILC) was constituted by the Ministry of Corporate Affairs on November

16, 2017 and reconstituted on March 6, 2019 as Standing Committee to make recommendations to the Government on issues relating to the implementation of the IBC as well as recommendations received from various stakeholders. Parliamentary Standing Committee on finance presented its 32nd Report on Implementation of Insolvency and Bankruptcy Code- Pitfalls and Solutions, which took evidence from representatives of MSME, Small Industries Development Bank of India and Federation of Micro, Small and Medium Enterprises (FISME) among others.

Thus, given the special status of the MSME sector and its specific requirements, an insolvency regime that caters to their needs is required. The present paper evaluates the insolvency provisions in place for the MSME sector both as a debtor and as a creditor, and provisions and relaxations under IBC are provided specifically to this sector.

OBJECTIVES AND METHODOLOGY

The objectives of the paper are:

a) To examine specific provisions of IBC applicable to MSMEs and relaxations available to them.

b) To study the effect of IBC on MSME as an operational creditor (OC)

c) To discuss the utility of the pre-packaged insolvency resolution process (PPIRP/pre-pack) for MSMEs

Through literature review, various issues relating to IBC and MSME have been ascertained and supplemented with data collected from secondary sources which include reports, quarterly newsletters, annual publications, research articles, and case laws, etc. of the Insolvency and Bankruptcy Board of India (IBBI), RBI, ILC among other sources available in the public domain. These identified key issues were organised into different themes to create a broad framework of how IBC impacts MSMEs. Based on this comprehensive outline, a final SWOC analysis has been carried out.

IBC for MSMEs: Provisions and Safeguards

The main objective of the IBC is to aid in reorganizing a resolution for the corporate debtor (CD) in a limited time frame, keeping in view the interests of all stakeholders.

Figure 1: Objectives of IBC

The Code is not just a recovery legislation which is evident by the overarching objectives it seeks to achieve (Figure 1). The Supreme Court of India in its judgement of *Swiss Ribbons Pvt Ltd. v. Union of India* referred to the Code as a 'beneficial legislation' and a 'successful experiment' where the 'defaulter's paradise is lost' (IBBI, 2019). The Supreme Court also observed that there has been an exponential increase in financial flows to the commercial sector as a result of financial debts being repaid.

MSMEs can come within the ambit of IBC in the capacity of a debtor or as a creditor (Figure 2).

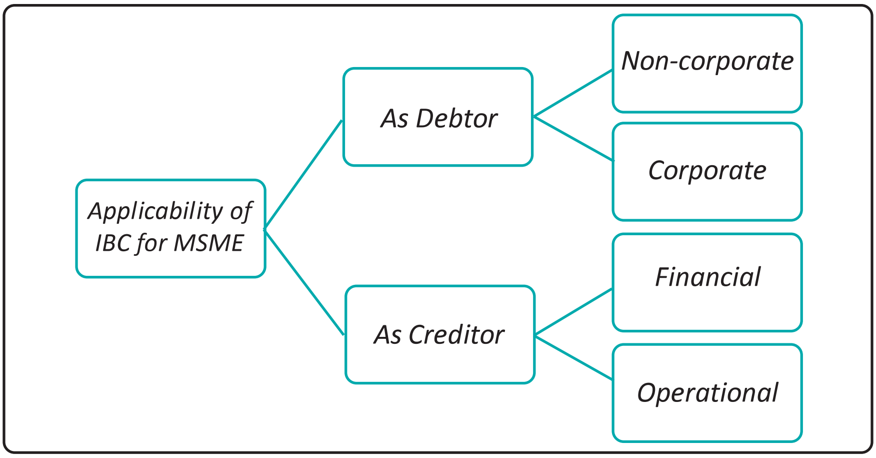


Figure 2: Ambit of IBC for MSMEs

Section 2 of the IBC, lists out the provisions relating to the applicability of the Code concerning insolvency, liquidation, voluntary liquidation, or bankruptcy, as the case may be. It provides that the provisions of the Code apply, *inter alia*, to any company incorporated under the Companies Act, 2013; any limited liability partnership incorporated under the Limited Liability Partnership Act, 2008; personal guarantors to CDs; partnership firms and proprietorship firms; and individuals, other than persons referred to in clause (e).

As per the National Sample Survey (NSS) conducted during the period 2015-16, there were 633.88 lakh unincorporated non-agriculture MSMEs in the country engaged in manufacturing, non-captive electricity generation and transmission, trade, and other services (Govt. of India, 2022). However, in 2021, PPIRP was introduced only for corporate MSMEs, leaving out majority of MSMEs who are either sole-proprietorship or partnership firms. Corporate Insolvency Resolution Process (CIRP) is the standard process provided under the Code for resolving the corporate insolvency of a CD.

CIRP may be initiated by a financial creditor (FC), OC, or by CD itself. The application for initiating CIRP has to be filed with the NCLT, which may accept or reject the application. If the application is accepted, NCLT appoints an Interim Resolution Professional (IRP) and declares a moratorium on the debtor's operations. Claims are invited from stakeholders and IRP is required to receive, verify and collate all claims submitted. A committee of creditors (CoC) is formed which comprises of FCs. OC above the threshold limit can attend meetings of the committee but do not get voting rights. CoC then appoints the resolution professional (RP) to conduct the CIRP and manage the operations of the CD. Such RP may be the IRP appointed earlier or a new RP. The appointed RP then invites applicants to submit a resolution plan for the CD. Eligible resolution plans are then presented before CoC for approval which requires a 75% majority vote to be approved. If CoC approves a resolution plan, it is then submitted to NCLT by RP for approval. If approved by NCLT, the resolution plan becomes binding on all stakeholders involved in CIRP.

An analysis of the stepwise process of CIRP reveals it to be a strenuous process, with scope for delays at various levels. This process can be financially draining for the MSMEs and can lead to potential liquidation under a myriad of circumstances.

Section 29A, introduced via 2018 amendment to the Code, provides the eligibility criteria for resolution applicants. It restricts those persons from submitting a resolution plan who can have an adverse effect on CIRP. The four layers of ineligibility are - ineligibility of the person himself, ineligibility of a connected person, ineligibility of a related party of a connected person, and ineligibility of a person acting jointly/in concert with a person suffering from the first layer/second layer/third layer of ineligibility. However, for MSMEs, certain exemptions from the applicability of the provisions of section 29A have been introduced by the Government.

The Ministry of Law and Justice through the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, inserted section 240A in the Code which specifically exempted resolution applicants from the ambit of section 29A, and paved the way for them to submit resolution plans for MSME(s) that are undergoing CIRP. Section 240A specifies that clauses (c) and (h) of section 29A shall not apply to the resolution applicant in respect of the CIRP of any MSME. The Central Government has been empowered to allow further exemptions or modifications for the MSME sector, if required, in the public interest. The Supreme Court in the case of *Swiss Ribbons Pvt Ltd. v. Union of India* has provided the rationale for excluding MSMEs from eligibility criteria laid down in section 29A(c) and 29A(h) of the Code as in 'such industries, other resolution applicants may not be forthcoming which would not lead to resolution but liquidation'(IBBI, 2019).

The intent behind the insertion of section 29A in the Code was to prevent defaulting persons, including the promoters, from buying back the CD, at steep discounts to the grave prejudice of other stakeholders. The above could also apply to a promoter of MSME who may try to take undue advantage of the exemption from section 29A.

Thus, by disallowing wilful defaulters from submitting a resolution plan and at the same time allowing a promotor who is not a wilful defaulter or specifically disqualified to submit a resolution plan, the law takes a balanced view of the situation. Such an exemption is 'mindful' and may enable MSMEs to find bidders and prevent them from having to undergo liquidation (ILC, 2018).

Due to the contribution of MSMEs as one of the largest sources of employment, job preservation for MSME employees is a vital issue in their insolvency resolution. As per NSS survey conducted during the period 2015-16, the MSME sector has been creating 11.10 crore jobs in rural and urban areas across the country (Govt. of India, 2022). Adverse consequences of IBC in the context of MSMEs leading to liquidation rather than resolution can have a disastrous domino effect in this regard. On the other hand, an efficient and expeditious insolvency system can help in job preservation. For example, in UK, when a business was sold as a going concern, revised reorganisation laws resulted in new owners retaining all employees of enterprises in 65% of receivership and administration cases (RBI, 2019).

The ILC also noted that the intent is not to push MSMEs into liquidation as it can affect the livelihood of employees of these enterprises. Table 2 reveals that in many cases CD is pushed into liquidation due to Adjudicating Authority (AA) not receiving any resolution plan for approval (176 cases out of 429 where final reports are submitted and 410 out of 1378 ongoing liquidations). These numbers are particularly relevant for MSMEs are in their case apart from promoters and existing management, it is unlikely that they will find other takers. In this light, the exemptions provided through section 240A and the provision of pre-packs for MSMEs are much warranted.

Table 2: Reasons for liquidations

Circumstances	Number of Liquidations	
	Where Final Reports Submitted	Ongoing
CoC decided to liquidate the CD during CIRP (u/s 33(2))	244	908
AA did not receive any resolution plan for approval (u/s 33(1)(a))	176	410
AA rejected the resolution plan for non-compliance with the requirements (u/s 33(1)(b))	9	44
CD contravened provisions of the resolution plan (u/s 33(3))	0	16
Total	**429**	**1378**

(Source: Insolvency and Bankruptcy Board of India Quarterly Newsletter, Jul-Sep, 2022)

The judiciary interpreting the IBC to the advantage of MSMEs is also heartening as was observed in the observations made by NCLAT (2019) in *Saravana Global Holdings Ltd. & Anr. v. Bafna Pharmaceuticals Ltd. & Ors.* NCLAT (2019) observed that *'in exceptional circumstances, if the 'Corporate Debtor' is MSME, it is not necessary for the promoters to compete with other 'Resolution Applicants' to regain the control of the 'Corporate Debtor'.*

MSMEs as OCs

MSMEs need to be protected not only as debtors but also as creditors. As creditors, the three contentious issues facing the MSMEs are - cost, time taken, and differential treatment of FCs and OCs. MSMEs can be deterred from acting on legitimate claims due to the prohibitive costs of pursuing a claim legally. These costs increase the longer the resolution process takes. Though section 12 of the Code provides for the CIRP to be mandatorily completed within a period of 330 days from the insolvency commencement date, the data at the end of September 2021, showed that CIRPs yielding resolution plans took an average of 428 days while those resulting in liquidation, took 375 days on average. Though in comparison to the pre-IBC era, these numbers look promising, but for already distressed MSMEs, the long duration of the CIRP adds to the cost and drains out the resources.

MSMEs are generally OCs though they may be FCs as well. Section 5(7) of the IBC defines a FC as *'any person to whom a financial debt is owed'* and section 5(20) defines an OC as *'a person to whom an Operational debt is owed'*. MSMEs form a major part of OC along with employees and other trade creditors (ILC, 2020).

Under CIRP, only FCs have been given the right to vote on the resolution plan. The rationale behind this has been explained by the Supreme Court in *Swiss Ribbons v. Union of India*. The court observed that FCs were better equipped to assess the viability of the debtor and could evaluate the effectiveness of the resolution plan in resolving the debtor's insolvency. The OCs, on the other hand, may not be able to assess the viability and feasibility of the business (IBBI, 2019).

The law has sought to protect the interests of non-FCs. Regulation 38 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) requires that the resolution plan should contain a statement as to how it has dealt with the interests of all stakeholders. Section 30(2)(b) of the Code guarantees that OCs are to be paid either liquidation value or the amount that would have been due to them had the amounts to be distributed under the resolution plan been distributed according to the liquidation waterfall mechanism. However, despite the legislative safeguards provided above, there are concerns that FCs gain at the expense of non-FCs. This perception also arises because, unless the stakeholders are OCs who are owed at least 10% of the CD's debt, or members of the suspended Board of Directors, they cannot participate in the meetings of the CoC. Further, under the liquidation waterfall given in section 53 of the Code, unsecured FCs have been given priority over unsecured non-FCs (other than employees and workmen).

CoC can include those OCs in their deliberations to whom more than 10% of the value of the CD's total debt is owed. However, such instances involving a specified amount owed to a single OC may not be very prevalent. The FCs have no incentive to ensure that the resolution plan maximizes value for all as long as their concerns are addressed. It may not be possible for non-FCs to make their case by appearing before AA in case their rights have not been considered by the CoC. In such situations, OCs remain on the outside to discussions of the CoC and are not privy to how their concerns are being dealt with by the CoC, even if they are. This can lead to a lack of trust and confidence in the CIRP and increased litigation (ILC, 2020).

Classified as OCs under CIRP, MSMEs are virtually left out of the entire IBC process. Unlike under MSMED Act, there is no statutory protection provided to MSMEs for their dues. Many MSMEs get poor recoveries from CIRPs of large corporates.This can result in corporate non-performing assets (NPAs) leading to MSME NPAs which would be disastrous for the economic health of the country.

The FISME has highlighted the plight of MSMEs as OCs in the market. In a representation made to Parliamentary Standing Committee on Finance, they pointed out that while MSMEs do not get credit in the market, they have to give credit to survive in the market. But with CoC comprising of only FCs, their recoveries can fall flat. In the report, FISME representative noted that a comparison of recoveries and OCs and FCs as on September, 2020 showed that while recoveries of FCs was 42%, recoveries of OCs which include MSMEs crashed from 49% to 14% (Parliamentary Standing Committee on Finance, 2021).

Keeping in view the special needs of MSMEs as OCs, (ILC, 2020) has suggested that OCs should be allowed to have recourse to CIRP on a minimum default of ₹ 5 lakh only. FISME has proposed that a small percentage of the total CIRP amount can be kept aside for priority payment to small & micro companies which can enable them to recover the majority or all of their dues.

NEED AND FEATURES OF PRE-PACKS

One of the core objectives of the IBC is to speed up the insolvency resolution, especially in the context of MSMEs as time is of great essence for their survival and revival. In 2021, the PPIRP/pre-pack framework was introduced only for corporate MSMEs.

The CIRP is a vigorous and strenuous process, with scope for delays at various levels. This process can be financially draining for the MSMEs and can lead to potential liquidation under a myriad of circumstances. By contrast, the pre-pack method is a faster and more efficient rescue mechanism that provides for a very limited role of the court while ensuring maximum preservation of asset value.

The PPIRP framework seeks to build on mutual understanding between CD and creditors. It allows the CD and creditors to explore and negotiate the best way to resolve stress in business. PPIRP envisaged in India is a combination of informal and formal processes. The informal outlook at the beginning offers flexibility and speed to the reorganisation process and the ensuing formal court process helps provide statutory protection. The features of pre-pack in India are given in Figure 3.

Consensual	• Build on mutual understanding between CD and creditors which allows the CD and creditors to explore and negotiate the best way to resolve stress in business.
Cost-effective	• CD and lenders can arrive at a mutually agreeable resolution plan to save which can help minimize cost during the course of resolution. Costs associated with court is reduced due to its limited role.
Semi-formal	• Informal outlook at the beginning offers flexibility and speed. The ensuing formal court process helps provide statutory protection.
Less-disruptive	• Rehabilitation of the CD as a going concern is one of the core objectives of PPIRP which puts emphasis on preserving the business and jobs.
Debtor-in-possession combined with creditor-in- control	• The control and possession continues to vest with the CD while RP conducts the process under guidance and oversight of creditors. No asset sale is possible without approval of empowered creditors.
Value preservation and maximization	• PPIRP framework also provides flexibility to obtain a better resolution plan compared with the base resolution plan submitted by the CD. The Swiss Challenge method adopted within the framework can help in value maximization.

Figure 3: Features of pre-packs in India

Though the PPIRP for corporate MSMEs came into force from April, 2021, till December 31, 2022 only four applications were admitted as given in Table 3.

Table 3: Cases admitted for PPIRP as on December 31, 2022

Sl.	Name of CD	Date of Admission	Name of NCLT Bench
1	GCCL Infrastructure & Projects Ltd	14-09-21	Ahmedabad
2	Loonland Developers Pvt. Ltd.	29-11-21	Principal Bench, New Delhi
3	3 Enn Tee International Limited	10-10-22	Principal Bench, New Delhi
4	Amrit India Limited	28-11-22	Principal Bench, New Delhi

(Source: Insolvency and Bankruptcy Board of India Quaterly Newsletter, Oct-Dec, 2022)

The lackluster response to PPIRP clearly shows that pre-packs have failed to take off in India. The ground realities and causes for the same need investigation especially since, on paper at least, the pre-pack framework as an expedited reorganisation process seems quite appealing. A comparison of the PPIRP framework implemented in India with those existing in the UK and USA, reveals that learnings from experiences in these jurisdictions have been incorporated into the Indian version (Subbiah and Mehrotra, 2021; Iyer and Marwah, 2021). As such, the pre-pack framework at present hasn't been tested at all to assess if the checks and balances in place to ensure its efficiency and effectiveness are working or not. Reasons for pre-packs garnering low interest from MSMEs could be due to a lack of support from creditors and a lack of awareness among debtors and creditors.

Some other considerations relating to pre-packs that need to be kept in mind include concerns of non-corporate MSMEs who will not be benefited from the pre-packs in its present form. A majority of MSMEs in India are either sole-proprietorship or partnership firms. Therefore, pre-packs must evolve and provide a solution for the unincorporated MSMEs in India. Apte and Das (2021) observe that it is important to examine the treatment of non-corporate MSMEs under other jurisdictions so that the pre-pack for non-corporate MSMEs in India, can be brought into existence to benefit the un-incorporated MSMEs in India. The Parliamentary Standing Committee on Finance (2021) has noted that the pre-pack framework to be gainfully employed must strictly adhere to timelines to achieve swift and cost-effective resolution. Further, standalone MSMEs i.e. who are not supported by any large group of companies should be given assistance to implement the PPIRP framework. Also, any misuse or perception of misuse of provisions by MSMEs who are part of or supported by large groups of companies should be avoided. Due to the confidentiality of the process at the beginning, only approval from secured creditors is required. There is a need to also keep in view the interests of unsecured creditors. There is also the fear that pre-packs can lead to an increase in undervalued or preferential transactions with assets being sold to a third party or related party at an undervalued price.The role of IPs in pre-packs would be crucial to work in tandem with promoters of MSMEs. The promoters of MSMEs may not be well-versed with the complexities of the code and may require some hand-holding

DISCUSSION AND RECOMMENDATIONS

The IBC has marked a paradigm shift in the bankruptcy and insolvency framework in the country. Supreme Court of India has commended it as a beneficial legislation that puts CD back on its feet rather than being only a recovery tool for creditors. This is pertinent for the MSMEs since revival, rather than liquidation is of prime importance for units in this sector. Time is of ‘increased’ essence to this sector as, the longer the insolvency process goes on, higher are the costs and value deterioration of assets.

However, the experience with IBC so far has not been without lessons to be learnt. Though the time taken for resolution under the IBC regime has drastically reduced from an average time of 4.3 years in 2017, it still exceeds the authorised timeline of 330 days by a big margin. Costs of pursuing a claim only increase as the process stretches and can discourage MSMEs from acting on even legitimate claims.

RBI (2019) noted that once the entire IBC regime for insolvency/bankruptcy of firms, proprietary firms, and individuals is in place, it will boost lender confidence by providing added certainty and greater predictability regarding the recovery of defaulted loans. This can lead to a reduction in the credit gap and an increase in the amount of credit available to MSMEs in the Indian economy. A study involving SMEs in France, Germany, and UK found that banks priced their loans based on their expected rights in the event of a default. Further, in Brazil, reforms in the insolvency legislation caused an average reduction in the cost of credit ranging from 7.8% to 16.8% from the level before the reforms were enacted (RBI, 2019).

The Parliamentary Standing Committee (2021) noted that the main reasons for the delay in the insolvency resolution process are delays in the admission of cases in NCLT and delays in approval of the resolution plan by the NCLT. It also noted that NCLT judgements are continuously litigated in NCLAT and Supreme Court delaying resolution and recovery. The report has recommended that NCLT benches solely for IBC may be created along with specialized benches for MSME sectors with requisite domain expertise.

The IBC has been constantly tested and has evolved with various changes. The amendment to introduce section 240A has provided exemption from the applicability of section 29A clause (c) and (h) if the CD is a MSME has provided relief to promoters of MSMEs. Lack of resolution applicants can lead to liquidation rather than resolution for an MSME undergoing CIRP. Thus, an amendment to allow existing promoters of MSMEs to submit a resolution plan, subject to meeting other eligibility criteria, is a meaningful improvement that can go a long way in serving the interests of MSMEs.

It needs to be reiterated that MSMEs need to be protected not only as debtors but also as creditors under the IBC regime. MSMEs are generally classified as OC under CIRP and are virtually left out of the entire IBC process. MSMEs as OC under IBC come after secured creditors in the waterfall mechanism and as such, many MSMEs get poor recoveries from CIRPs of large corporates. Under the Code, there is no statutory protection provided to them for the recovery of their dues. This can seriously affect the health of these MSMEs which in turn would have adverse consequences for the economy as a whole.

MSMEs are unlikely to be able to meet the minimum threshold limit of default of ₹ 1 crore to file for insolvency of a CD. This limit needs to be reduced specifically for the MSME sector so that these units as OCs, have the recourse to initiate a CIRP. In the case of MSMEs as OCs, provisions could be made to ensure their greater participation in the finalization of the resolution plan so that their concerns can be better understood, and a better resolution plan may be accepted. This can be done by giving a right to vote on the resolution plan to MSMEs who are OCs. Within the ambit of the Code as such there is no ineligibility of OCs to vote on the resolution plan. For example, in case a CD doesn't have any FCs, under regulation 16 of CIRP Regulations, OCs would constitute the CoC. This can be leveraged to provide for a greater role of MSMEs as OCs in the CIRP.

The RBI Expert Committee on MSMEs recommended that due to the vulnerability and size, the insolvency code should provide for out-of-court assistance to MSMEs such as mediation, debt counselling, and financial education (RBI, 2019). The introduction of pre-packs for MSMEs particularly after a distressful pandemic can provide a revival mechanism for stressed MSMEs. However, certain challenges remain for MSMEs under IBC. Pre-packs at present, apply only to corporate MSMEs who are just the tip of the iceberg of the entire sector. As such, MSMEs have to rely on CIRP which can be a long uncertain road that may lead to liquidation rather than resolution.

The major takeaway for the MSME sector is the special status accorded to it through section 240A which has exempted MSMEs from clauses (c) and (h) of section 29A. However, for MSMEs as OCs, IBC offers very little. Since these units are in no position to absorb massive haircuts, they may be pushed off the cliff in case of CIRPs of big corporates leading to poor recoveries for them.

Pre-packs offer a quick and cost-effective resolution mechanism which has various other inherent strengths. The pre-pack process keeps the promoter in control and offers an independently run, statutory process with court approval to minimise the risk of future objections. It is a less disruptive process and with a blend of formal and informal stages, it helps to speed up the process while ensuring legitimacy. These strengths of pre-packs present a myriad of opportunities for MSMEs. Pre-packs can help avoid liquidation as they can be initiated at the slightest sign of distress and thus, contribute to the preservation of businesses and jobs. The reduced timelines can help in the maximum preservation of asset value. The prospect of a base resolution plan emerging as the final resolution plan is high due to less number of resolution applicants in the case of MSMEs. However, given the lackluster response to pre-packs so far since their introduction, the scheme might need a revamp to address the concerns of debtors and creditors. Table 4 presents the SWOC analysis of IBC for MSMEs

Table 4: SWOC Analysis of IBC for MSMEs

STRENGTHS	WEAKNESSES
• Exemption from clauses (c) and (h) of section 29A. • Section 240A has empowered the Central Government to notify any situation of non-application of the Code's provisions to MSMEs.	• As a CD, the CIRP can be financially draining, lengthy, and costly for MSMEs • MSMEs are generally OCs and are virtually left out of the entire CIRP
OPPORTUNITIES	**CHALLENGES**
• A strengthened IBC regime can help increase the amount of credit available to the MSME sector • Introduction of pre-packs which offer a timely, cost-effective, semi-formal, debtor-in-possession resolution mechanism.	• Strict adherence to timelines • MSME promoters may require assistance to implement the pre-pack framework • Pre-packs at present, apply only to corporate MSMEs who are just the tip of the iceberg of the entire sector. • To address lack of support by creditors for pre-packs

Based on the synthesis of the literature reviewed, this paper makes the following recommendations:

- Protection of interests of MSMEs as OCs either through provisions enabling them to be an active participant in the finalisation of the resolution plan or setting aside a fixed percentage of CIRP value for recovery of dues of MSME lenders.
- Pre-pack framework to be gainfully employed must build on the learnings available so far and should be modified to extend its potential benefits to the entire MSME sector.
- Setting up of specialized IBC benches of NCLT for MSMEs to fast-track the resolution process.

CONCLUSION

The objectives of IBC per se are also the objectives that need to be met vis-à-vis the MSME sector. Under the first-order objective of the resolution, special exemptions provided for the MSME sector can help boost their chances of resolution rather than liquidation. Adverse consequences of IBC in the context of MSMEs leading to liquidation rather than resolution can have a disastrous domino effect. Efforts are required to provide a time-bound resolution that increases the efficiency and effectiveness of such a resolution. Further, 'equitable asset distribution to all stakeholders' is an objective that needs to be highlighted concerning MSMEs as OCs.

As IBC has proved in its evolution so far, it is not only 'a' successful experiment, rather a 'series' of successful experiments put together. As an economic legislation, it continues to build upon learnings presented by empirical investigations. A developed IBC regime for MSMEs can boost lender confidence and help increase the credit available to this sector. The introduction of pre-packs for the MSME sector can help boost their chances of resolution rather than liquidation. The availability of pre-packs provides revival options for stressed MSMEs, particularly after a distressful pandemic. Pre-packs offer a globally recognised hybrid insolvency process that is simple, flexible, cost-effective, accessible, least disruptive, and employment friendly. These characteristics of the pre-pack framework in India make them attractive for MSMEs. A comparison of the PPIRP in India with that existing in the UK and the USA reveals that some in-built checks and balances have been put in place in the Indian framework. However, certain challenges emerge for the extant pre-pack framework. Pre-packs at present, have found only two takers since their introduction. Pre-pack framework to be gainfully employed must build on the learnings available so far and should be modified to extend its potential benefits to the entire MSME sector.

BIBLIOGRAPHY

(1) Apte P. and Das S. (2021), "Treatment of MSME Insolvency under IBC", Quinquennial of Insolvency and Bankruptcy Code, 2016.

(2) Govt. of India (2020), Ministry of Micro, Small and Medium Enterprises, F. No. 2/1(5)/2019-P&G/ Policy (Pt.-IV (1st June, 2020).

(3) Govt. of India (2022), Annual Report, 2021-22, Ministry of Micro, Small and Medium Enterprises.

(4) IBBI (2019) *Swiss Ribbons Pvt. Ltd. and Anr. v. Union of India and Ors*., (2019) 4 SCC 17.

(5) IBBI Quarterly Newsletter, July- September, 2022.

(6) IBBI Quarterly Newsletter, October-December, 2022.

(7) ILC, Report of the Insolvency Law Committee, March, 2018.

(8) ILC, Report of the Insolvency Law Committee, February, 2020.

(9) ILC, Report of the Insolvency Law Committee, July, 2021.

(10) Iyer and Marwah (2021), "Pre-pack Framework: A step in the Right Direction", Quinquennial of Insolvency and Bankruptcy Code, 2016.

(11) NCLAT (2019), Company Appeal (AT) (Insolvency) No. 203 of 2019.

(12) Parliamentary Standing Committee on Finance (2021), Report on Implementation of Insolvency and Bankruptcy Code- Pitfalls and Solutions.

(13) Reserve Bank of India (2019), Report of the Expert Committee on Micro, Small and Medium Enterprises, June 25, 2019.

(14) Subbiah and Mehrotra (2021), "Pre-pack Insolvency Resolution Process: Judiciously Strengthening IBC in times of crisis", Quinquennial of Insolvency and Bankruptcy Code, 2016.

(15) The Insolvency and Bankruptcy Code, 2016.

(16) UNCITRAL (2021), UNCITRAL Legislative Recommendations on Insolvency of Micro- and Small Enterprises.

(17) World Bank Group, Report on the Treatment of MSME Insolvency, 2017.

15 ROLE OF MEDIATION IN CORPORATE FINANCIAL DISTRESS

- Dr. Puranjoy Ghosh

EXECUTIVE SUMMARY

The central part of transitional shift from debtor-friendly to creditors' priority denotes effective protection of the creditors' interests and to enjoy the return on investment (ROI). Preservation of value of capital and ROI is important however, fixation of any uniform threshold limit without considering the capital concentration denotes an 'intelligible difference and discriminatory treatment' between large and medium or small-scale business firms. Introduction of mediation process would be effective in so far as cost of proceedings and provision of fresh start is concerned.

Keywords: Mediation, Financial Distress, MSME

RESEARCH PAPER

The central part of transitional shift in the Indian insolvency laws from debtor-friendly to creditors' priority denotes adequate consideration of the realities of the management culture and psychology of the business entities in India in combination with the factor of abuse of process of laws in debt recovery enforcement mechanism. Effective protection of the creditors' interests ensure debt supply and alignment of time-bound debt recovery enforcement influence the debt market and instills the confidence among the prospective investors to enjoy the ROI, both the domestic and foreign and additionally it contributes the financial development of the economy of the country. Preservation of value of capital and ROI depends upon the combination of various legislations and Insolvency and Bankruptcy Code, 2016 (IBC/Code) is but one of them. Present Code, i.e., the IBC has addressed the previous relaxed features of both the *ex-ante* efficiency and *ex-post* efficiency factors in the legislative norms relating to debt-recovery and has been reformed hence, it has mostly been initially criticized as another debt-recovery legislative tool. Certain stimulus of the financial aspects in any corporate firm, like, capital structuring and capital budgeting, operational financial decisions, agency cost of debt, incentivation through debt, etc. are the *ex-ante* factors where management enjoys the 'freedom' in setting the combination of such variables and also protected from any interference unless it causes apprehension to the minds of the shareholders relating to the performance of the corporate firm. Asymmetric information between the managers and shareholders lead to evaluate whether the financial decision being translated into action to run the business firm is optimal or sub-optimal. Creditors' friendly approach necessarily would have negative influence on the debt market therefore, similar restrictive norms to equal extent in the capital market regulations is necessary as equity financing reduces bankruptcy risks and inequities. At a glance the prioritization of the committee of creditors in the corporate insolvency resolution process (CIRP) may suggest the imbalance of opportunities of the debtors in framing of the resolution plan of the entities however, considering the market volatility in today's liberal economy to ensure the accountability and effective corporate governance in view of normative compliances, disclosures, following financial accounting standards, value maximization of the firms, etc.

The author opines that the necessity of mediation may appear to be of some benefit for the medium and small-scale business firm but it is not necessary for large business firms. Fundamentally the opportunities of mediation would be in either a) Settlement before court proceeding; or b) Out-of-court settlement during the continuance of court proceeding. The former provides the voluntary approach to resolve the disputes without entertaining any supervision and/or intervention of court and in such cases refinancing, rescue would be seamless journey. May it be the fact that the supervision and intervention of the creditors into the debtor's management through debt-equity swap is possible. The cost of such rescue culture for the medium/small size business firms would also be less in comparison to litigation costs required for the court proceedings. In so far as the out-of-court mediation during the continuance of the court proceedings are concerned the supervision and interference of the court would be there to consider and adjudge the legality of the terms and conditions whether derogatory or against public policy or defeating the provisions of other laws or voluntary choices of the parties or not etc. Mediation, *per se* has not operative force in the eye of law unless documented and endorsed by the appropriate Adjudicating Authority (AA). It merely beholds a consensus for the time being of the parties. So, for the medium/small scale business firms' mediation may be one cost-effective option however, the application of the provisions of mediation in matrimonial cases the reluctant attitudes of the professionals and sometimes of the parties even lead to the abuse of time as well as the process of the laws made for speedy disposal. A survey on it in any mediation centers relating to number of cases sent for mediation and final disposal through mediation would endorse the veracity of such fact.

With regard to formal out-of-court mediation already pre-pack administration with a definite time-period has already been appended in the latest amendment. Any large business firm interested to undergo mediation proceedings could avail of the pre-pack administration. The indicatives that are absent, though not explicitly prohibited as well, are the application of 'cram down' principles and the principle of super priority rights of the creditors for giving effect to the rescue of the business. The present Code has mostly followed the legal framework of Germanic Laws on insolvency. The author would like to suggest that imposing of the legal obligations upon the creditors in pre-pack administration process to prepare a rehabilitation plan on receiving all necessary information of the debtors and to submit the same to the AA separately and also to ask for the base resolution plan from the debtors as well. The AA may invite the expertise having economic wisdom and to obtain the opinion and enlarge the opportunities to the parties to such insolvency proceeding to settle the disputes amongst themselves. Each business entity is an economic agent and the more expansion of business the more sustainable economic growth would be possible through increasing employment and standard of livelihood. However, any subsidized mechanism like, writing off the debt would dilute the value of the capital and would impose additional economic burden to the taxpayers to support the developmental schemes of the Government. Fixation of any threshold limit to ascertain the large or medium or small-scale business firm has already been addressed in the Micro, Small and Medium Enterprises Development Act, 2006 (MSME Act, 2006). Any further relaxation of IBC by adopting the mediation proceedings within fold of the legislative norms would weaken the desired efficacy of the Code and foreign investment to the country as well. Expropriation of money has always been an issue in the minds of the shareholders and creditors hence, enlargement of the opportunity of mediation proceedings would dilute the confidence not only of the investors rather would encourage the increase of non-performing assets (NPAs).

For the purpose of the present study the analytical methods would be fruitful to review and analyse the growth and subsequent changes in the legal principles surfaced through various legal pronouncements. And at the same time an empirical survey method of the judicial pronouncement with comparative analysis would also be necessary in order to ascertain the compatibility and suitability of the legal principles in Indian socio-economic context. The data could be collected from the websites of various web-portals of Ministry of Law & Justice of different jurisdictions.

The foundation of corporate insolvency legislation across the globe, apart from some fragmented deviations in national lines, inflexibly, is focused to preserve business performance as well as to strengthen the credit ecosystem for economic growth. Hence, due weightage has been specified in the resolution process of insolvency proceeding in a) time-bound, b) cost-effective, and c) transparent manner for the business-recovery from indebtedness and the economic shock of insufficiency of cash flows. Speedy resolution mechanism evidently ensures as contributory to reduce the risk-factors and instils confidence to the creditors to undertake the greater issuance of long-term debts. The main purpose of insertion of pre-pack administration under the Insolvency and Bankruptcy Code (Amendment) Act, 2021 is to restore the business from the distressed scenario by availing of the 'consensus procedure' by and between the debtor and creditors within the institutionalized framework of professionalism. This freedom of expression enlarged to the parties to opt to resolve such financially distressed condition, in 'out-of-court settlement mechanism' through 'negotiation or mediation' which would manifest the interrelations between the parties in the backdrop of financial distress of the business enterprises. In negotiation and mediation process, the 'combination-cooperation' approach of the parties in unitary manner would exhibit the shared confidence by and between the parties resulting in the rescue of the viable business as well as preservation of repayment incentives. On the other hand, in existing ethos of adversarial structure with 'supervisory approach' of Resolution Professional (RP) for furnishing the 'turn around' proposal with interdependent approach (may be at times independent approach) may lead to cooperative persuasion either via 'negotiation and/or arbitration'. For example, the bottom line of successful mediation lies in materialising the availability of leverage primarily from the existing creditors but where the management concludes some aggressive stance to mitigate the financial risks locate some other conditions to earn abnormal profits[1] in such case the flexible approach of creditors would not lead the mediation successful as well. Disclosure of information relating to the firm's performances and risk-levels as the decision of sharing of such information varies with the management-board. Per contra, the furnishing of the same to the regulators are the routine-schedule as compliance of corporate governance. Large Board size often appears to be conservative and seldom have the well-considered approach in sharing the same unto the creditors evolves the perception of information asymmetry. And these would sow the seeds of complexity in the interrelationship of the parties. Studies show that independent management board take most risk-averse decision Negotiation in arbitration mechanism, predominantly, focused upon the transactional negotiations what is again influenced by the extent of existing collateral and the external resources of the debtor. Hence, any negotiation or compromise in the guise of restructuring or refinancing for business rescue the dominant preference becomes the distribution-contribution ratio of resources which mostly dilutes the willingness to trade-off. The eventual success of such consensus procedure via cooperative persuasion suggests the efficiency in swarming consensus by entwining and balancing independent issues in such re-settlement or re-payment plan or resolution plan. And the remarkable aspect in such re-payment or resolution plan, as provided, are that: (a) Special majority consent of the creditors; and (b) Court intervention. This would make the interrelations of the parties' irreconcilable. In persuasive-cooperation the predominating approach of the creditors are the recovery of assets from the estate of debtor and fair distribution of recovered value amongst them. Creditors compete with each other out of the limited resources of the debtor that ultimately result in the end of job, tax revenue, and business of the debtor. Though adjudication process ensures the equality and the recent amendment by providing the pre-initiation phase for 'level playing field' however, the main objective of pre-packaged administration at a reduced cost would not become possible. To avail of the relief under pre-packaged administration under IBC, the cost of the proceeding is to be incurred for access to have the advantage of such equality. To large scale business enterprises, say for CIRP, such processual norms are not detrimental because of the freedom the big corporate entities enjoy relating to (a) the formulation of strategic business planning, (b) the financial decision-making process, (c) scope of raising fund from sources other than its own assets, (d) operational domain for investment(s) & tax treatments, (e) profit margin and risk absorption strength, (f) opportunities of making arrangement of external resources and so on. Whereas, in case of small-scale business enterprises all such scopes and extents are very limited, and which is why following the same procedural steps for pre-pack administration for micro, small and medium enterprises (MSMEs) would be dearly almost in all respects, to such small-scale business enterprise that already met with financial difficulties. Neither it is possible for the small-scale business enterprises to make arrangement of external resources in financially distressed condition save another fresh debt-arrangements or selling out the valuable part of the business which would adversely affect its survival or rehabilitation once pre-packaged administration is completed. The reasonable apprehension would be to turn down the opportunity of debt capital for running the same even after somehow managing the financial distressed conditions. This possibility might, over passage of time, may encourage some large-scale business entities to buy out such small-scale business enterprises - means may lead to evolution of an oligarchic market in the society.

The next opportunity that is available to the large-scale business enterprises on examining the ensuing financial distress (like, conversion of debt-equity swap, contribution from some other stakeholders, for example, promoters, employees, etc.) are very limited to only a few medium scale business enterprises and not all small and medium size business enterprises. Hence, in order to ensure the scope of proportional equality for the survival of micro-scale and small-scale enterprises should not be at par as envisioned in the amended provisions of pre-packaged administration process in recent amendment of 2021 of IBC.

The pertinent point that would call attention is that in absence of the implications of the combination-cooperation approach in the legislative provision(s), the opportunities expanded for negotiation or reorganisation in court-intervened resolution process is but ineffective provision for small scale business enterprises. The initiative to validate the informal rescue the in-step of AA is highly appreciable but the supervisory role of RP, alike as in CIRP because fundamentally there is an intelligible difference between a large scale business enterprises and to that of a small scale business enterprises. To promote the level playing field for the micro and small-scale business enterprises in the pre-packaged administration process, consideration of inculcating the principles of proportional equality is necessary otherwise, the uniform treatment would fail to extenuate the rescue of the distressed business of all MSMEs. Inherently MSMEs being low-capital intensive the debtor is shortfall of adequate collateral and external resources but the opportunities of trust-building with the creditors is missed out. The scope of pre-initiation phase has not duly extended to the debtor to conclude the mutually beneficial rescue plan by and between the debtor and creditors rather the mandate of appointment, intervention and supervisory role of the RP in the pre-packaged administration process has restricted the scope of trust building. Therefore, the efficiency of the provision of pre-pack administration to achieve the objective of business rescue appears to be implausible and ineffective in reality in view of MSMEs.

Generally, business rescue plan takes place with the intervention of the court by appointing a revenue-efficient expertise as an external agent, who usually assist in suggesting the efficient capital structure to debtor's business whereby in addition to make debtor's business as a going-concern, the interests of the creditors is also protected. The appointment of such revenue-efficient agent on recommendation by the creditor has been sought for under pre-pack provisions. But keeping in mind the pre-initiation stage of restructuring, the functional role of such revenue-expertise has been kept as it is for the CIRP. The opportunity provided to the debtor under IBC, in pre-pack administration, is to receive the assents of the creditors on its base resolution plan, because as stated above, business rescue requires legal validation of the informal settlement by the initiation of the pre-pack provisions before the AA for the effective compliance of court's approved re-financing agreement at a reduced enforcement costs of the creditors'. Such court-intervened working mechanism relating to pre-pack administration under IBC is very similar to most EU member-States.[2] Some specialized forms of mechanism, however, is evoked while dealing with informal and formal business rescue, for example, the concept of 'lay judges'[3] in the Commercial Court of Belgium, General Courts in Germany, Greece, Hungary, Italy, Latvia, the Netherlands, Sweden, and – to a lesser extend – Spain,[4] designated Commercial Courts and Chancery Division in UK[5] are some of the instances, whereby joining of relevant trade body or association are accredited to ensure the 'market test' i.e., the efficiency of the relevant market to resolve quickly the market uncertainties. So, what is remarkable in such process is that economic wisdom and business acumen have been given preference and that too from the perspective of ordinary prudent business expertise from the market and not from the technical assessment perspectives. Market trends, perceptions and prospects are given preference in such informal rescue mechanism. The tenets of sustainable economic growth, that is, efficient allocation and/or reallocation of resources has duly been prioritized in every nation's bankruptcy resolution process, i.e., appointment of expertise and intervention to the debtor's business respecting to reorganisation or resolution or re-payment process but the distinct feature in IBC is that no change in the functional role of such expertise has been endorsed. It is kept polarized to the extent of creditors' and the appointment of such expertise would also be nominated by the creditors. But the opportunity of informal rescue mechanism to the debtor has not been endorsed in recent amendment. For example, in *Greyhound Lines Inc. v. Rogers*[6] the Bankruptcy Court ordered for requiring the claimants to participate in mediation prior to hearing any motion[7] and also opined that such order is 'clearly beneficial to the speedy administration of this case and should not be used as a vehicle to punish those claimants who chose to participate….'[8] In *Dore & Associates Contracting Inc. v. American Druggists' Insurance Co*[9] the Michigan Circuit Court mediation Rule[10] was invoked and in spite of objection by the dissenting creditor against such mediation the Court applied the cram down principle to resolve the creditors' disputes and facilitated the settlement that ended in confirming the rescue plan. Chapter 11 of U.S. Bankruptcy Code has thus, expanded the elements of reorganisation process through mediation and/or negotiation even when the bankruptcy proceedings has been triggered by the creditors with debtor's-friendly approach of debtor-in-possession model. Without legislative endorsement and Court's pro-active approach negotiation and/or mediation couldn't be the legitimatized process in adversarial system of justice and its enforcement thereof. Such scope has not been conferred to the AA to initiate such process for amicable settlement by and between the parties without any intervention. Seeking for expert's opinion has verily been present in resolving civil disputes in India. Hence, an alternative mechanism, like, to ask for the resolution plan from (i) the debtor, (ii) from the creditors, and (iii) jointly from the parties concluded through informal rescue mechanism could have enlarged the opportunities to (a) evolve the unified combination-cooperation approach, (b) the trust in the relationship by and between the parties, (c) perfect coordination amongst the parties, (d) informational coherence, (e) speedy resolution and effective enforcement. And on receiving such resolution plans the AA would ask for the revenue expertise to evaluate and examine the said resolution plan(s) to find the (i) the presence of the vitiating factors that may be detrimental to the cause(s) of any of the parties; (ii) viability of the plan in conformity of the distressed conditions of the distressed business firm; (iii) imposition of any further legal restrictions in the business operation of the debtor's firm; (iv) any other restrictions that would be necessary for prioritizing to protect the interests of the creditors, etc. Under the Insolvency and Bankruptcy Code (Amendment) Act, 2021, hardly any difference between ordinary CIRP and pre-pack administration process is earmarked. The significant aspects of revival, e.g., early neutral evaluation and neutral fact-findings unless given due importance then the provisions of pre-pack administration would not promote the business rescue because in the existing norms the acceptable settlement through consensus to be endorsed by the revenue expertise would be focused to analyse, evaluate, examine and account the value of debtor's business and assist the AA in resolving the issues. Such consensual acceptable settlement hardly confines the scope to the debtor for reconditioning itself rather this approach promotes the active judicial management of underlying issues of financial distress of debtor's business at the earliest. Substantive consideration of each case by the AA unto mediation under IBC is absent. The only point of benefit that the debtor might avail of in such court-intervened case of dissenting creditors, is the application of cram down principle for the purpose of revival of business. There is little scope and extent provided to the AA under IBC to inspire the creditors for mediation.

The recent judgment of the Court of Justice, European Union[11] has nicely explained the initial phase of pre-pack proceedings and later phase of the same. As under Article 1(1) of Law on Insolvency of Netherland, '*the debtor is to be declared insolvent by the court, on its own declaration or at the request of its creditors or one of them, where it is unable to pay its debts as they become due and it has more than one creditor*[12]*……The insolvency order also includes the name of the insolvency administrator and the supervisory judge*'.[13] As per Article 68 of the Law on Insolvency of Netherland, the Insolvency Administrator is entrusted with the duties not only for the management and winding up of the insolvency business rather also to consider and account the collective interests besides the interest of all the creditors.[14] The notable issues, *inter alia,* related to pre-pack proceedings before the Court were whether:

a) the objective of the pre-pack is to enable, in the subsequent insolvency proceedings, a method of liquidation whereby (part of) the undertaking belonging to the assets of the transferor is sold as a going concern so as to obtain the highest possible return?

b) the structure of the procedure ensures that objective is in fact the guiding principle?

The relevant exceptions of the judgment of the Honourable is hereunder:

> ….a special administration procedure entailing two types of effects for the undertakings subject to it. That case was characterised by the fact that, on the one hand, the transferred undertaking could be placed under a system of compulsory administrative liquidation the effects of which were comparable to those of insolvency proceedings and, on the other hand, that undertaking could, although placed under that scheme, continue trading, under the supervision of an auditor, for a period determined according to legislative provisions. In the latter case, that auditor was to draw up a programme whose implementation had to be authorised by the supervisory authority and which had to comprise, as far as is possible and taking account of creditors' interests, a restructuring plan compatible with the trends of industrial policy, and specify the plants to be brought back into operation and those to be expanded as well as the plants or business units to be transferred. That legislation therefore had different characteristics, depending on whether or not the decree ordering compulsory administrative liquidation authorised the undertaking to continue trading…[15]
>
> The Court held that the first of those effects was comparable to insolvency proceedings, since it was designed to liquidate the debtor's assets in order to satisfy the body of creditors, and transfers effected under this legal framework were consequently excluded from the scope of Directive 77/187. However, it took the view that, where the second effect applied, the primary purpose of the special administration procedure was to give the undertaking some stability allowing its future activity to be safeguarded. The social and economic objectives thus pursued could not explain nor justify the circumstance that, when all or part of the undertaking concerned is transferred, its employees lose the rights which that directive confers on them under the conditions which it lays down…[16]
>
> The Court added, in relation to the differences between those two types of procedure, that a procedure is aimed at ensuring the continuation of the undertaking where that procedure is designed to preserve the operational character of the undertaking or of its viable units. By contrast, a procedure focusing on the liquidation of assets is aimed at maximising satisfaction of creditors' collective claims. Although there may be some overlap of those two objectives within the aims of any given procedure, the primary objective of a procedure aimed at ensuring the continuation of the undertaking is, in any event, the safeguarding of the undertaking concerned…..[17]

> It is necessary in that respect to verify, in each situation, whether the pre-pack procedure and the insolvency proceedings at issue were carried out with a view to the liquidation of the undertaking as a result of the established insolvency of the transferor and not with a view to the mere reorganisation of that undertaking. In addition, it is necessary to establish not only that those proceedings have as their primary objective to satisfy to the greatest extent possible the claims of all the creditors, but also that the implementation of the liquidation through the transfer of the undertaking or a part thereof as a going concern, as prepared in the pre-pack procedure and carried out following the insolvency proceedings, enables the achievement of that primary objective. Accordingly, the aim of the use of the pre-pack procedure, for the purposes of liquidating a company, is to enable the insolvency administrator and the supervisory judge appointed by the court after the declaration of that company's insolvency to increase the chances of satisfying the creditors' claims...[18]

The chief objective of reorganisation or rescue or re-payment plan is considered to promote a synergic environment conducive to the proliferation of healthy debt repayment practices and to enhance the trust factors between creditors and debtors so that a better survival rate for viable businesses could be achieved.[19] French bankruptcy law has specific focus upon expanding the scope to the debtor's businesses as a going concern in order to preserve employment and social objectives. The pre-pack administration under IBC has the primary objective towards recovery dimension to instil confidence amongst the creditors and to strengthen the debt market. The legal imperatives are textured in this recovery mechanism to restructure the behavioural patterns of debtors of the business enterprises to evolve the healthy debt repayment practices in a time bound manner. The consequential evil of such coercive legal attributions upon the behaviours and practices of the parties to the debt-transaction may downsize the sizeable amount of demand in the debt market, in particular by the MSMEs. Therefore, in the light of such legal mechanism of pre-packaged administration scheme the equity financing platform enlarged by the Securities and Exchange Board of India (SEBI) is to be revamped to provide enabling ecosystem for the MSMEs so that MSMEs could raise capital from the market by following more simple procedural compliance (for example, listing, initial public offer, etc.) than the large corporate entities. The weakness lies on the part of the MSMEs in that unless any business enterprise is on the top tier of the definition of the expression MSME, there is hardly any alternative means of making arrangement of external resources at the time of financial distress for its survival or rehabilitation, except the collateral.

Informal rescue is tenuous as it is influenced by higher degree of cooperation from range of parties. The combination-cooperation approach of the parties in evolving consensus for the refinancing plan in pre-pack administration is required to be inculcated by necessary implications under IBC, particularly for the MSMEs. The existing implications are mostly focused towards compromise and/or arrangement or re-settlement, all of what evoke recovery-oriented dynamics through transactional negotiation. The singular feature of compromise, and/or arrangement, or resettlement, in the context of financial distress of a business entity, is that it eventuates only when the parties are under compulsion. Debtor's compulsion is that even after exhaustion of regular opportunities or scopes the debtor wants to have a second opportunity to perform based upon the renewal of the ex-ante clause with control-in-interests; and the creditors' compulsion is like, to stand by the future scope(s) for full realisation of the capital on examining that the debtor's business is economically viable and having prospective market value in future. The potential reorganisation or repayment plan, or arrangement, or refinancing plan would surface only when the potential availability of collateral and external resources of the debtor are accounted. The implication of reorganisation or refinancing plan through pre-pack administration has been moderated in the provision but the overtone of the early liquidation steps in such pre-packaged arrangements and has subverted the scope of informal rescue. Presumably the legislative intent behind such provision is that the enlargement of such scope to the debtor would again be the circumvention of the earlier time-bound performance under ex ante clause relating to borrowing. Another fact that compromise, or re-settlement, or re-organization, etc., under compulsion could hardly be continued for a longer period of time unless debtor's performance evidently exhibits within the commitment duration towards due compliance of the re-payment plan as confirmed under pre-pack administration. Hence, such surveillance mechanism to account and evaluate the performance of the debtor in consonance with the resolution plan is also necessary when the control-in-interest would be in the hands of the debtor.

Pre-pack administration is but a preventive arrangement to achieve the objectives of healthy ecosystem of debt repayment habits, increased trust between debtors and creditors, and higher degree of rescue for viable businesses through resolution and the substantial elements in such pre-pack administration, as already mentioned earlier, are: (i) combination-cooperation in unitary manner; (ii) symmetry of information between the debtor and creditors; (iii) perfect coordination. Once these postulations could be inferred from the provisions, the judicial process of pre-pack administration would ensure the (a) fair exercise of bargaining power in negotiation or settlement, (b) due importance in the business strategic management and capital structure to preserve the interests of the creditors & other stakeholders of the business firm; (c) seamless formulation of refinancing plan; (d) time bound implementation of such refinancing plan; etc., be it asset sales of the debtor, or substantial financial commitments between the parties, or other arrangements. Fact that, keeping in mind the trajectory of prolonged behavioural patterns of the business entities in India, towards uneasy approach in openness and being enthused in existing ecosystem of abusive practices by the business entities the scope of mediation in IBC might not have been given due importance but again, to weigh the corporate debtor (CD) and MSME at par and to equal extent would be partisanship and discriminatory. Or it might have been presumed that keeping uniformity in the provisions in all contexts of resolution process would, besides strengthening the debt markets, insist the MSMEs to avail of the opportunities of the existing platform equity financing in the capital market of the country.[20]

The business rescue as recommended by the Cork Committee (1982), *'We believe that a concern for the livelihood and well being of those dependent upon an enterprise which may well be the lifeblood of a whole town or even a region is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequences upon any given failure can potentially be so disastrous to creditors, employees and the community that it must not be overlooked'.*[21] In the backdrop of Cork Report the elementary components of such mutually beneficial and sustainable informal rescue plan, if be valued in the procedural legal technicalities in such compromise, or re-settlement, or reorganisation, etc. are: (a) perfect coordination, (b) bargaining power, (c) symmetry of information, and (d) collateral (including the loan size and the proportion of long-term debt) then the likelihood of informal rescue with the cheaper and faster successful reorganisation plan may be achieved to a higher scale. If these essentials are present any attempt for negotiation, mediation may bring forth the eventuality of pre-pack provisions in attaining the proliferation of healthy debt-solution and repayment process at a reduced cost of procedures. In addition, to take the strategic decision for debt solution and risk allocation of the business under pre-pack scheme also permeates the trust-building opportunities and informational coherence. Other than financial variables, the factors that could foster a seamless re-payment plan in pre-pack administration process as the creditors' perception of efficient management would contribute in shaping the perfect coordination. The informational coherence with the creditors is the cultural part of the debtor's business management as the impact of operational management has the bearing unto the non-financial goals. It is that confidence of the creditors upon the business manager(s) with reference to the management would imbibe the creditors to enlarge the perfect coordination and fairness in exercising the bargaining power to ensure effective rescue of the business.

The economic contribution of MSME to the gross value added for 2019-2020 has been accounted to 30.8%[22] and the gross domestic product (GDP) growth projection of the country is expected to be 8.0-8.05% in 2022-2023.[23] The financial stability and sustainability of MSME would not only contribute the accounted economic contribution of previous year rather may fulfil the desired goal provided that market risks are duly addressed by the regulatory bodies in view of legal framework. To put it in simple words, the Government promotional schemes (including subsidy) to MSME in order to ensure vibrant economic growth of the country necessarily would be considered on the basis of credibility and performance of such MSMEs and in conformity with other directives, circulars of the regulatory body Reserve Bank of India (RBI) and notifications of the Ministry of MSME and Government in this regard from time to time. The statutory compliance of annual or bi-annual report furnish by the debtor before various regulatory bodies and institutions permeates (a) the firm's characteristics; (b) the loan characteristics; (c) the financial and economic status of the business entity; (d) the monitoring of cash flow position; (e) the credible capital structure of the business, and the scope and extent of creditors; (f) ratio of current assets and current liabilities; (g) the inclination of the management etc. In addition, the priority of the product/service of MSME that would be contributory to priority list of the ministry (for example foreign trade) and coming within the purview of notified cluster would have the preference of the government fund (including subsidy). However, from the documents furnished by MSMEs under mandatory compliance necessarily, therefore, the basic available information would be like, a) the value of such business enterprise in the market, b) demand of the product/service of such enterprise in the market and economic viability, c) the values of such firm's assets, d) the volatility of the assets of such business enterprise, e) the operational dynamics of the enterprise, f) the transparency in statutory compliance, and most importantly, g) the default point - i.e., the book value of such enterprise's total debt. With low-capital base and heavier dependence on both formal source of credit from the banks and informal sources, MSMEs are prone to sickness at the time of economic downturn. The conflict of interests between debtor and creditors leads to economic inefficiency and the notable thing is that in MSMEs, unless it is financially of top notch of MSME category, the degree of agency cost of debt is least, hence, the scope to incentivize such agent through debts would hardly arise. Each MSME mostly being the private initiatives the arrangements of financial resources necessary for its products/services would evidently be based upon debt transactions. Making arrangements to absorb the market volatility, the expected default frequencies due to other externalities, and creditworthiness of such enterprises is restrictive as well. Much protection of creditors' right related to lower the costs of debt enforcement would evidently influence the increase of size of debt market and the interest rate. Again, too much emphasis would cause reasonable apprehension to the debtors about the dilution of their capital along with the debt-capital in the event of financial distress of their enterprise. The subsistence of trust by and between the creditors and debtor would act as catalyst in the event of financial constraints of debtor's enterprise. This could better be addressed through mediation and negotiation in private workouts. As mentioned earlier, debt financing being the primary source of cash inflow of such enterprises the scope of mediation be an effective legal tool. The pre-packaged administration process for MSME should have been distinct than the CDs. The uniformity of the process of insolvency resolution process, irrespective of the size, strength and opportunity would be diminishing to the growth of MSMEs. The key recommendations made by Insolvency Law Committee in its 5th report are: the procurement and furnishing of the necessary data from Information Utilities, alike the CIRP and to monitor the time-bound disposal within 120 days since the commencement of the proceedings of pre-packaged administration process are welcome provisions but the supervision and intervention of the RP into the management of the debtor's business in case of MSME would be detrimental towards the opportunities of mediation and negotiation. The call of IBC is to achieve a very health business environments with the robust economy and therefore, to protect and enhance the balance of wealth of debtors and creditors are very much significant. The designated model in IBC, in recent Committee Report,[24]on a plain reading manifests its inclination towards protecting the creditors' priority to recompense the increasing NPAs. The pre-initiation stage of informal rescue where, in essence, the creditors and debtors would directly and voluntarily would conclude the mutual beneficial arrangements for the business rescue, has been eclipsed by the dominant effect of formal rescue mechanism as it requires that such resolution plan is to be endorsed by the RP. This enhances the sceptical relations amongst the parties instead of the opportunity of combination cooperation among the parties. Due importance to harmonizing the conflicting interests of the parties has not been explicitly provided rather it is prone to 'holding out' issues. Such 'holding out' would encourage the enhancement of relative value of creditors' claim which is again against the elementary factors of informal negotiation or mediation process, like, perfect coordination and bargaining. The indicative(s) of exhortation of mediation approach to provide the level playing field to the debtor from the ends of AA is not even ingrained in such provisions of IBC rather the legal framework has emphasized the role of the RP in the guise of business recovery by pre-liquidation option of business firm. Instead of facilitating the debtors of MSMEs in working out the harmonious, quick, economical solution in a transparent manner to foster the growth of MSME the consternation in the event of indebtedness and eventuality has been pressed upon. The liberal approach by expanding the mutually beneficial resolution to the parties to absorb the economic shock of insufficiency of cash flows in debtor's enterprise and for monitoring and implementation of rescue mechanism through arrangements, agreements, compromise, or resolution plan, etc. for the sustenance of the firms would enable the essence of market economy. The rehabilitation of debtor's enterprise would ensure the optimal use of resources, ensuring the competitiveness in the market, protection of employment, etc. would fulfil the objective of the market economy. Hence the decisive part for consideration might be that the appointment of RP in such pre-packaged insolvency process for distressed MSMEs should have been advisory and not supervisory. The advisory role of the RP would more be justifiable for ranking the remuneration of such expertise in top of the rank of claims. The incentive of the debtor of such MSME in exchange of incurring the cost of pre-packaged process would be the scope of redesigning the capital structures of the enterprise. The sole objective consideration of creditors' consent with 66% threshold limit for the purpose business rescue or rehabilitation would have inverse effect on some viable and prospective enterprises in the market economy. According to the pre-packaged insolvency resolution process for MSMEs, given effect to,[25] section 4 of IBC has been modified that has empowered the Government to notify the minimum default benchmark for triggering such pre-packaged process from time to time. The basic structure of financial creditors' approval is retained[26] for setting in motion of pre-packaged resolution process, on admission of such application of the debtor the appointment of RP, public notification, moratorium, etc. are made mandatory.[27] In spite of the fact that MSMEs are low capital-intensive business enterprises the prerequisites of pre-packaged administration process have been hanged on to the credit discipline at par alike, corporate insolvency. MSMEs being the part of corporate ecosystem thus have become unfair competitors and suffer from uncertainties in the context of financially distressed conditions. The institutional support of the Government through subsidy scheme to MSMEs upto 80% are limited to the certified Zero Defect Zero Effect (ZED) category MSMEs that are ensuring innovative, clean and green manufacturing MSMEs[28] assisting and supporting the market expansion[29] to ensure Indian companies globally competitive. The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)[30] in Clause 5(iv) clarified that such support arrangement is available even for operational capital needed to the MSMEs but such credit facility is not free from the operative forces of relevant provisions of any law related to such lending and/or any directives or instructions to be issued by the Central Government or RBI in this regard. Therefore, the uncertainties remain the same to MSMEs, like debt-capital by furnishing collateral and guarantor's provisions, treat the default in payment as NPAs by the lending institutions, unless coming within the purview of specified category schematized by the government from time to time. Even Credit Linked Capital Subsidy Scheme (CLCSS)[31] is also made available to those MSMEs having advanced technology approved under this scheme. For such specified category of MSMEs. The fragmented approach with specified categories of MSMEs are provided with the opportunities for inflow of capital but in each such cases it is basically debt-capital. In exchange those MSMEs are incentivized with opportunities of inflow of cash, even working capitals but the decisive factor is that in every such cases no specific and uniform legal objective considerations are visible that are exclusively for the MSMEs. Preliminary inspection and inquiry of the specified aspects of the schemes has been retained by the governmental agencies the scope of intermeddling, at times, in ultimate conclusion of the availability of cash inflows unto such specified and categorized MSMEs.

The debtor-in possession proposition though has been provided alike the U.S. Bankruptcy Code, however, the interference of the appointed RP to the debtor's management in conformity with the creditors' nomination would necessarily would count such default of the debtor as NPAs and would preferably would carry on the debtor's business for the recovery of the NPAs during such resolution process. Therefore, the changes to be surfaced by the RP in the capital structure of debtor's enterprise would be in making payment of more money with reference to higher rate of interest to ensure the speedy recovery of creditors' claim and least pay in investment.[32] The interference and influence of the RP in pre-packaged administration may have the negative impact upon the debtor's future borrowing and such reluctance of the debtors, in turn, would influence the growth of MSME economically as well. And again, due to lower adverse selection costs to the creditors there may be the increase of credit supply in the debt market but since better legal protection are provided to the creditors the debtors may forego debt capital. Such misgivings may drive down the interest rate of the debt market and may resulting in regulatory competitiveness even. The mandate of appointment and supervision of the revenue expert to the management of the debtor's firm, the debtor's scope to make investment to some projects having positive net present value and to improve and arrange some possibilities of external financial resources has thereby to be forgone. In addition, the cost of pre-packaged insolvency resolution process has thus been increased for such financially distressed enterprises with the eventuality of uncertainties. The scope to mature the debtor-creditor relationship towards combination-cooperation in unitary manner has been restricted. Next important aspect is that in the resolution plan is sought to be prepared alike large-scale CDs. This pre-packaged insolvency resolution process is available only to the corporate MSME where minimum threshold default limit is ₹ 1 crore, means MSMEs not touching the prescribed threshold limit amounting to ₹ 1 crore are to undergo the arbitration and/or conciliation process as state under MSME Act, 2006.

This consensual-adjudicative mediation process is not that one size fits all. It is applicable in appropriate cases (as there are the variances of size, sector, scope, etc. of the MSMEs even) rather this support arrangement is possible where the aforesaid substantial elements are present in the case. The psychological bottleneck of aspiring entrepreneurs like MSMEs would be the procedural limitations and the cost of the resolution plan under pre-pack administration would be the dead burden to such enterprises. The financial distress of small-scale business entity ushers the management, capital and labour to standoff. The free-rider of informal rescue, like private arrangements through private work-outs with the supervision and/or mediation of the 'lay judges' as in Belgium, etc. for the small, medium and small scale enterprises would develop a strong alignment and interrelation between the creditors and debtors which in turn, would ensure strong long-term relationship between the creditors (preferably in case of MSMEs the Banks) and the debtor, the healthy repayment schemes, strengthen the credit discipline, the security of job of the employees, state revenue, and above all the inclusive and sustaining economic growth. Such development of trust between the banks and the borrowers would also help in evolving the combination-cooperation approach, which in turn, would influence the fair bargaining, coordination and fair practices in informal rescue mechanism at a reduced cost and resolve default also. It is that the informal economic sector that addresses a large populace of India for their livelihood and also significantly contribute to the employment generation, and country's exports.[33]

The key policy objectives of pre-packaged administration, generally, are to preserve highest feasible proportion of the values and maximizing values; to ensure distribution over a period of time; to protect employment; and to ensure business environment. While the procedural mechanism for addressing the financial distressed conditions of MSMEs should have been more flexible, simple, cost-effective recognizing the size and diversity of the MSME. As already stated, the singular feature of most MSMEs is that they have greater inclination towards short-term debts due to lack of available collateral, and only surviving firms shifts their financial needs from short-term to long term debts. In order to make the MSME viable a chance to reorganize their operations and liabilities through informal process and therefore, the cost-effective insolvency regime is a must in order to mitigate the required and challenges of MSMEs. But the insolvency regimes provided in pre-pack process are designed suitable for large scale businesses. Pre-packaged administration is an aspect of the movement towards anticipatory action[34] while in the recent amendment none of these aspects have been given due consideration. An approach either from RBI or Government to coordinate with the creditors on the basis of some informal guidelines with the view to obtain collective approach to protect the financially distressed MSMEs while examining the assets deployed currently for optimal use by the MSME or asset stripping for sale out etc.

Keeping in mind the benchmark created by the Insolvency and Bankruptcy Code (Amendment) Act, 2021 relating to the default threshold limit of MSME now there is two dispute resolution forums with distinct legal mechanism become operational. In so far as section 10 of MSME Act, 2006 has explicit implications that the policies and practices of the credit facilities to the MSME would be specified by RBI from time to time in this regard, that is, the debt-financing stream and that the RBI guidelines would also contain the minimization of incidence of sickness to such enterprises, and enhance the competitiveness of such enterprises. And section 13 has envisioned that the Central Government would consider to provide fund/grant for specific measures, to be credited to such MSME. But in the light of the RBI Guidelines on Priority Sector Lending[35] would be followed. Even the operational frameworks ingrained in the Trust created[36] is also lending in nature. Again, cluster financing is another recommendation of the Prime Minister's High Level Task Force relating to lending to MSMEs hence compliance of the directives of RBI[37] by the bankers interested to lend to MSMEs. The comprehensive approach of all the governmental schemes is primarily focused upon the basic principles of risk-return ratio and such spreading could be accounted from the given prerequisites of each such scheme. The mandatory compliance by the lenders have already been sought for by the RBI[38] through its Master Circulars and guidelines on such schemes. The complicity arises to the point that whether RBI guidelines relating to NPA would have the operative force for the recovery of borrowing or a separate one for the MSME not having the corporate status as prescribed in the Insolvency and Bankruptcy Code (Amendment) Act, 2021 in pre-packaged administration process. In absence of clear guidelines from RBI insolvency dispute resolution of MSME would be a complex one. Section 18 has provided for the scopes of conciliation - either by the MSE Facilitation Council, or may refer the dispute(s) seeking assistance of any other institution or centre providing alternative dispute resolution services for conciliation process to be followed as per Part III of Arbitration & Conciliation Act, 1996,[39] in default, either on termination of conciliation process or absence of settlement between the parties, arbitration proceedings would be initiated either by itself or by referring the same to the institution or centre providing the arbitration dispute resolution services.[40] The crux of arbitration mechanism is parties' autonomy in concluding dispute resolution agreement, appointment of Arbitrator, choice of law, seat of arbitration, etc. Section 18 does not contemplate the scope available to the debtor of MSMEs rather such arbitration and/or conciliation likely to take place would necessarily be unilateral and would have the inclination to the recovery process instead of rescue. Centralized mediation with potential negotiation between the parties through the Facilitation Council is expected to be recovery of NPAs, and in default, making reference by the Facilitation Centre to such Arbitration Institute would be deemed. The consensus agreement between the parties might be deemed to have been effectuated by the strength of centralized mediation of Facilitation Council which is non-conformity with the essence of arbitration process of dispute resolution mechanism. And what is significant is that the overriding effect of the Act in relation to the resolution of the disputes.[41] The time period for disposal of such disputes is to be made by 90 days from the date of such reference. Relating to procedural measures the Act of 2006 is silent as prime focus of dispute resolution is confined to conciliation and/or arbitration and the operative force relates to the directives of Arbitration & Conciliation Act, 1996. Though Arbitration and Conciliation Act, 1996 has provided under section 30(1) for mediation but the crucial element, that is, consensus of the parties would be the decisive factor. Informal rescue demands that the parties with contractual rights agree to compromise, waive, defer debts or alter priorities. Dissenting creditors would try to thwart by triggering formal insolvency procedures. The secured position of the creditors' rights under IBC has provided much preferred options of the creditors and as such much insistence by the creditors would be upon the application of credit recovery and forum selection through Debt Recovery Tribunal as provided under IBC. The crux is that the insolvency has not yet been considered as arbitrable under Indian legal regime. Therefore, MSME dispute resolutions relating to financial distress suffers from uncertainties. As already mentioned, all such provisions of MSME Act, 2006 implicate that the conciliation or arbitration process could be triggered with the Institutional intervention. The informal approach of business rescue based upon either arrangements, or settlements between the debtors and creditors is not endorsed either in MSME Act, 2006 nor in the pre-packaged administration of IBC.[42]

Even having the potentials to contribute 1/3rd of GDP of the country the business rescue in the context of financial distress still suffers from uncertainties and ambiguities. Such complexities require further socio-legal exploratory research as the current legal regime of MSMEs would only encourage to promote some specified MSMEs, having highest capital-intensive operations. The lack of uniformity, certainty, and equality in the treating the financial distressed conditions of MSMEs would inversely affect the socio-economic sustainability, employment opportunities and progressive moves of the country in the long run.

[1] Hussain. R.Y. et al. (2022), "Do leverage decisions mediate the relationship between board structure and insolvency risk? A comparative mediating role of capital structure and debt maturity", South Asian Journal of Business Studies, Vol.11(1), pp.104-125.

[2] European Law Institute, Rescue of Business in Insolvency Law, 2017.

[3] *Ibid.*;The lay judges are businessmen, independent company chairmen and chief executives, accountants, bankers, etc. in Belgium Commercial Courts.

[4] *Ibid*.

[5] *Ibid*.

[6] 62 F.3d 730 United States Court of Appeals for the Fifth Circuit · No. 94-60393: 204 N.Y. L.J. 114, 3 col. 1 (1990).

[7] Welsh N. A. (2010), "You've Got Your Mother's Laugh: What Bankruptcy Mediation Can Learn from the Her/History of Divorce and Child Custody Mediation", Penn State Law Legal Studies Research Paper. 7: 441(427-461).

[8] Supra Note 6.

[9] 43 B.R. 717 (Bankr. E.D. Mich. 1984). *Cf:* In re John Breuner Co. No. 93-47076 J Chapter 11 (Bankr. N.D. Cal. Jul. 23, 1999); In re El Paso Elect. Co., No. 92-10148 (Bankr. W.D. Tex. Jan. 15, 1993); In re Enden, Inc., No. 90-22343-GM (Bankr. C.D. Cal.;In re Eagle-Picher Indus., Case No. 1-91-00100 (Bankr. S.D. Ohio).

[10] Art. IV 3: "If there are any objections to any claims, those claims shall be submitted to binding mediation, pursuant to the Bay County Rules of Mediation. The mediators to determine these claims shall be chosen from the panel of mediators from the Bay County Bar Association and the determination from that panel will be binding as to the allowability of any disputed claims".

[11] Judgment of the Court of April 28, 2022 in Case C-237/20 (*Federatie Nederlandse Vakbeweging v. Heiploeg Seafood International BV*), EU:C:2022:321.

[12] *Ibid.,* para 12.

[13] *Ibid.,* para 14.

[14] *Ibid.* para 15.

[15] *Ibid.,* para 40.

[16] *Ibid.,* para 41.

[17] *Ibid.,* para 44.

[18] *Ibid.,* para 53.

[19] Nigam N. and Boughanmi A. (2017), "Can innovative reforms and practices efficiently resolve financial distress?", Journal of Cleaner Production, Vol.140, Part 3, pp.1860-1871.

[20] Chapter IX of the SEBI (ICDR) Regulations, 2018.

[21] The Report of the Review Committee on Insolvency Law and Practice (Cork Report) 1982: Para 203-204.

[22] Economic Survey 2021-2022, Item No. 8.24, p.282.

[23] Press Information Bureau, Ministry of Finance, Government of India, January 31, 2022.

[24] Report of the Insolvency Law Committee, May 2022.

[25] In pursuant to the Insolvency and Bankruptcy Code (Amendment) Act, 2021 Clause 2 of the President's Ordinance by President of India, April 4, 2021 the Notification dated April 9, 2021 under Memo No. G.S.R. 256(E), The Gazette of India: Extraordinary, Ministry of Corporate Affairs, Government of India.

[26] Section 54A of the Insolvency and Bankruptcy Code (Amendment) Act, 2021.

[27] Section 54(A)(2)(e) of the Insolvency and Bankruptcy Code (Amendment) Act, 2021 and Regulations 14(1), 14(2) & 14(3) of IBBI (Pre-packaged Insolvency Resolution Process) Regulations, 2021.

[28] Market Assistance and Technology Upgradation Scheme (MATU Scheme).

[29] Operational Guideline for Zero Defect Zero Effect Scheme, Ministry of MSME.

[30] Credit Guarantee Fund Scheme for Micro and Small Enterprises, 2000.

[31] Credit Linked Capital Subsidy Scheme, March, 2020.

[32] FrédéricClosset & DanielUrban (2019), "The balance of power between creditors and the firm: Evidence from German insolvency law", Journal of Corporate Finance, Vol.58, pp.454-477.

[33] Supra Note 13.

[34] Finch V. (2006), "Pre-packaged Administrations: Bargains in the Shadows of Insolvency or Shadowy Bargain?", JBL 568.

[35] RBI Master Directions FIDD.CO.Plan.BC.5/04.09.01/2020-21(RBI/FIDD/2020-21/72).

[36] Supra Note 22.

[37] RBI/2009-10/510: RPCD.SME & NFS.No.BC. 90 /06.02.31/2009-10.

[38] RBI/FIDD/2017-2018/56: Master Direction FIDD.MSME & NFS.12/06.02.31/2017-18.

[39] Sections 65 - 81 of Arbitration & Conciliation Act, 1996.

[40] Section 18(3), MSME Act, 2006.

[41] Section 24, MSME Act, 2006.

[42] Chapter III-A of the Insolvency and Bankruptcy Code (Amendment) Act, 2021.

16 SHAPING INDIA'S CROSS-BORDER INSOLVENCY FRAMEWORK: LESSONS AT THE COMMON LAW

- Kavya Lalchandani

EXECUTIVE SUMMARY

This paper makes an attempt to trace international instruments devised for the purposes of dealing with cross-border insolvency situations and India's recent step to adopt those framework(s). This paper delves into the discussion of application of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross Border Insolvency (MLCBI) and the concepts therein. More importantly, this paper attempts to draw out a comparative framework of the interpretation and application of the MLCBI along with allied model laws by the common law countries. This will then be analysed in the context of Draft Part Z in India. The suggestions made through this paper would not only have a legislative context but also suggestive of how the judiciary would be expected to apply the concepts under Draft Part Z.

Keywords: MLCBI, Modified Universalism, Public Policy Exception, Draft Part Z, Insolvency-related Judgements, Group Insolvency Framework, Draft Part ZA.

INTRODUCTION

The obvious starting point for discussion of cross-border insolvency laws is, do we even need an instrument at a global level? Is it not enough that the countries are still struggling to strengthen their national laws in this field? There is no single or desirable answer to this question. Civilised countries place heavy reliance on the unification of laws in this era of globalisation[1] and their belief is not completely unfounded. In a perfect world, where the laws and priorities of different countries would have aligned together, coordination and cooperation among the countries for recognition and enforcement of judgements would have been enough, at least theoretically.

Since the world is far from perfect, it needs to be realised that not only there is a difference in laws among the countries but also the pace with which such laws have developed is also different. The classic example is that of the UK and India. The UK developed its insolvency framework in the 1980s whereas in India this field has come to the fore only when the Insolvency and Bankruptcy Code, 2016 (IBC/Code) became a part of the discussions in the academic forums and the ministries. It could not have been said with certainty, that an insolvency judgement passed by a court in the UK would have been enforced and recognised with equal force and acceptance (The judgement may have been recognised under the Civil Procedure Code, 1908 and the principle of comity and reciprocity but it is debatable if the parties would have received a satisfactory relief under the Indian law) as it would be done in today's time. The solution to this problem is found in the unification of laws of countries to the maximum extent possible.

However, the unification of laws in any field is not an easy task, especially in the context of commercial laws which can directly impact the economy of a particular country. It is extremely important from the perspective of a globalised world that there should necessarily be some unification of the laws in accordance with the standards set by the concerned international organisation as the countries can no longer close their borders. It has been suggested that the increasing globalisation should be complemented by the globalisation of insolvency laws as well.[2] It is pertinent that the countries focus on attracting investment and increasing their ease of doing business while also not compromising on their sovereignty. Ideally, such laws should give a correct level of discretion to the countries to modify the provisions according to their national priorities and policies. Evidently, the parties prefer getting governed by the laws of a favourable jurisdiction for that particular transaction therefore, it is completely possible that the same transaction has different aspects being governed by different laws. Consequently, substantial unification of laws may not be that easy.[3]

This paper will make an attempt to trace international instruments devised for the purposes of dealing with cross-border insolvency situations and India's recent step to adopt the framework. The paper is divided into five parts. Firstly, the different approaches available for formulation of international insolvency instruments including universalism, modified universalism, and territorialism will be discussed. Second, core concepts under the primary instrument, i.e., MLCBI will be discussed. In this part, various interpretations given to these concepts by the courts of different countries will also be discussed. Third, it may be noted that since the MLCBI has already been developed and applied extensively now, the allied laws for the insolvency-related judgements and the group insolvency framework are also critical in these times. Consequently, this part will delve into a deeper discussion with respect to these model laws. Fourth, the most critical as well as relevant part is India's adoption of the MLCBI and hence, the need for the adoption in the Indian context will be briefly touched upon and also the differences between the MLCBI and Draft Part Z will be carved out. The author will also attempt to point out the hits and misses of Draft Part Z. This will be done by carrying out a comparative exercise. Lastly, in this part, the author will briefly conclude and summarise the suggestions made throughout the paper.

A STEP TOWARDS UNIFICATION: THE UNCITRAL MODEL LAW

The UNCITRAL is one such international organisation that focuses on the unification of laws and proposed the MLCBI in 1997. Countries have, since then, proactively adopted it (with or without modifications) due to its modified universalist nature instead of being completely territorial or universalist in nature. Since, substantial unification of laws was not possible by the countries during that time, and still has not been done, the MLCBI was adopted as a model law instead of a multilateral treaty.[4]

Though there have been arguments in favour of the adoption of treaties, at least, regionally for having a greater force in the adoption and enforcement of the cross-border laws, the suggestion has not yet reached fruition.[5]

MLCBI becomes a guiding force for the countries (at least with respect of the procedural aspects of insolvency) for developing a more structured insolvency framework, with or without modifications. This is an important normative deviation since the countries will always feel a challenge to their sovereignty if they cannot mould such laws according to their own policies. This has gained more relevance in a post COVID-19 scenario where havoc was not only created on the health front, but the economies have still not recovered from its impact. Under any insolvency proceedings, the principle of collectivity is important in order to maximise the value of the assets of the financially distressed business. Due to globalisation and internationalisation of transactions, it is seldom true that the operations of a company would be restricted to one country. This makes the situation more complex as the creditors, company's operations, directors, and business interests, all could be dispersed in a manner that is not suitable for winding up or restructuring in just one place. An Insolvency Professional (IP) has to take various interests into account and carry out the investigation accordingly but a cross-border insolvency situation like this would make it very cumbersome as to the law applicable, duplication of laws, different treatment of assets, and a conflict between the laws. On top of that, there is always a risk of non-recognition of a judgement passed by one country by the court of another country. This raises the most fundamental questions as to the approach of a country towards universalism, territorialism or modified universalism. These three concepts had become the foundation of the initial discussion on the MLCBI. As already stated, MLCBI follows the modified universalism approach.

Approaches to the cross-border insolvency framework

There is no straight-jacket answer as to the approach taken by different countries. However, any regime adopted by a country could be strictly territorial, strictly universalist or somewhere between the spectrum and can adopt a modified universalism approach. If a country adopts the MLCBI as it is, it would be adopting a modified universalism approach. At least the theoretical basis of the MLCBI was made with the vision to incorporate it in a modified universalism format.

In its purest form, universalism simply means that there is only one proceeding governed by only one law, irrespective of where the creditors, assets, directors, and other stakeholders are situated. This proceeding will have a worldwide application and consequently, the assets will be turned over to the 'primary' jurisdiction (such as where the centre of main interests (COMI) will be present) and then distributed accordingly. Single bankruptcy proceedings would be governing the assets of the corporate debtor (CD) and the decisions, and the orders made by that court will have a worldwide application. Consequently, countries will be willing to cede to the jurisdiction of one foreign court even though they may have jurisdiction and an economic benefit from the proceedings. This, by all means, is not altruistic as the country would be trying to treat all the creditors at par but it would definitely benefit if the other countries would also extend a similar treatment to that country and the creditors generally should that country be the proper forum for institution of the proceedings.[6] On the contrary, territorialism means the location of the assets are determinative of the law and jurisdiction applicable to a particular insolvency case. It is also referred to as the grab rule where the country in which proceedings are filed, assumes the jurisdiction over the assets of the business in bankruptcy. Territoriality defeats the policy of treating all similarly situated creditors equally which has been accepted as a matter of international policy. This is especially because countries do not have a similar way of dealing with crucial matters such as priority of disbursement, avoidance transactions, processes, among other things.[7]

While territorialism and universalism are opposite ends of the spectrum, modified universalism (with varying permutations and combinations) tries to find a theoretical balance between the two.

The approach is not only justified by the economy of a particular jurisdiction but also by the legislative system, judicial outlook (especially in the common law), political interest, public policy concerns and public interests. There are still arguments in favour of territorialism, in the sense that unification may not really be needed in most cases, and the problem could be solved by cooperation and coordination among the countries.[8] This is not wholly true. If reciprocity and coordination would have been enough, then the Indian framework on recognition and enforcement before Draft Part Z was introduced, would also have sufficed (sections 234 and 235 of the IBC). These were categorically mentioned to be as inefficient and thus the requirement for a separate framework was put forth.

This article argues as to why modified universalism should be and in most cases is the preferred approach for the countries to protect their priorities while also giving a breather for companies across jurisdictions to wind up thereby maximising the values of the assets.

Different versions of modified universalism: EIR and CBIR

The most advanced jurisdiction in adoption and application closer to home would be the UK and Europe. Traces of modified universalism, apart from the MLCBI, can be found in European Insolvency

Regulations (EIR).[9] and Cross-Border Insolvency Regulations, 2006 (CBIR) adopted by the UK (discussed below). It appeals to the courts to defer to the proceedings in *lex concursus*.

In the UK, the theory of universalism, although utopian in nature, received approval from Lord Hoffman in *Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings PLC.*[10] Lord Hoffman insisted on universalism being a part of English common law to act fairly amongst the creditors and having regards to principle of comity. In *Re HIH Casualty and General Insurance*,[11] Lord Hoffman went a step further and stated that the principle of modified universalism is the 'golden thread' that has always been present in the English international insolvency law. But in *Rubin v. Eurofinance SA,*[12] the Court imposed conditions for the common law rule application, that is, only if the judgement debtor was present in that jurisdiction or submitted to the laws that jurisdiction was the judgement going to be recognised. This approach was also endorsed by *Singularis Holdings Ltd v. PricewaterhouseCoopers (Bermuda)*.[13]

CBIR Schedule 1[14] states that for the English Court to recognise a particular proceeding, an application will have to be made to the Court and it will be granted depending on whether the COMI is present or not, if it is then there will be a recognition of foreign main proceeding and if not and there is an establishment then it will be recognised as non-main proceedings. On the other hand, under the EIR, the recognition is automatic.[15]

But once the proceedings are recognised under CBIR, there is an automatic stay and moratorium that applies.[16] Furthermore, it also provides for the coordination of concurrent proceedings.[17]

UK courts have time and again emphasised cooperation with the foreign courts rather than giving them a clear way of automatic recognition. This is what creates a somewhat blurry line between recognition of the proceedings and assistance to the court exercising the jurisdiction. Moreover, the relief that a court of another country may grant would not even be present in the other country.

The basis of the MLCBI itself is modified universalism but it remains a soft law.

The US approach is also, arguably, a modified universalist approach in *re Maxwell Communication Corpn*[18] but has also been termed as 'an aspiration, not reality' in *Bernard L Madoff Investment Securities LLC v. Primeo Fund*.[19]

A case for adoption of modified universalism

Modified universalism is not as glorified as it seems. It suffers from a few basic problems such as party shifting their COMI, the divergence between the provisions of company law and insolvency law, and the problem getting exaggerated if there is ambiguity in the law that is to be applied in a particular scenario. Despite its cons, it still is the most feasible way to deal with the problem of disunification of the international insolvency law.

The choice of the legal regime not only affects the ex-post situation, i.e., the bankruptcy of the business but also ex-ante issues such as the allocation of capital. Viewed from this lens, territoriality would be the antithesis to maximising capital allocation while universalism will favour it.[20] This is because the investments will not flow at a multi-national level as they should if the territorial regime becomes the norm. Therefore, the approach adopted by the countries becomes a problem on a macroeconomic level and not just a concern for a few businesses or countries.

There are matters that countries do not want to give their jurisdiction away on, such as public policy reasons. More importantly, the MLCBI and almost all regulations make this exception. Some countries want only their fundamental public policies (UK, EU, US) to remain untouched but there may be other countries that would want to make this a broader exception such as Singapore.

The approach cannot be narrow as a territorial one, but it cannot be too broad to not have control over the assets in your own jurisdiction as sovereignty is also one of the fundamental principles which is the essence of the universalist approach. Territoriality in many ways tries to confine the insolvency laws which can no longer work in a bubble. Although universalism is desirable as a first-order matter, the normative framework of modified universalism will be desirable as a second-order matter and is referred to as procedural incrementalism.[21]

Modified universalism thus is a more pragmatic approach than others considering the least number of challenges in implementing the same. It centralises the administration of proceedings while taking national laws into account. Moreover, it will also help overcome the peculiarities of different national commercial laws such as different voting thresholds required by the respective Companies Acts for the shareholders to pass a resolution or votes by creditors to vote on a plan, or the creditors can have different ranks owing to the difference in economic structures. There cannot be one single insolvency law that can be imposed on all the countries owing to different economic structures and industry dynamics but the closest we can get to it is an increase in recognition and cooperation amongst courts of different countries. This will make it possible, theoretically, for the insolvency of companies works out in a feasible way for all the creditors.

CORE CONCEPTS UNDER MLCBI ACTING AS A GUIDING FORCE FOR INDIA

MLCBI lays down four basic elements expected of any cross-border insolvency regime – access, recognition, coordination and cooperation.[22]

Comity

The basic principles arise from the age-old principle of comity, which cannot be particularly defined[23] nor is compulsory to be granted. In plain terms and focussing on the efficiency aspect of the same, comity has been defined thus: *'deference to foreign insolvency proceedings will often facilitate the distribution of the debtor's assets in an equitable, orderly, efficient and systematic manner, rather than in a haphazard, erratic or piecemeal fashion'*.[24]

COMI, foreign proceedings, and the public policy exception

Since the main aim is to reduce the procedural hurdles to the maximum extent possible, the MCLBI makes an effort to define a few basic concepts which would make that task simpler and efficient. A proceeding would be considered as a foreign main proceeding in a country where the debtor would have its COMI and will be considered a non-main proceeding if the debtor has an establishment. Clearly, which court will have a primary jurisdiction is dependent on the fact whether the debtor has it COMI in that particular country or not.

MLCBI gives the following definition of 'COMI' – Article 16(3) - In the absence of proof to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the centre of the debtor's main interests.[25]

The rebuttable presumption with regard to COMI has been interpreted in several different ways and this concept is closely linked to the tricky beast 'forum shopping'. Therefore, significant time and energy has been invested by the court of the countries who had adopted the MLCBI in not only identifying the COMI but also factors rebutting the presumption of COMI being at a place of 'registered office of the debtor'. It is useful at this juncture, to take into account the interpretation given by the various courts that can act as a guide for the Adjudicating Authorities (AAs) in India when applying the concept of COMI.

In *re Eurofoods* case,[26] the European Court of Justice (ECJ) held that the presumption that the debtor's COMI is at its registered office and the burden of rebuttal could only be discharged when there are factors, being objectively ascertainable by third parties, that point to the debtor's COMI being elsewhere. The COMI should possess an autonomous meaning.[27] The English courts have emphatically adopted the same meaning as given by the European Courts and interpret COMI in the same manner.[28]

In *Re Cinram International Inc.*,[29] a group of companies were involved, having an international presence in Canada, the USA and Europe. While the European group entities were not a part of the Canadian proceedings, the debtors had contended that Canada was the country where the debtors (insolvent members of the group) had their COMI and not the US. The Canadian Court took the following factors into account while holding that the COMI is in Canada: The headquarters out of which the main functions of the debtor took place was situated in Canada, centralisation of key corporate decisions (both executive and administrative) took place in Canada and the key contracts that were termed into, the functional decision including the pricing decisions, cash management decisions, corporate accounting, etc were taken in Canada, the meetings of the board of directors of the debtor was also held in Canada, and the compliance requirements with respect to tax, auditing, insurance, took place according to Canada.

In *Re SphinX*,[30] the debtors had their registration office in the Cayman Islands. The debtors had a commercial relationship with an individual in the US and tried to reach at a settlement which was pending before the Court. An insolvency proceeding was commenced in Cayman Islands and the foreign representative sought the recognition of the Cayman proceeding as the foreign main proceeding before the US Court. The US court rejected the recognition as a foreign main proceeding but only recognised it as a foreign non-main proceedings as it could not be proved that the debtor had its COMI in Cayman Islands despite having a registered office over there. The US District Court highlighted the following factors while reaching this conclusion: No business was conducting in the Cayman Islands in its absolute sense; apart from the registered office, there was no presence of the debtor, as there were no employees or assets of the debtor in the Cayman Islands. The court also looked into the fact that the motivation to launch an insolvency proceeding was only done to stop the recognition of the settlement agreement in the US Courts. The Court relied on *Bondi v. Bank of America*, popularly known as *Re Eurofoods Case* (mentioned above).[31]

There is a difference in the approach that has been taken by the courts in USA and Canada when compared with New Zealand, Australia and the UK. The latter countries have given an interpretation which is closer to the definition in the Eurofoods case and other cases decided by the European courts and consequently the MLCBI.[32] The presumption is not easily rebutted in these jurisdictions. When it comes to USA and Canada, various factors are taken into consideration for deciding the COMI.

The fact of the matter is that none of the decisions can give an exhaustive formula that either needs to be met or readily fits in all situations. Each debtor's insolvency will need to be dealt with the factors fitting best in the peculiar situation that the debtor is placed in.[33]

The date of the commencement of foreign proceedings also plays an important role in determining COMI. The date that is taken by the courts into consideration is the date of commencement of the insolvency proceeding. This is mainly to prevent any forum shopping between the time of commencement and the application for recognition being filed in another state.[34]

Another concept that deserved mention here is the exception of public policy that has been carved out in the MLCBI for not making it onerous on a particular country to recognise and enforce the judgement when it is itself facing problems. The provision is worded thus: [Article 6] - Nothing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of this State. The Guide to Enactment of the MLCBI suggests that the provisions should be narrowly interpreted[35] and recognition and enforcement may be refused only when the most fundamental policies of that state would come in question. This is also because the meaning of public policy varies from one country to another. The word manifestly acts as a 'qualifier' indicating a restrictive interpretation of the exception[36] where the most fundamental policies, particularly the constitutional guarantees,[37] of a state are being violated.[38]

This view has been applied in several cases such as *Re Eurofoods*. Moreover, the exception is interpreted differently in national and international context. A domestic meaning of public policy cannot be extended to the international context as is.

Public policy cannot be construed as being synonymous with public interest[39] or economic crisis.[40] This means that the economic crisis caused by the COVID-19 situation may not be a ground enough under the narrow meaning of the public policy.

The other provisions deal with procedural aspects of recognition, access, cooperation and coordination among courts including granting similar relief (provision), holding concurrent proceedings, participation by a foreign representative in the proceedings being held in recognising state, protection of domestic creditors, facilitation of communication and cooperation between the courts, etc.[41]

MLCBI AND ALLIED MODEL LAWS

After more than a decade of implementing the MLCBI across jurisdictions, UNCITRAL devised the frameworks for Model Law on Recognition and Enforcement of Insolvency Related Judgements (MLIJ) and the Model Law on Enterprise Group Insolvency (MLEGI). India has not yet taken steps to adopt these model laws but they definitely fill a few gaps in the MLCBI at a certain level and complements the goal of unification as desired by many.

The model law on insolvency-related judgements

The MLIJ deals with insolvency-related judgements which have been categorically defined and differentiated from the main judgment passed in the insolvency proceeding for its commencement. Insolvency-related judgment: (i) means a judgment that: (a) arises as a consequence of or is materially associated with an insolvency proceeding, whether or not that insolvency proceeding has closed; and (b) was issued on or after the commencement of that insolvency proceeding; and (ii) does not include a judgment commencing an insolvency proceeding.[42]

The Guide to Enactment to MLIJ further provides clarity on which kind of judgements should be covered by the laws so specified. It includes but is not limited to: judgements relating to avoidance actions, judgements concerning proper or improper disposal of the assets of the debtor, whether a cause of action can be raised against the director or representative of the debtor, and a judgement that would confirm or vary a reorganisation plan proposed for the revival of the CD or approving a voluntary liquidation of the debtor or discharging the debtor of the debt owed.[43]

This was partially a result of the judgment passed in *Rubin v Eurofinance*[44] where recognition of an insolvency-related judgement was refused by the Courts in the UK. To avoid such situations, or at least have an open door for consideration of such situations, MLIJ was welcomed as an addition to MLCBI. The provisions which govern the judgements covered under MLIJ are similar to that of MLCBI and are drafted with respect to insolvency-related judgements. It may be reiterated that the main aim is to complement and strengthen the unification of laws.

It must be noted, however, that MLIJ has not gained a lot of traction. The reason can be twofold, (a) the MLIJ has been recently proposed and the status of its effectiveness is not yet known; (b) there is some ambiguity as the grounds of refusal have an expansive meaning when compared to the ones under MLCBI (which essentially just accounted for public policy exception as a ground for refusal).[45]

As a side note, it may be important to recognise that full recognition may not be provided by MLIJ and one such scenario can by presented by the Singapore High Court (judgement pronounced by Aedit Abdullah J) in *re Tantleff*.[46] There was a refusal to recognise an insolvency-related judgement passed by a US Court. The debtor in this instance was a Real Estate Investment Trust primarily operating in the US but also had Special Purpose Vehicles (SPVs) in Singapore. These SPVs filed a voluntary liquidation petition under Chapter 11 of the US Code followed by the parent also filing a petition under the US Code. The US Court accepted the petitions. The foreign representative then sought recognition of the confirmation order and the plan approved with respect to the parent in Singapore. The Singapore High Court did not recognise the plan or the confirmation order as Real Estate Investment Trusts are not treated as corporations under the relevant laws of Singapore. The Court in fact noted that the judgement may be recognised at common law but not under the MLCBI and decided to give assistance under Article 21(1)(g). However, not recognising the judgement under the MLCBI is erroneous on at least two counts.[47] First, the court could have applied the US Law in giving recognition and enforcing the insolvency-related judgement passed by a competent US Court.[48] Secondly, it highlights the distinction that the court might make between merely assisting the foreign court and recognising the judgement with its full force. Unfortunately, this comes from one of the most respected commercial law jurisdictions around the globe. This does not mean that Singapore is not a welcome jurisdiction for foreign representatives, it is one of the most progressive commercial jurisdictions and there have been instances when it has gone beyond to uphold the party's legitimate commercial expectations. But in this instance, it is important to note that the exhaustive discussion with regard to recognition was unwarranted. The MLCBI read with MLIJ specifically enabled the Singapore court to recognise the judgement passed by the US Court.

MLEGI

Among different attempts to unify varied aspects of the cross-border insolvency law, formulating a framework for the enterprise groups has been the most daunting one. Discussing specifically the group insolvency framework is beyond the scope of this paper. But an effort will be made to discuss the relevant parts which could be incorporated into the Indian framework.

The first question to ask here is: what is expected of a group insolvency framework? Group insolvencies have posed a problem, especially in a transnational context. Like a registered office in a single corporate entity becoming insolvent, the home country of an enterprise group becoming insolvent becomes relevant. It poses an exaggerated challenge as it depends on the range of factors being considered individually and in groups.[49] One of the factors that becomes relevant is the structure of the group companies, whether equity based or contractual.[50]

Considering which parts of the group will become a relevant consideration for the purposes of insolvency (taking into account the complex structure of the group enterprise) is another factor that needs to be taken into account after determining the structure is, if it can be done in a proper manner.

Again, the problem of forum shopping will become increasingly prevalent in this case. The real connection of the debtor to the jurisdiction will have to be proved. Place of incorporation may not be the best solution to determine the jurisdiction which has the closest connection to the group members. The requirement of substantial connection will become important for the relevant group member.

The MLCBI did not deal with group insolvencies specifically. However, it should be noted that there is nothing in the MLCBI that prevents recognition of judgements being passed in the case of a single debtor forming a part of the group enterprise.[51] It is also true that the application to a single debtor will again vary from country to country so an effort was made by UNCITRAL again to propose a framework to harmonise the group insolvencies. A comprehensive framework was needed for the same. The MLEGI was recently introduced by UNCITRAL in that vein. Currently, the evidence is scarce with respect to its effectiveness and readiness. However, an endeavour has been made to devise a 'group insolvency solution' to which provisions similar to MLCBI will apply. A few of the relevant characteristics of the MLEGI can be mentioned here. The group insolvency solution can be developed for either the entire group or part of the group which can include a reorganisation, sale on a going concern basis or a combination of the two depending on the involvement and participation of the group members. Voluntary participation by the group members is allowed. Enterprise group is defined in terms of both significant ownership and control. For a group insolvency solution to reach fruition a planning proceeding will be required. A planning proceeding does not encompass opening the proceedings in all the jurisdictions where the group members have a presence but only where it would be found to be relevant and necessary.[52] The number of planning proceedings would depend on the structure of the group. If there are independent units within the group then, the number of planning proceedings would increase. One of the proceedings would be the main proceedings where the debtor will have the COMI.[53] It is critical to note that it is not the aim of the MLEGI to have a ripple effect on all the members of the group and consequently recognition will not be granted in case the group member is not covered or supposed to be covered by such planning proceeding.[54]

INDIAN LAW AND MLCBI

Historical background and the need

The Indian law in the past half a decade has shown tremendous growth in its insolvency framework. Since the time of various committee reports, the adoption of IBC, and the allied rules and regulations, the Indian insolvency framework has developed in an organic manner. India was ready for the next step: adoption of the cross-border insolvency framework. The discussion with regard to same had been taking place since the time IBC came into the picture. The need was first highlighted by the Bankruptcy Law Reforms Committee Report in 2015.[55]

The relevant historical developments should be summarised briefly here. The current Indian framework for recognition of a foreign insolvency judgement would have constituted of sections 234 and 235 of the IBC[56] Section 234 of the IBC, 2016 states

'(1) The Central Government may enter into an agreement with the Government of any country outside India for enforcing the provisions of this Code.

(2) The Central Government may, by notification in the Official Gazette, direct that the application of provisions of this Code in relation to assets or property of corporate debtor or debtor, including a personal guarantor of a corporate debtor, as the case may be, situated at any place in a country outside India with which reciprocal arrangements have been made, shall be subject to such conditions as may be specified and the Civil Procedure Code, 1908. Both the solutions are not efficient as they would have led to extreme territoriality and dependence on the Central Government's ability and willingness to enter into treaties and agreements for recognising and enforcing the judgements passed by a foreign court in the insolvency proceedings. More importantly, there would have been an isolated and patchy recovery of assets thereby reducing the value of the assets.

Axiomatically, if the earlier framework would have been effective there should have been no need to develop a separate protocol in *Jet Airways case*[57] or Supreme Court's judgement to allow the foreign operational creditors to make a claim in the Macquarie Bank Limited case.[58]

In the *Jet Airways case,*[59] the State Bank of India had filed an application to the AA against the debtor (Jet Airways). There was also a simultaneous action launched in the Netherlands and a Dutch administrator was appointed. It was held by the AA that the COMI of Jet Airways was in India after consideration of various factors and would therefore become the main proceeding in this instance. In fact, the Dutch proceedings needed to be carried out in accordance with the result in the Indian proceedings.

A similar conclusion would have been reached if India would have adopted the MLCBI, but a separate protocol had to be made at that point in time. Consequently, Draft Part Z was introduced which was the instrument through which India adopted the MLCBI.

Draft Part Z

Draft Part Z recognises the four bedrocks on which the MLCBI was formed: access, recognition, coordination and cooperation. Much thought has gone into customising the MLCBI according to the Indian needs and IBC. Since MLCBI is modified universalist in nature, it did not need extensive modifications while it was adopted. However, it would be naïve to say that India's Draft Part Z does not have undertones of territoriality, and rightly so. To encompass a broad range of countries for applicability of Draft Part Z, it has been made applicable on the basis of the foreign country's adoption of the MLCBI as well as reciprocity (as it includes countries with which the Central Government enters into an agreement).

To prevent the instances of forum shopping, while the determination of both establishment and COMI, the provisions specify the time for such determination.[60] With respect to establishment, the MLCBI uses the term 'goods' whereas this has been replaced by 'assets' in Draft Part Z. Now, this may look like a trivial modification at first instance and has not been researched in detail by academicians, but the term asset has a broader connotation than the term good. This is clear from the UK's modification to the definition similar to the Indian law. [61]

Section 4 of Draft Part Z incorporates the public policy exception. The importance of the public policy exception cannot be overstated. Indian courts have themselves witnessed the complexity and narrowed down this exception in cases relating to arbitration. It can be seen that the public policy exception is qualified with the term 'manifestly' in the MLCBI which narrows down the exception significantly. If India is faced with a situation where economically, it would not be sound for the courts to enforce a particular insolvency judgement by a foreign court, will it be able to avoid it on the grounds of flouting the public policy exception remains a moot question. Perhaps the best way to deal with the situation is to drop the word manifestly where sufficient discretion remains with the courts in India. Singapore is one of the most prominent commercial hubs across the world but has decided to drop 'manifestly' to retain that discretion,[62] yet has recognized bankruptcy proceedings in Japan.[63] It would not mean that the courts are to exercise the exception in a broad manner, but a critical situation may arise in the future where courts might have to make some hard decisions in which they have little experience in deciding.

The provision on 'limited jurisdiction'[64] is missing in Draft Part Z. This means that Draft Part Z does not prevent the foreign representatives and assets being subjected to Indian laws. In fact, the foreign representative will be subjected to the Code of Conduct as devised.[65]

Exclusion with respect to foreign tax and social security claims remains unaffected even though the foreign creditors have same rights as the domestic ones.[66] Interestingly, the drafters have not left the time limit for the recognition of the foreign proceeding ambiguous. Under the MLCBI, recognition is supposed to be given as per the 'earliest possible time'.[67] Draft Part Z fixes the time limit of 14 days.[68]

Draft Part Z does not take into account the provision for provisional relief (colloquially, interim relief) provided[69] under the MLCBI. This might be a miss because preserving the value of the assets of a CD is like a race against time and there might be instances where provisional, and in some cases, urgent relief might be required.[70] Here, even the time limit of 14 days may not be enough. The aim of including such a provision was the flexibility to be offered to the courts which may be exercised after considering the facts of the case.

Hints of territoriality can be felt where the provision for intervention by the foreign representative (subject to the laws of that country) in any proceeding where the debtor is a party[71] has been omitted in Draft Part Z. It seems like a provision having far-reaching consequences at first, however, the negative effects may be mitigated by the presence of provision in MLCBI and Draft Part Z with respect to protecting the domestic creditors and the interests of the debtor. The downside of not having this provision is theoretical viz. complete access to the foreign representative may not be granted. At the same time, actions affecting the assets of the debtor in any case are stayed by the operation of the moratorium.

CONCLUSION

Cross-border insolvency is a tricky turf, to say the least. The fact is that a binding instrument will not gain a lot of acceptance by the countries. The countries are anyway apprehensive about adopting an instrument which is binding in nature. The best solution that was thought out was to propose a legislative insolvency guide (based on the principle of modified universalism) which could be adopted by countries with or without modifications. And this is the main feature as well as the reason for the popularity of the MLCBI.

This solution was needed as traditional concepts such as comity and reciprocity were not helping the countries at a global level and a substantial unifying instrument was needed irrespective of whether a country was a common law country or whether there was a treaty signed between the countries or not.

As discussed at length above, at least the common law countries have a similar way of interpreting the provisions of the MLCBI unless there is any substantial modification in that very provision. However, it may be noted that MLCBI in some spheres falls short during its implementation and its application is not global in its true sense as there are countries that have not adopted the MLCBI which may act as a deterrence for other countries to adopt the same.[72]

India has adopted the MLCBI with some modifications which have been discussed above. What could have been done better and what has been missed from an Indian perspective have also been discussed at length in this paper. Perhaps, a greater effort should be made to check the viability of the adoption of the allied model laws: MLEI and MLIJ. It would strengthen the framework for cross-border insolvency and improve the ease of doing business which was one of the aims of adopting the MLCBI in the first place.[73]

The Insolvency and Bankruptcy Board of India's role has been promising and a lot of positive steps have been taken by it whether it relates to regulating the behaviour of IPs or formulation of the rules and regulations. Similarly, the foreign representatives being governed by the regulations as a part of Draft Part Z will also play a crucial role in its implementation.

The framework for Group Insolvency in India has been proposed through Draft Part ZA. Interestingly but disappointingly, the framework's foundation is based on MLEGI but only in the context of domestic group insolvency proceedings. This will narrow down the scope of the group insolvency framework because the group companies seldom restrict their functioning to domestic borders, and it will pose another problem for dealing with the group cross-border insolvency separately. This might also lead loss of value in assets.

Lastly, there is no particular downside to adopting international instruments in this era of globalisation. In fact, we should also look forward to adopting the Bank Insolvency Framework that the International Institute of Unification of Private Law (UNIDROIT) is currently working on. It will not only be able to help India in developing a solution to bank insolvency problems (which also deals with cross-border aspects) but also develop its national regime at par with the matured commercial jurisdictions. Adopting the MLCBI is just one, albeit a big one, step forward in making India a commercially viable and desirable jurisdiction.

[1] Shukla S. and Jayaram K. (2020), "Case to Cross the Border Beyond UNCITRAL", IBBI's Annual Publication 2020 titled 'Insolvency and Bankruptcy Regime in India: A Narrative'.

[2] Westbrook J. (2001), "Global Development: The Transnational Insolvency Project of the American Law Institute", 17 Connecticut Journal of International Law, pp.99-100, refer '*If the market is becoming more global, bankruptcy law must become global as well*'.

[3] Franken S. (2014), "Cross-Border Insolvency Law: A Comparative Institutional Analysis", 34(1) Oxford Journal of Legal Studies, pp. 97-131.

[4] Burman H. and Westbrook J. (1997), "United Nations Commission on International Trade Law: Model Law On Cross-Border Insolvency", 36(5) International Legal Materials, pp. 1386-1398.

[5] Murphy P. J. (2002), "Why Won't the Leaders Lead? The Need for National Governments to Replace Academics and Practitioners in the Effort to Reform the Muddled World of International Insolvency", 34(1) The University of Miami Inter-American Law Review, pp.121-153. This article discusses why entering into a Treaty between the US, Canada and Mexico is a plausible solution for these countries. The article gathers support from the precedents of these countries entering into a Treaty such as NAFTA.

[6] Trautman D. et. al (1993), "Four Models for International Bankruptcy", 41(4) The American Journal of Comparative Law, pp. 573-625.

[7] *Ibid*.; Bütter M. (2002), "English Fixed And Floating Charges In German Insolvency Proceedings: Unsolved Problems Under The New European Regulation On Insolvency Proceedings", Singapore Journal of Legal Studies, pp. 271-301.

[8] Supra Note 3.

[9] Franken S. (2005), "Three Principles of Transnational Corporate Bankruptcy Law: A Review", 11 European Law Journal, p. 232.

[10] *Cambridge Gas Transp. Corp. v. Official Comm. of Unsecured Creditors of Navigator Holdings PLC* , [2006] 3 All ER 829.

[11] *HIH Casualty & General Insurance Ltd v. Chase Manhattan Bank*, [2003] UKHL 6.

[12] *Rubin v. Eurofinance SA*, [2012] UKSC 46.

[13] *Singularis Holdings Limited v. PricewaterhouseCoopers*, [2014] UKPC 36.

[14] Article 5, Schedule 1, CBIR, 2006.

[15] Para 67, Regulation (EU) 2015/848 of The European Parliament and The Council, (Recast), 2015.

[16] Article 20, Schedule 1, CBIR, 2006.

[17] Article 29, Schedule 1, CBIR, 2006.

[18] *Re Maxwell Communications Corporation*, 93 F.3d 1036 (1996) [US].

[19] *Re* Bernard *L. Madoff Investment Securities LLC,* 654 F.3d 229 (2d Cir. 2011) [US].

[20] Bebchuk L. and Guzman A. (1999), "An Economic Analysis of Transnational Bankruptcies", 42 Journal of Law and Economics, pp. 775-808, and Harvard Law and Economics Discussion Paper No. 180, 1996.

[21] Pottow J. (2014), "Beyond Carve-Outs and Toward Reliance: A Normative Framework for Cross-Border Insolvency Choice of Law", 9(1) Brooklyn Journal of Corporate Financial and Commercial Law, pp. 197-220.

[22] Main Features of the Model Law, MLCBI, 1997.

[23] Boshkoff D. (1987), "United States Judicial Assistance in Cross-Border insolvencies", 36(4) The International and Comparative Law Quarterly, pp. 729-750. Comity has been referred to as an elusive concept which cannot be defined.

[24] *In re Atlas Shipping*, 404 B. R. 726 (Bankr. S.D.N.Y. 2009) [US].

[25] Article 16(3), MLCBI, 1997.

[26] *Re Eurofood IFSC Ltd.*, [2006] Ch 508.

[27] Armour J. (2006), "Cross-Border Insolvencies: The Race goes to the Swiftest?", 65(3) The Cambridge Law Journal, pp. 505-507.

[28] *In the Matter of Stanford International Bank Ltd.,* [2010] EWCA Civ. 137. [UK]

[29] *Re Cinram International Inc*., 2012 ONSC 3767. [Canada]

[30] *In re Sphinx*, [2007] 371 B.R. 103 [US].

[31] *In re Jonathan A. Loy*, Bankr. E.D. Va. 2007 [US].

[32] Hannan N. (2017), "Cross Border Insolvency, The enactment and interpretation of the UNCITRAL Model Law", Springer.

[33] *In re British American Insurance Company Limited*, [2010] 425 B.R. 884 (US). For more examples on the interpretation of COMI, please see*, in re Tri-Continental Ltd.*, [2006] 349 B.R. 629 (US); *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund Ltd.*, [2008] 374 B.R. 122 (US); *In re Betcorp Ltd.,* [2009] 400 B.R. 266 (US); *Lavie v. Ran*, [2009] 406 B.R. 277 (US).

[34] *In re Paul Zeital Kemsley*, Bankr. S.D.N.Y. 2013 (US). Please see, *In re Millennium Global Emerging Credit master Fund Ltd*, Bankr. S.D.N.Y. Aug 2011 (US), *and In re Gerova Financial Group Ltd*, Bankr. S.D.N.Y. 2012 (US). In these cases, same principles have been discussed.

[35] MLCBI Guide to Enactment [30].

[36] *Re Eurofood IFSC Ltd* [2004] IESC 47 [61]; MLIJ Guide to Enactment [73].

[37] United Nations, *Legislative Guide on Insolvency Law* (United Nations Office 2005) 326 [87].

[38] *In re Ephedra Prods. Liab. Litig., 349 B.R. 333 (SDNY 2006) [CLOUT case no. 765]; In re Juergen Toft, 435 B.R. 186 (Bankr. SDNY 2011) [CLOUT case no. 1209].*

[39] *WR Grace & Co v Local Union* 461 US 757, 761 (1983).

[40] *Bond Van Adverteers v Netherlands* [1988] ECR 2085 [34].

[41] Articles 9, 15, 25, 28, and 29, MLCBI 1997.

[42] Article 2(d), MLIJ, 2018.

[43] MLIJ Guide to Enactment, 60.

[44] Supra Note 11.

[45] Article 14 of the MLIJ specifically talks about the Grounds for Refusal. These grounds for refusal include: if the defendant was not properly notified, conflict in the judgement passed as an insolvency-related judgement and any other judgement that might be passed, the judgement passed by the Court was obtained by fraudulent means, it is a case where the jurisdiction of the court which has passed the judgement can be questioned, and the judgement interferes with the interests of the creditors materially. These grounds were not present for refusal under the MLCBI.

[46] *Re Tantleff*, 2022 SGHC 147.

[47] This is assuming that the Courts in Singapore are to give full effect to the judgments passed by a competent foreign court.

[48] Article 13, MLIJ, 2018

[49] Mevorach I. (2008), "The 'Home Country' of a Multinational Enterprise Group facing Insolvency", 57(2) The International and Comparative Law Quarterly, pp. 427-448.

[50] *Ibid*.

[51] *Re Agrokor DD* [2017] EWHC 2791 (Ch), 54.

[52] MLEI Guide to enactment, 2019, 42, 43.

[53] MLEI Guide to Enactment, 2019, 47.

[54] MLEI Guide to Enactment, 2019, 48.

[55] Report of the Bankruptcy Law Reforms Committee, 2015.

[56] Section 234 of the IBC, 2016 states *'(1) The Central Government may enter into an agreement with the Government of any country outside India for enforcing the provisions of this Code.*

(2) The Central Government may, by notification in the Official Gazette, direct that the application of provisions of this Code in relation to assets or property of corporate debtor or debtor, including a personal guarantor of a corporate debtor, as the case may be, situated at any place in a country outside India with which reciprocal arrangements have been made, shall be subject to such conditions as may be specified'.

Section 235 of the IBC, 2016 states *'(1) Notwithstanding anything contained in this Code or any law for the time being in force if, in the course of insolvency resolution process, or liquidation or bankruptcy proceedings, as the case may be, under this Code, the resolution professional, liquidator or bankruptcy trustee, as the case may be, is of the opinion that assets of the corporate debtor or debtor, including a personal guarantor of a corporate debtor, are situated in a country outside India with which reciprocal arrangements have been made under section 234, he may make an application to the Adjudicating Authority that evidence or action relating to such assets is required in connection with such process or proceeding.*

(2) The Adjudicating Authority on receipt of an application under sub-section (1) and, on being satisfied that evidence or action relating to assets under sub-section (1) is required in connection with insolvency resolution process or liquidation or bankruptcy proceeding, may issue a letter of request to a court or an authority of such country competent to deal with such request'.

[57] *Jet Airways (India) Ltd. v. State Bank of India*, Company Appeal (AT) (Insolvency) No 707 of 2019.

[58] *Macquarie Bank Limited v Shilpi Cable Technologies Ltd.*, (2018) 2 SCC 674.

[59] Supra Note 55.

[60] Section 2(c) of Draft Part Z defines establishment in similar terms as that of MLCBI but qualifies the ascertainment with the determination capped at three month period before the commencement of the proceedings. A similar time limit is given while determining COMI under Section 14 of Draft Part Z.

[61] In *Shierson v. Vlieland-Boddy*, [2005] EWCA Civ 974 [UK], the Court of Appeal held that beneficial interest would also be covered under the definition of establishment. However, the same would not be true for the countries which have adopted the MLCBI without any modifications. See, Hannan, 2017 for more discussion on this aspect.

[62] *Re Zetta Jet Pte Ltd and others*, [2018] 4 SLR 801. (Singapore)

[63] Karadelis K.(2022), "Singapore court gives guidance on COMI and scope of Model Law recognition", Global Restructuring Review.

[64] Article 10. MLCBI, 1997.

[65] Section 7(2), Draft Part Z, 2018.

[66] Section 10(2), Draft Part Z, 2018.

[67] Article 17(3), MLCBI, 1997.

[68]Section 15(4), Draft Part Z, 2018. Even the UK, in its CBIR, does not provide a time limit to the courts for recognising the judgment and retains the language as under MLCBI.

[69] Article 19, MLCBI, 1997.

[70] The jurisprudence in the application of this provision is not well developed. However, see *In re Japan Airlines Corp.*, Bankr. S.D.N.Y. Jan. 28, 2010 [US], where if the immediate relief would not have been given, it would have resulted in undermining the efforts of the foreign representatives and debtors to preserve the assets and creditors taking actions to the detriment of the corporate debtor.

[71] Article 24, MLCBI, 1997.

[72] Supra Note 1.

[73] Benefits of Enacting the Model Law, Draft Part Z, 2018.

17 GAPS IN INFORMATION RETRIEVAL MANDATE BY IUs FOR VARIOUS STAKEHOLDERS IN INSOLVENCY AND BANKRUPTCY REGIME

- Khyati Sharma

EXECUTIVE SUMMARY

It was a notification dated December 19, 2017[1] issued by Reserve Bank of India (RBI), that stated as per section 215 of Insolvency and Bankruptcy Code 2016 (IBC/Code),[2] a financial creditor (FC) must be submitting the financial information and any information related to assets in relation to which security interest has been created, to an Information Utility (IU). While section 215[3] talks about information submission to be mandatory for FCs; for operational creditors (OCs), the leeway was left open by making this submission optional for them. The very success of insolvency proceedings depends largely on the correct as well as complete information available to various stakeholders regarding the corporate debtor (CD). This is one of the reasons as to why the Insolvency and Bankruptcy Board of India (IBBI) strengthened IUs by allowing them to access data from MCA-21 portal. In the 2020 case of *Univalue Projects Pvt. Ltd. v. The Union of India & Ors.*,[4] the NCLT New Delhi order that reasoned it being mandatory for all FCs to submit financial information to the IU as a pre-condition to file section 7[5] application was challenged and Calcutta High Court overturned the order concluding that harmonious reading of section 215[6] along with section 7 of IBC[7] and rules and regulations of the IBBI does not hold it mandatory for any class of creditors to provide financial information to an IU. This paper intends to look in the dichotomies and gaps of information retrieval mandate in IBC ecosystem and whether such a mandate is necessary for efficient working of insolvency and bankruptcy proceedings for all kinds of creditors whether secured or unsecured and operational or financial. It also aims to compare the position of FCs with OCs and analysing whether such a difference in position justified and the reasons for the same, and whether OCs do deserve seats in committee of creditors (CoC) along with comparing this position with other jurisdictions.[8] This paper also intends to look into what role can block chain technology play in ensuring overall solution for this problem and addressing the good governance issue in financial institutes (FIs).

Keywords: IBBI, IU, IBC, Univalue Projects, Financial Institutes.

INTRODUCTION

An order was issued by the Registrar of the National Company Law Tribunal (NCLT) at its principle bench in New Delhi, on May 12, 2020 that imposed a mandatory prescription on all the FCs, as per the extant provisions of the IBC, to submit certain financial information as part of the record of default before IU, while filing an application under section 7 of the Code,[9] with retrospective effect. On August 18, 2020, a single judge bench of Calcutta High Court struck down this aforementioned order. Herein, the author intends to look into the various aspects of information retrieval mandate in IBC. Another matter at hand to be analysed is the current position with respect to various judicial decisions in respect of CoC, and critically review that whether justice in the current framework has been provided to various class of creditors or do we need a better system to ensure the same with the help of comparative analysis and try and seek the balancing of interests of various stakeholders. The next point to be dwelt upon will be the unjust position of FCs and their power in approving a resolution plan on the expense of OCs.

LITERATURE REVIEW

Here, in this paper a very profound research gap is being dealt with. There exists no research paper or any relevant material that focuses on the gaps and loopholes of the information retrieval mandate of IBC ecosystem. The author herein, has tried best to do the original research regarding the same and come up with solutions to close such loopholes and further suggestions for creating a risk averment infrastructure for creditors. Furthermore, it has been tried at all possible levels to make that idea of risk averment infrastructure within IUs, defect proof by providing solutions for problems that might arise in such an infrastructure that is created with the help of closing loopholes in the current information retrieval mandate of the IBC ecosystem. Further, the issue regarding dichotomy in absolute mandate between OCs and FCs with respect to section 215[10] and notification RBI/2017-18/110[11] is also dealt with in detail. The idea and suggestions regarding such an infrastructure are the original thoughts of author and are found a miss in the current existing literature. Further differences between OCs and FCs in the IBC ecosystem regarding voting in the CoC has been inspired with current literature but the suggestions and alternatives to the current position as inspired with other jurisdictions is unique about this paper. Apart from that, the risk averment infrastructure proposed in this paper is further suggested to be protected with the help of block chain technology, which is again inspired from the existing literature pointing towards the need of block chain technology to be implemented in the IUs although the further suggestions of additional protection through tokenization of the sensitive information, are the original ideas of the author.

a) **OCs in insolvency: A tale of disenfranchisement:[12]** The very objective of this paper is to analyse the situation of OCs under the IBC regime. It examines very well the different factors that had been considered by judiciary in various different pronouncements that resulted in the current day scenario when it comes to OCs. It also gives out solutions that could be used for the constructive resolution of so many other issues at hand. First part would be the discussion of the case of CoC of *Essar Steel India Limited v. Satish Kumar Gupta* and the key findings of this case. The next part offers a critique of the court's decision in the case and proposes that OCs should be granted a position in the CoC, which aligns with global norms. Third part discusses a lacuna in IBC regarding treatment of claims of the creditors along with 'disputed claims' in the insolvency process and proposes an alternate framework for the determination of such claims. The very last part has concluding thoughts of the author on this article.

b) **OCs: The outcast of IBC:[13]** This study probes into how primary objective of the drafting of IBC was timely resolution of insolvency crisis. The code was made in order to empower the credit ecosystem in the market. Although, the code is evolving in a manner wherein, rather than being conducive to the creditors, it is rather being oppressive to the OCs in general. And though the legislators have taken steps to protect OCs, the adequacy of these protections is highly questionable.

c) **Differential treatment among creditors under India's IBC: Issues and solutions:[14]** The three problems that this paper revolves around are; vesting almost absolute authority with a CoC which is made up of exclusively of FCs leading to a perception of inequitable distribution among classes of creditors; inconsistency of corporate insolvency and resolution process (CIRP) provisions with the public policy leading up to failure to protect interest of even secured claims and further another issue discussed is lack in the standards of procedural fairness in CIRP provisions and related regulations.

d) **IUs and block chain: An unlikely but holy partnership:[15]** This research paper tries to probe into the problem that is related to stakeholder trust in IUs. It tries to read between the lines in the judgment of Calcutta High Court in *Univalue projects v. Union of India.* It proposes that block chain technology can be the answer of protecting a valuable institution like IUs from the distrust of creditors as their trust in its ability to manage and protect the data is the foundation that is needed for the success of an IU.

RESEARCH ISSUES

The following research issues/research questions are aimed to be addressed by the paper:

a) What are the dichotomies and gaps in the IBC ecosystem pertaining the information retrieval mandate and whether these are needed to be addressed along with how to address them?

b) Whether the current sources of information adequate for IUs to act as efficient facilitators of a fast, effective and transparent CIRP?

c) Whether there should be information disclosure mandate for creditors?

d) Whether the aforementioned mandate should be for all kinds and classes of creditors including FCs as well as OCs?

e) Whether CIRP is justified in giving more importance to FCs?

f) What role can block chain technology play in easing the fear of data theft and streamlining the information access through IUs encouraging FCs to submit the information to IUs?

g) Whether an effective block chain system and technology and a strong cyber security fortress can result in an effective system without doubts and fears that allows IUs to be connected with all kinds of FC databases from the very inception of the loan as a mandate under IBC?

RESEARCH METHODOLOGY

The research methodologies that will be used in the current paper consists of mainly doctrinal research methodology coupled with comparative research and qualitative empirical methods of research.

The main legal research methodology that is used in the research is doctrinal research, also known as the 'black letter' methodology and qualitative empirical research wherein the main focus of the research will be on interpreting various provisions of IBC and IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations), along with various judgments and orders passed by NCLT/NCLAT, High Court and Supreme Court. This method will be employed in determining the existing dichotomies and gaps in existing law pertaining to information retrieval mandate in IBC ecosystem. And later the comparative tools are used to lay out a picture of various block chain technologies that can be employed to make the storage of data safer and increasing stakeholder confidence in not only submitting the information voluntarily but making the government more confident about rolling out an integrated and mandatory information exchange ecosystem between IUs and FIs. Comparative tools are also used to compare security of creditors with foreign jurisdictions in terms of FCs and OCs.

This is because the main crux of all the research issues/research questions stated above starts with the very first issue which is pertaining the question of dichotomies and gaps in current IBC legal regime pertaining information retrieval mandate which is ought to be identified only after detailed doctrinal research of current statutes, regulations and notifications. The second part of the solution for the same issue involves empirical qualitative research of various orders, judgements etc. of NCLT/NCLAT, High Courts and Supreme Court. Which is later looked into, as to what are the possible reasons for not having a mandate in place and how to solve it through block chain; wherein comparative tools are employed to look into various block chain technologies.

ANALYSIS

Before moving further with the analysis, the importance of IUs as one of the pillars of IBC ecosystem, must be understood.

Historically, it was a tough nut to crack for creditors to pursue recovery through Code of Civil Procedure (CPC)[16] provisions in this nation. Later, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI Act)[17] brought into place existence of Debt Recovery Tribunals (DRTs), for recovery of any debt that was due to banks or FIs. In the RDDBFI Act,[18] DRTs had the very power to issue a recovery certificate after the process of debt adjudication which was used by the Recovery Officer attached to that DRT to recover the debt in a manner specified for income tax recovery under Schedule II of the Income Tax Act, 1961.[19] This design was devised in order to speed up the recovery process. But though, the RDBBFI Act[20] gave 180 days for the recovery process, as of April, 2016, there had been more than 5 lakh cases pending in DRTs. The Securitization and Reconstruction of Financial Interest and Enforcement of Security Interest, 2002 (SARFAESI Act)[21] was enacted in order to overcome this hurdle and to further speed up the debt recovery process. The said Act gave power to banks and FIs to recover debts that are classified as non-performing assets (NPAs) through various modes, including taking possession as well as sale of the security, without approaching any court or any tribunal for that matter of fact. The SARFESI Act[22] did away with the requirement of debt adjudication and the demand notice issued by the creditor within section 13(2) of the SARFAESI Act[23] would be authority enough for recovery actions under the Act.[24]

Most litigation in such cases had been due to ascertaining and disputing the amount of debt that is duly payable to the creditor. In order to avoid this under India's newly formulated insolvency regime, concept of IUs was formed. IUs being the third-party entities that would do the function of collection, collation and dissemination of information regarding debts or defaults, which is verified and authenticated by the debtor itself and can be relied upon by the Adjudicating Authority (AA) as credible source of information and such information can have evidentiary value.[25]

IUs play a key role in expeditious facilitation on reliable and verified information which has evidentiary value in the court of law. But as our main research question pertains to dichotomies and gaps in information retrieval mandate, we must necessarily dwell on two important questions.

a) What is the information submission mandate for FCs?

b) What is the information submission mandate for OCs?

Then further explore that whether that what are the gaps and dichotomies in such mandate and whether an absolute mandate for all classes of creditors will be beneficial, and further explore the situation of OCs in IBC ecosystem's CoC and possible use of block chain technology for the IUs and its scope in making the mandate for information submission absolute, along with the scope of creating an ideal risk averment ecosystem with the enhanced use of IUs for creditors as well as retail investors planning to invest in debentures, bonds, loan stocks, convertible debentures and shares.

Univalue Projects Pvt. Ltd. v. The Union of India

In the case of *Univalue projects v. Union of India*;[26] Calcutta High Court had struck down the order of the New Delhi Bench of NCLT that retrospectively prescribed it to be mandatory for all FCs to file financial information with IU as a record of default, before even applying for initiation of CIRP under section 7.[27] This was specified to be in violation of section 7(3)(a)[28] which states that along with application, FC must furnish *'(a) record of default recorded with the IU or such other record of evidence of default as may be specified;'...*

Now, as per section 7(3)(a), there exists an option other than record of default recorded with IU, that as specified, can be an alternative. The reasoning of the High Court was, that NCLT making it mandatory for the FCs to submit financial information as record of default with the IU was a clear violation of the section 7(3)(a), wherein an alternative to this can be specified and legislative intent seems to be providing for an alternative. Here the keyword that was stressed by the petitioner was 'or' within section 7(3)(a).[29] The court ruled that applicants do have an alternative from record of default submitted to IU in form of any other document that shows existence of the proof of debt. Now, this being a 2020 judgment, there have been developments in the contemporary regime wherein the information submission has been rendered mandatory for applicants of CIRP by bringing an amendment in regulations. Now, this further can be contested to be in violation of section 7(3)(a),[30] and that dichotomy will forever exist. Rooting that out as an evident problem, when we focus on what are some other gaps in the information retrieval mandate under IBC ecosystem, some interesting findings await us.

Section 215 of IBC: A difference in mandate

When the author wished to analyse the information retrieval mandate within IUs arena of IBC ecosystem, she first started her probe with section 215 of IBC.[31] Section 215 of IBC[32] talks about 'procedure of submission etc. of financial information'. Sub-section (2)[33] talks about submission of information to IU by an FC and on the other hand, sub-section (3)[34] talks about submission of information to IU by OCs.

Now the language of the sub-section (2) of the section 215[35] states that:

> A financial creditor shall submit financial information and information relating to assets in relation to which any security interest has been created, to the IU in such form and manner as may be specified by the regulations.[36]

The word that had been used by the legislators is 'shall' which signifies a mandate.

Language of sub-section (3)[37] is *'An operational creditor may submit financial information to the IU in such form and manner as may be specified'.*[38]

Herein, in this sub-section 'may' is used, which does not signify a mandate within the meaning and interpretation of section 215[39] for OCs to submit the information to IUs. So, on the very face of the legislation, there does not exist a mandate for OCs to submit financial information and for FC there is.[40] When section 7(3)(a) is referred, it was very specific to submission of information for evidentiary purposes at the time of application for CIRP. Although section 215 which segregates mandate for OCs and FCs, does not specify an event or purpose for submitting information related to assets in which security interest has been created and gives general mandate for submitting the aforementioned to the FC. But, with further developments, mandate for information retrieval while submitting an application under section 7 or 9 of IBC has been changed defying the aforementioned Calcutta HC judgment.

IBBI (Information Utilities) (Amendment Regulations), 2022: No difference in mandate

The IBBI (Information Utilities) (Amendment Regulations), 2022,[41] wherein an amendment has been made to regulation 20,[42] which now mandates the creditors to file the information of default with the IU, before going ahead and filing an application with the AA to initiate CIRP under section 7[43] or 9.[44] The difference in mandate that was being talked about, for OCs and FCs, does not exist anymore when it comes to application for initiation of CIRP, wherein as per the aforementioned new amendment, the mandate to file information of default with IU before filing application for initiation of CIRP exists for both FCs and OCs.

The amendment also has introduced a new form, called Form D; which is nothing but an instrument to facilitate the issue of 'record of default' which will serve as authentication of the default. The provision for record of default has been inserted after sub-regulation (1)[45] of regulation 20[46] as (1A)[47] and has been verbatim inserted as *'(1A) "record of default" means the status of authentication of default that has been issued in the Form D of the Schedule'.*[48]

Further, this mandate has been stated in regulation 20[49] of the principle regulations i.e., IBBI (Information Utilities) Regulations, 2017 (IU Regulations),[50] after sub-regulation (1),[51] the following clause shall be inserted, which is:

> (1A) before filing an application to initiate corporate insolvency resolution process under section 7 or 9, as the case may be, the creditor shall file the information of default, with the IU and the IU shall process the information for the purpose of issuing record of default in accordance with regulation 21.[52]

So, as per this new amendment, the 'record of default' is nothing but verified information, verified as per regulation 21[53] and the information of default must be necessarily filed by the applicant creditor before filing an application under section 7[54] or 9[55], with the purpose of availing the 'record of default' from IU and produce verified information before AA.

The literal interpretation is the cardinal rule of interpretation for construing statutes. And as per literal interpretation of section 215;[56] there is no mandate for OCs to file any kind of information with IUs, but as per the new amendment in IU Regulations, at least on the occasion of filing an application for initiation of CIRP, the OC is mandated to file information of default with IU in order to get 'record of default'. Now, why do such a mandate for OCs within section 215 is needed is something that the author will dwell later on in this paper.

NeSL: The alone IU that India has

India, as of now, has only one IU that is NeSL. NeSL has been set up by leading banks as well as public institutions and is incorporated in the form of a Union Government Company. The equity of NeSL is fully held by FIs, wherein public sector holds 65% of the equity. There are total 17 stakeholders that include 13 banks, three insurance companies, along with one depository:

1. Life Insurance Corporation of India: 6%
2. State Bank of India: 10%
3. Canara Bank: 10%
4. Bank of Baroda: 10%
5. ICICI Bank: 9.9%
6. Axis Bank: 9.5%
7. Karnataka Bank: 6%
8. HDFC Group: 5%
9. Indian Bank: 5%
10. Punjab National Bank: 5%
11. New India Assurance Company Ltd: 5%
12. Union Bank of India: 5%
13. Central Depository Services (India) Ltd.: 4%
14. Dena Bank: 4%
15. NABARD: 2

16. United India Insurance Company Ltd.: 2%
17. SIDBI: 1.6%[57]

The primary role of NeSL is to serve as a repository of legal evidence and to hold the information that very much pertains to debt or claim, which is sourced from FC or OC and is rather authenticated by the parties to the debt. It intimates any information pertaining default when filed by any creditor to all the creditors linked to a debtor. NeSL is also involved in making sure that information asymmetry between parties to a debt is mitigated. It also facilitates an agreed outstanding balance between parties to a debt.

As creditor submits the debt information to NeSL, NeSL accepts as well as send the authentication request to the debtor. Then the debtor either confirms/authenticates or disputes the information sent. Then further debt information is solicited by Interim Resolution Professional (IRP) across creditors. Information that is authenticated, is stored and reserved by the IU. And the reports are sent to AA by IRP.

NeSL now needs to abide by circular no. IBBI/IU/51/2022[58] dated June 15, 2022 issued by the IBBI. As per this circular, the IBBI must forward the application for initiating the insolvency received by it to the IU. And IU shall inform the other creditors of the CD of the application against the CD, by sharing such information, issue notice to the applicant, wherein it is required to file 'information of default' in the specified format as per the IU Regulations.[59] And further, it must process such information of default to generate 'record of default' as per IU Regulations. This circular was issued within the powers of section 196 of the IBC.[60]

NeSL was set up majorly with the aim and objective of giving out a level playing field regarding financial contracts by providing services to store facts related to borrowing, default and security interest, along with additional safeguards like authenticating terms of the contract, digital storage of details in a central server along with information security policies. Now, let us understand the nature of financial information that is required to be submitted.

Information that FCs are mandatorily required to submit (and yet not mandatory)

Although when it comes to the FCs, on a raw reading of section 215,[61] it is clearly understood that there does exist more to the 'financial information' apart from the financial information that they 'shall' give to NeSL (the only IU India has as of now) which is '*in relation to the assets on which security interest has been created*' and '*in such form and manner as may be specified by the regulations*'.

On December 19 2017, the then Chief General Manager of the RBI, Mr. Prakash Baliarsingh, in his name issued a circular RBI/2017-18/110[62] addressed to all the scheduled commercial banks (Including RRBs), small finance banks, local area banks, all co-operative banks, all NBFCs and all India financial institutions wherein they were informed that as per section 215 of IBC,[63] a FC shall submit financial information, as well as information related to assets in relation to which security interest has been created, to an IU, in such form and manner as many be specified by regulations. For that they must submit such information as per Chapter V of IU Regulations. For the purpose of the same, they must get themselves registered as per Regulation 18 of the IU Regulations.[64] Upon registration, the IU will intimate the unique identifier to the registered user. And as per regulation 20,[65] information must be submitted to the IU in Form C of the Schedule. And the debt information and information itself will be given a unique identifier number.

All such FCs regulated by RBI, were asked to put such systems and procedures in place, in order to ensure compliance with the provisions of the Code as well as Regulations. But it must be noted that this guideline was without any specific deadline. Question is that why is it important to have deadline in a notification such as this one? What makes this gap a profound gap in the first place? Let's compare this circular with other circulars such as tokenization circulars that RBI issued to implement safe payment ecosystem in India. Also, though it is understood that section 215 notification must have been kept open ended to give banks time for implementing necessary systems, but tokenization which is a much more complex process, and had to be implemented by all the stakeholders in a complex payment ecosystem of India; came with deadlines in several phases,[66] which can be done for the mandate under section 215 as well. For answering the question that what makes it important for such a guideline to have deadline, let's deliberate further.

As per the aforementioned notification, it had been made mandatory that all specified institutions provide financial information to IU i.e., NeSL. As per this notification, all the Banks and NBFCs are required to register and upload their loan records on NeSL,[67] in accordance with section 215 of the IBC.[68]

This move was important, keeping in mind, the large amount of cases of mismatches in the financial information provided by these institutes regarding debt information of their individual borrowers. NeSL provides diverse range of services and modes of submission to make this process simple. Now, coming back to probe of what further kind of financial information is mandated to be submitted to the IU, apart from the assets on which the security interest has been created? Loans given by banks as well as NBFCs have to be recorded.[69] Loans given to all kinds of applicants, i.e., companies, LLPs, other commercial entities and secured as well as unsecured loan given to individuals have to be registered with NeSL.[70] The data regarding the aforementioned have to be submitted. This is simply because section 215(2) states that a FC shall submit '*financial information and information related to assets in relation to which security interest has been created*' which means all kinds of information about loans whether secured or unsecured i.e., whether the ones in relation to which an asset has been secured or not. Although by March 21, 2019, only 49 banks, 81 NBFCs had signed up with NeSL[71] and 34 and 60 of those respectively, had even started uploading data on the portal. The Digital Document Execution (DDE) of NeSL can be linked with the Loan Management System (LMS) of banks, which will at least provide information regarding existence of debt in the first place. As of June 10, 2022, only 26 financial entities had integrated themselves with the NeSL's DDE. This must be necessary under section 215 of IBC.

Information regarding all debt can be submitted to an IU, irrespective of its health. And this is because when an account is in standard assets category, just before getting delinquent, have greater chances of getting authenticated, which the creditor can fall back on in the case of default. This is just another reason why in order to create a healthy risk averment ecosystem in IBC regime, RBI/2017-18/110 must have a compliance deadline for players in financial sector. Along with that, this will create a safe ecosystem wherein, frauds can be prevented to largest possible extent, if loopholes for compliance are sealed.

By virtue of notification RBI/2017-18/110[72] till February 19, 2019, NeSL had records of two-thirds of loans given by lenders and creditors. Recently, American Express notified its customers that from November 2022, it will start reporting debt information to NeSL as per notification RBI/2017-18/110[73] mentioned above. American Express wrote to its card holders that in compliance with the regulatory guidelines, on the submission of the financial information to IUs, American Express will commence reporting the information of card holders to NeSL from November 2022.[74] And all the other credit card companies are reported to follow the suit soon. But again, without a deadline for compliance of RBI's notification, there exists a gap which can be exploited by non-compliance.

The objective of IBC had been corporate resolution of corporate persons *'in a time bound manner, for maximization of value of assets of such persons'.* This is the reason as to why recently in 2022, IU Regulations have been amended in June to make sure that creditors must mandatorily file information of default with IUs[75] before filing application of CIRP, which in turn will generate 'record of default'. So, question arises as to why separate amendment to mandate the provision of such information to IUs. In order to clear out the jurisprudential dilemma, the 2022 amendment[76] made furnishing of information of default a pre-requisite for initiation of CIRP, after which the CD is asked by the IU to authenticate the information of default before generating the record of default, along with the fact that such loan information as is mandated to be submitted under section 215 by FCs is not ironclad yet, if it had been then there would be no reason to bring amendment to regulation 20 of IU Regulations in the first place, as information regarding default would already be available with the IU. It is proposed in this paper, that if loopholes in the compliance with section 215 is closed then at least the time required to authenticate the default amount would be considerably reduced. It is also proposed that providing access to the LMS of a bank to RBI credited IUs must be mandated.

In the loan authentication process, three reminders are sent at three days' interval; beyond which if CD does not authenticate the default; then it is deemed to be authenticated. After such authentication process, the information is passed down to the creditors. When maximization of the value of assets is the goal, time is an important factor, because of which even this process of three days, if can be eliminated with LMS installed with every FC and access of the same being provided to IUs by an ironclad mandate, then that will save considerable duration of time. The notification of the Ministry of Finance, asking banks to put systems in place to ensure integration of LMS with NeSL's DDE was issued on August 11, 2020 and as was stated earlier, by June 2020, only 26 FIs have integrated their LMS with DDE of NeSL, and that is again because the aforementioned notification too, does not have a compliance deadline for the integration.[77]

All of this is being argued because businesses need smooth exits as much as smooth start-ups. In many jurisdictions, insolvency regimes help entrepreneurs to close down the unviable businesses and start new ones. This in turn proves to be good for the productivity of the economy. In today's global narrative, it is a common acceptance across jurisdictions that, reforms in the insolvency processes increases the competitiveness of the economy. New amendments in the IU Regulations[78] have been rightly introduced in order to reduce the time period taken for acceptance of application of CIRP, as applications with authenticated information, will automatically get approved faster, and hence will save assets from losing value in the meantime.

But apart from all this, though there is mandate for providing information while initiating CIRP by both FCs and OCs and though submitting information of loans is necessary as per notification RBI/ 2017-18/110,[79] there is no mechanism in place to make the FIs comply with the notification as the notification is without a deadline which leaves it open for stakeholders to delay the storing of information, and this needs stringent and immediate action if objectives of IUs are to be met, efficiently.

The Potent Uses of IUs (Whether OCs must be mandated to submit Information?)

As of now, IUs work to provide authenticated information to AA in order to reduce the wastage of time in CIRP, along with holding a repository of information about loans and related defaults given out by FIs for registered users to access. This information can be accessed by other creditors in order to get cautious about the defaulters and this is made possible as all the FIs have been informed and mandated by RBI notification[80] to upload the credit and default records on NeSL. Apart from all that, NeSL has access to MCA 21 portal.[81] Now, the question is that what kind of information is available on MCA 21?[82] MCA 21[83] portal provides master data of a company, and that data contains several bits of information, such as company's name, CIN number, ROC code, class and category of the company etc., but no such data available, apart from the debt and default data; that can be used to project financial health and future liquidity of the company, is available with IUs, that can be utilized by the creditors to assess the nature of risk that might not be that visible on the surface level.

This brings another question that why the kind of information that can signify the financial health of a company is being stressed on?

Now, considering the huge amount of money from Indian credit ecosystem that simply got sunk in huge corporate bad debts, it is highly important that we do the utmost to improve our systems and make them aligned to such processes that make sure that public money does not get sunk in NPAs. Which makes it important to improve the due diligence facilities that creditors currently have.

As per section 5(8) of IBC,[84] the protected operational debt that is sold in the money market, is considered financial debt. But apart from it, the operational debt that is not factored or discounted or that is on a non-recourse basis is not informed to the IUs. Now, why does the necessity of doing so must arise? That will in turn, also help FCs to gaze an idea about the financial health of a company and in case, the company had been delaying the payments of unprotected operational debt for reasons of financial gains in terms of time value of money; this will only encourage the debtors further to go ahead and pay the due and deserved bills of vendors on time in order to have a clean profile in front of the FCs. That is, if vendors are providing operational debt to the CDs, they must be mandated to provide this information-to-IUs, which will only help their claims if CD denies to accept the existence of default.

The separate saga of OCs in CoC

The classification 'FC' and 'OC' itself had been introduced by the IBC.[85]

As has been discussed above, the mandate under section 215(2)[86] and notification of RBI issued thereunder, is applicable to the FC, and such a mandate is simply not applicable to the OCs.

Further, apart from that, OCs do not have a seat in the CoC and are only given right of representation through directors, partners or representative. This representative does not have a right to vote in the CoC. This is simply gross injustice, as per regulation 24(7),[87] even the minutes of a meeting are sent to the participants of the meeting, which means that, OCs who are owed less than 10% of the aggregate amount of debt (now this can still be a huge amount, depending upon the total aggregate and the size of the business of OCs, considering a lot of small vendors can also be sometimes involved), will not even be informed about the meeting details and hence the progression of the CIRP, which will be deciding the fate of the money owed to such operational debtors. Again, the question here is - what effects such unjust systems have on the operational credit ecosystem of this nation? Now, FC will have a right to vote in the CoC, even if the financial debt owed to them is less than 1% of the total debt owed by the creditor. Now, this is unfair and unjust in terms of a situation where a small vendor has given an operational debt of less than 10%, suppose 9% of the total aggregate debt and someone who holds debentures of less worth than 1% of the total aggregate debt.

The CoC plays a very important role in the CIRP as all the important decisions that might affect the resolutions that are taken by CoC. This is turn promotes only the financial credit given against the time value of money. It is only in the absence of any FCs that CoC is constituted of 18 largest 'OCs' and representative of workmen and employees.

In the *Essar Steel Case*[88] it was held by the Supreme Court that OCs are not needed for any reason whatsoever to be treated on the similar lines of the FCs.

The role of the OCs, is an important one as they provide gifts and services to the CD. The IBC came up with rigid differential treatment for the different class of creditors. India is a common law country, so it only makes sense to draw a comparison with the other common law country. When it comes to UK, where common law originated, all classes of creditors are allowed to form part of CoC in the ratio of their debt, but on the other hand, it is not so in India. In India, from *Swiss Ribbons v. Union of*

India[89] till *Essar Steel India Ltd. through authorised signatory v. Satish Kumar Gupta*,[90] the Supreme Court has always held the position that the FCs are better equipped to be part of CoC in comparison to OCs. Unlike UK, where Insolvency Professional (IP) does not have to consult CoC on all major decisions, in India, almost all major decisions in CIRP have to be consulted with and taken via CoC. Despite this, CoC is solely comprised of FCs, unless no FCs exist as per section 21 of the IBC.[91] In UK, it is IP who takes care of CIRP who is a neutral party. In India, rights must be given to OCs as well at par with FCs in the CoC. It is understood that there are adequate safeguards in place to ensure payment to OCs like regulation 38 of CIRP Regulations that mandates the dues of OCs to be paid before FCs, but adequate representation of OCs and a say in the important decisions of CIRP is more a matter of right and can be provided by at least giving voting rights to the representative of OCs.

Block chain technology for a remodelled IU

In the method of block chain technology, data is stored wherein, it is stored in blocks that are chained together using cryptographically created hash functions, which in turn allows easy access of all the blocks to all participants of that particular network.[92] One block chain can contain several participants and they are referred to as 'nodes', and they are allowed access after verification of their identities as well as credentials. So, a block chain along with allowing accessibility to the information shared on the network, makes sure that the integrity and security of the network remains intact.

The concept of IUs is aimed at bringing in a shift in the credit ecosystem of the country by revolutionizing the way in which credit information is collected, collated as well as disseminated across, given that it is able to garner that kind of strong support needed for the able execution of its objectives, from various stakeholders. The IUs are deemed to be the cornerstone of the new insolvency regime for a reason that, storing data on borrowing, default and security interest along with the requisite and needed function of authenticating that information is highly important and crucial to the time factor in expeditious and productive core of the new regime.

As discussed earlier, RBI notification RBI/2017-18/110[93] issued on December 19 2017 though comes with a mandate to store information in IUs, that mandate is without a concrete date for following it. It must be understood that why certain creditors might not be very much willing to upload financial information on IUs.[94] There are many angles to it. It is well known about what happened in YES bank fiasco. In order to avoid any such disaster and from the perspective of corporate governance, this mandate can be really beneficial. It must be understood that companies as well as FIs have their own data security concerns.[95] It must be made sure that background verification norms for a registered user must be made stringent, and along with that IUs must be protected with block chain technology and sensitive information that is being submitted must be protected with technologies such as tokenization.[96] This will only increase the trust of investors and make the ideal risk averment credit ecosystem for India possible.

CONCLUSION AND SUGGESTIONS

By formulating this concept of IUs and mandatory storage of financial information on that platform, is a highly healthy practice wherein, when FIs will give their loan records to NeSL (India's sole IU), and in turn, it not only saves time by serving the purpose of legit evidentiary debt information during CIRP, but it also serves the purpose of a risk averment system, wherein other FCs can get information about total indebtness and default information of the debtor beforehand.

It is suggested to provide a deadline for compliance notification with section 215 for FCs along with making it mandatory for OCs too to provide information regarding operational debt to IUs. It must be mandatory for the OCs to submit information regarding operational debt records, this is in different context from when as per the new amendment, wherein OCs have to mandatorily submit debt records with IU for generation of 'record of default'. This is regarding submission of general operational debt and default records, regardless of whether CIRP is being applied for or not. This will help boost the operational credit ecosystem as well as give additional information to FCs, which will in turn help OCs by motivating debtor to pay dues on time. It is also suggested that in order to speed up the process even further, separate insolvency courts must be set up, as NCLT has already the burden of other cases as well. Also, considering that mandate in notification RBI/2017-18/110 issued by RBI on December 19 2017,[97] comes without a deadline, making it simply possible for the creditors to delay with the compliance as per their wishes, it is simply suggested that this loophole must be closed with specifying a deadline for the entities that have yet not complied along with the penalty for non-compliance with that deadline. It is further suggested that, linking of LMS system of a bank with an IU's DDE must be made compulsory and provisions must be made for a mandate of providing access of LMS of a bank to an RBI certified IU.

Now, coming to CoC, it is seen how OCs are completely left out of the committee. Even in UK, OCs are part of the 'CoC' as per the proportion of the debt owed to them. That is, when the major decisions are not even taken by CoC but by IP, who is a person of court. Similarly, in Germany[98] too (if we wish to compare a civil law nation as well),[99] major decisions are taken by Insolvency Administrator[100] with creditors' committee[101] having a limited influence[102] over them.[103] It must be ensured that in order to bring justice, either the voting rights to OCs in the CoC must be given, or CoC's influence must be reduced on the major decisions of the CIRP.

As a result of this, in cases like *KN Raja Kumar v. Nagarajan*,[104] the decision to withdraw the insolvency proceedings was taken without any consent of OCs. And though the debts of the FCs are very large in comparison to the debts of the OCs,[105] one cannot dispute the fact that in the eyes of a prudent man,[106] that is no reason to deny the OCs, the voting rights in proportion of their debts, in the CoC.[107] And though, it is understood that the number of OCs is always far more compared to the FCs, in case the alternative of allowing them voting rights is adopted as compared to the alternative of limiting the control of the CoC, then in that particular case, this issue of numbers can be dealt with by allowing a certain number of cap on the representatives sent by OCs which must be proportion of their debt divided by 10 and then rounded off to the nearest number, in case the proportion of debt owed to OCs is more than 10% and in case it is less than 10%, the representation must be restricted to one representative, but voting right of these representatives, regardless of their number should be in proportion to the debt owed to the OCs. And as Supreme Court has stated again and again in various cases about the 'commercial wisdom' of the FCs, and how that is important and relevant for the restructuring of the CD, one must understand that the whole point of being in a committee is that the representatives appointed by OCs, if specified to have certain financial qualifications, will go ahead and explain OCs about the discussions and their implications. For the sheer lack of financial knowledge, it is no case to not give OCs voting rights but only representation in the CoC.

Further in order to strengthen the risk averment ecosystem, block chain technology must be implemented for fortifying IUs[108] along with the implementation of tokenization for the very sake of protecting further the sensitive information that creditors and companies might want to protect from the general eyes.

[1] RBI Notification "Submission of Financial Information to Information Utilities" dated December 19, 2017.

[2] Section 215, IBC.

[3] *Ibid.*

[4] MANU/WB/0628/2020.

[5] Section 7, IBC.

[6] Supra Note 2.

[7] Supra Note 5.

[8] BaFin, Credit institutions supervised by BaFin or the ECB, Article from the Annual Report 2016.
[9] Supra Note 5.
[10] Supra Note 2.
[11] Supra Note 1.
[12] Mahapatra S. et al. (2020), "OCs in Insolvency: A Tale of Disenfranchisement", NALSAR Stud. L. Rev., Vol.14, pp.78-93.
[13] Jain S. (2020), "OCs- the Outcast of Insolvency and Bankruptcy Code", Int'l J.L. Mgmt. & Human, Vol.3, Issue 4, p.77.
[14] Pryor C. S. and Garg R. (2020), "Differential Treatment among Creditors under India's Insolvency and Bankruptcy Code, 2016: Issues and Solutions", American Bankruptcy Law Journal, Vol.94, p.123.
[15] Gupta A. (2022), "Information Utilities and Block chain - An Unlikely but Holy Partnership", Research Paper, pp.3-81.
[16] The Code of Civil Procedure, 1908.
[17] The Recovery of Debts Due to Banks and Financial Institutions Act, 1993.
[18] *Ibid.*
[19] Income Tax Act, 1961, Schedule II, No. 43.
[20] Supra Note 17.
[21] The Securitization and Reconstruction of Financial Interest and Enforcement of Security Interest, 2002.
[22] *Ibid.*
[23] *Ibid.*, Section 13(2).
[24] Mathew R. (2022), "Concept, Utility and working of Information Utilities, under the Insolvency and Bankruptcy Code 2016", SCC online blog.
[25] *Ibid.*
[26] MANU/WB/0628/2020.
[27] Tiwari S. and Srivastava S. (2022), "Afflictions in the Mandatory filing of Records with the IU under IBC", The HNLU CCLS Blog.
[28] Section 7(3)(a), IBC.
[29] *Ibid*.
[30] *Ibid.*
[31] Supra Note 2.
[32] *Ibid.*
[33] Supra Note 2.
[34] *Ibid.*
[35] *Ibid.*
[36] *Ibid.*
[37] *Ibid.*
[38] *Ibid.*
[39] *Ibid.*
[40] Patel A. (2022), "The Law Around Information Utilities under the IBC", Leegality.
[41] IBBI (Information Utilities) (Amendment Regulations), 2022.
[42] Regulation 20 of the IBBI (Information Utilities) Regulations, 2017.
[43] Supra Note 5.
[44] Section 9, IBC.
[45] Regulation 20(1) of the IBBI (Information Utilities) Regulations, 2017.
[46] Supra Note 42.
[47] Regulation 20(1A) of the IBBI (Information Utilities) Regulations, 2017.
[48] *Ibid.*
[49] Supra Note 42.
[50] IBBI (Information Utilities) Regulations, 2017.
[51] Supra Note 45.
[52] Supra Note 47.
[53] Regulation 21 of the IBBI (Information Utilities) Regulations, 2017.
[54] Supra Note 5.
[55] Supra Note 44.
[56] Supra Note 2.
[57] NeSL website.

[58] IBBI Circular No. IBBI/IU/51/2022 dated June 15, 2022.
[59] Supra Note 50.
[60] Section 196, IBC.
[61] Supra Note 2.
[62] Supra Note 1.
[63] Supra Note 2.
[64] Regulation 18 of the IBBI (Information Utilities) Regulations, 2017.
[65] Supra Note 42.
[66] RBI notification "Tokenisation – Card Transactions: Extending the Scope of Permitted Devices", August 25, 2021.
[67] Ramann S. (2018), "I Believe it is Myopic to Look at Initial Failings of a New Law: NeSL's S. Ramann", *Mint*, 26 January.
[68] Supra Note 2.
[69] Mani V. (2023), "NeSL has records of two-thirds of loans given by lenders, creditors", *Business Standard*, 5 April.
[70] "Towards a More Transparent Credit Information Ecosystem", NeSL Blog News, April, 2020.
[71] Model IU Agreement, Agreement for IU Services for Financial Creditor, NeSL website.
[72] *Ibid.*
[73] *Ibid.*
[74] "American Express to report card information to NeSL", *The Economic Times*, 18 October, 2022.
[75] Upadhyay G. (2020), "Submission of Financial Information to Information Utility", Taxguru, 19 May.
[76] Supra Note 41.
[77] MCA discussion paper dated December 23, 2021.
[78] Supra Note 50.
[79] *Ibid.*
[80] Supra Note 1.
[81] User Login, MCA website.
[82] *Ibid.*
[83] *Ibid.*
[84] Section 5(8), IBC.
[85] The Insolvency and Bankruptcy Code, 2016.
[86] Section 215(2), IBC.
[87] Regulation 24(7), IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.
[88] *CoC of Essar Steel India Limited (through authorized signatory) v. Satish Kumar Gupta and Others,* (2020) 8 SCC 531.
[89] *Swiss Ribbons (P) Ltd. v. Union of India*, (2019) 4 SCC 17
[90] Supra Note 88.
[91] Section 21, IBC.
[92] Supra Note 15.
[93] Supra Note 1.
[94] Supra Note 75.
[95] Privacy Policy, NeSL website.
[96] Riesen M., "What is Tokenization and How Can I Use it for PCI DSS Compliance?", Security Metrics.
[97] Supra Note 1.
[98] Streit G. and Burk F., "Restructuring and Insolvency in Germany: Overview", Thomson Reuters: Practical Law.
[99] Brown M., "German Insolvency Laws-Rights and Duties of the Creditors' Committee", Lexology.
[100] Deloitte article on "Pre-insolvency restructuring proceedings: Overview and employment law implications".
[101] Securitisation and Regulations Germany 2022, (ICLG 2022).
[102] Lehmann A., "Germany's Insolvency Code Amended in Light of Economic crises", Squire Patton Boggs: Restructuring Global View.
[103] Baker McKenzie, "Global Restructuring & Insolvency Guide", pp.1-17.
[104] *KN Raja Kumar v. Nagarajan*, LL 2021 SC 459.
[105] Srinivas L., "Meeting of CoC under IBC", Taxguru.
[106] International Monetary Fund, "Orderly & Effective Insolvency Procedures".
[107] Dhaval Vussonji & Associates, "Financial Creditor and Operational Creditor under the Insolvency and Bankruptcy Code, 2016", Mondaq.
[108] Supra Note 15.

18 RETHINKING IBC: ROLE OF PROMOTERS/ MANAGEMENT IN RESOLUTION OF THE CORPORATE DEBTOR

- Kumar Saurabh Singh, Ashwij Ramaiah and Rohitesh Tak

EXECUTIVE SUMMARY

The scheme of the Insolvency and Bankruptcy Code, 2016 (IBC) recognises that a successful resolution of a corporate debtor (CD) warrants engagement and active cooperation of all its key stakeholders. Out of all the stakeholders of the CD, one of the critical stakeholders whose cooperation is necessary for a successful resolution of the CD is that of the erstwhile promoters/ management. Typically, the promoters who have been in management and control over affairs of a CD are most interested in preserving its value. Further, often the promoters possess specific sectoral and micro level skills and knowledge which can be beneficial to run operations of the CD during the insolvency resolution process.

However, the current IBC regime, through various ineligibilities including those under section 29A create disincentives for the promoters to actively cooperate in resolution process of the CD. The non-cooperation of the promoters negatively impacts the resolution process and may result in loss to the creditors and other stakeholders. Accordingly, this paper seeks to suggest the approach which may be adopted for improving cooperation of erstwhile promoters through creation of positive incentives rather than negative repercussions.

Keywords: Section 29A, Disqualification, Promoters, Resolution Plan

INTRODUCTION

Economic systems encouraging entrepreneurship are premised on individuals willing to take risk in building their businesses and expecting a return.[1] As risk is the reward for business, failures are also inevitable. To address these business failures and ensure stability of the financial system,[2] having an efficient legal framework is necessary.[3] Jurisdictions which lack an efficient legal system to resolve business failures run the risk of creditors losing their debt which increases the costs of credit in the market and impacts the overall economy.[4]

For ensuring an efficient insolvency resolution framework it is incumbent upon the states to adopt an approach which creates incentives for restructuring of viable enterprises,[5] ensures continuity of business, maximises value of debtor's assets for the benefit of creditors and balances the interest of all the stakeholders.[6] While these objectives are well-established, there is less consensus on the optimal design for adopting an insolvency resolution framework for which there is no 'one size fits all approach'.[7] Typically, the states based on their institutional set up and credit culture adopt a resolution framework for distressed companies ranging from a 'creditor in possession' to a 'debtor in possession' model. States adopt these models for optimising outcomes: (a) prior to insolvency when the company is financially sound (ex-ante efficiency); and (b) once the company enters into insolvency (ex-post efficiency).[8]

Typically, in a financing transaction, lending to healthy companies will not take place without sufficient creditor control rights.[9] Accordingly, creditors play an important role in ensuring ex-ante efficiency by constraining management of the company to act responsibly and in their interest.[10] Authors have argued that ex-ante efficiency can reduce if the reorganisation process favours the management and lets them off lightly.[11] However, at the same time insolvency law should not be excessively harsh such that the management tries to avoid it at any cost, by engaging in risky behaviours including 'gambling' with the company's assets,[12] hiding losses through the use of creative accounting or spending less on product quality and research & development.[13] Further, excessive creditor friendly regimes lead to low risk taking, innovation and investment by companies.[14]

Studies have also shown that if insolvency law is too tough on management of distressed entities, it can entail losses for ex-post efficiency due to bias of the creditor in liquidating/monetising the assets of the distressed entity to an outside buyer who is not cash constrained (even if inefficient vis-à-vis the existing manager whose retention can increase ex post efficiency).[15] Further, ex-post efficiency can increase if the existing management possessing necessary skills is retained to run to the business of the CD.[16] Considering these aspects, an ideal insolvency/bankruptcy law should seek to balance the interest of both the managers (i.e. promoters, directors, key managerial personnel) and creditors.[17]

However, the Indian insolvency regime, appears to be highly tilted in favour of the creditors as against the existing management and promoters of the CD. This is due to various ineligibilities contained under section 29A of the IBC, which prohibit promoters and their connected parties to submit a resolution plan.[18] Section 29A of the IBC states that persons who are/have (a) undischarged insolvents, (b) wilful defaulters, (c) having an account classified as non-performing asset (NPA), (d) convicted for any offence punishable with imprisonment of two years as provided under schedule 12 of the IBC or seven years, (e) disqualified to act as a director under the Companies Act, 2013, (f) prohibited from trading in the securities market, (g) promoters of a company in which an avoidance transaction has occurred in the past, (h) a connected person[19] who is disqualified under section 29A (1) (a) to (i) of the IBC, shall be ineligible to submit a resolution plan under IBC.

Surprisingly, the ineligibilities prescribed under section 29A of the IBC are not only applicable to a formal court approved resolution process under IBC but even to pre-packaged insolvency resolution process,[20] liquidations,[21] loan transfers,[22] and out of court restructurings.[23] Due to high disqualification criteria under section 29A of the IBC, promoters and existing management are often under the threat of losing the control over their companies,[24] which at times disincentivize them to cooperate with the resolution professional (RP) during the resolution process under IBC.[25] This lack of cooperation by promoters and erstwhile management[26] of the CD causes information asymmetry which discourages many prospective resolution applicant to submit their resolution plans, which overall affects the maximization of value for creditors.

Given persistence of these issues in the current insolvency framework under IBC, this research paper aims to address measures for securing active participation and cooperation of erstwhile promoters and management under the Indian insolvency regime. In this regard, the authors in this paper examine: (a) the global best practices related to participation of promoters in resolution process of a company, which can be drawn upon on this aspect to streamline the insolvency regime in India and (b) the legal and regulatory changes required to be introduced to incentivize promoter participation in the resolution process of a company.

APPROACHES TO BUSINESS FAILURES AND PROMOTER PARTICIPATION

USA

The constitution of the USA authorises the Congress to enact laws on bankruptcy. In exercise of this power the Congress in 1978 codified the 'Bankruptcy Code' as Chapter 11 of the United States Code (US Code or U.S.C.).[27] Chapter 11 of US Code contains the uniform federal law that governs all the bankruptcy cases of both individuals and companies.[28] The Federal Rules of Bankruptcy Procedure, 1983 govern the procedural aspects of the bankruptcy process along with the local rules of each bankruptcy court.[29]

Chapter 11 of the US Code is based on the premise that the existing management is best suited to turnaround the distressed company for the benefit of creditors and other stakeholders.[30] Accordingly, during the reorganisation process, the existing management of the debtor remains in the control of the debtor company and exercises all the rights and powers to maximize the value of the assets for the benefit of creditors and interest holders.[31] In USA, the existing management and promoters acting through the debtor company are entitled to submit reorganisation plan for revival of the debtor company. In fact, there is an exclusive period of 120 days where only the debtor[32] can submit the plan for its turnaround.[33] If a debtor files a reorganisation plan within the 120-day exclusivity period, the exclusive period is further extended to 180 days.[34] The reason for the extension of the exclusivity period to 180 days is to provide the debtor an opportunity to obtain confirmation of a plan without having to defend against a competing plan at the same time.[35] Once the exclusivity period expires, any party in interest[36] except the U.S. Trustee may file a reorganisation plan.[37]

However, under Chapter 11 of the US Code, the bankruptcy court can appoint a trustee for causes including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor company by the current management,[38] or if appointment of trustee is in the best interest of the creditors.[39] Once the trustee is appointed the debtor loses its exclusive right to submit the reorganisation plan for its turnaround.[40] But even if the trustee gets charge over the management of the debtor, still the promoters and other shareholders are eligible to submit a resolution plan in the resolution process.[41] Further, the trustee cannot decide to change current management of the debtor company unless it is either utterly incompetent, will not follow the trustee's instructions, or is demonstrably committing fraud.[42]

In the USA, the creditors are required to vote on the reorganisation plan submitted by the promoters/ existing management of the debtor. If such reorganisation plan is approved by the creditors, then the promoters are entitled to receive the benefits of starting the operations of the company on a clean slate basis with extinguishment of past liabilities pursuant to a discharge order passed by the bankruptcy court.[43] Typically, the bankruptcy court orders for the discharge as soon as practicable after the debtor completes all payments under the plan. However, a discharge may be revoked if the bankruptcy court finds that the discharge was obtained fraudulently[44] on account of transfer or concealment of assets, or false oaths or in sworn testimony at the meeting of creditors.[45] This revocation can be sought within one year of the discharge's being granted by any creditor, trustee, U.S. Trustee.[46]

While there is no bar on the erstwhile promoters and directors to submit a resolution plan for the debtor company there are various provisions under the US Code which make the directors and existing management liable for prosecution on account of any bankruptcy fraud (which includes concealment of estate property,[47] false oaths and certifications, false claims, improper receipt of estate property, bribery, destruction or falsification of records, withholding information from the trustee, wrongful trading).[48] These crimes include penalties of fines and/or imprisonment for not more than five years. However, altering, destroying, or concealing records with the intent to obstruct proper administration of the estate could also lead to additional fines and/or imprisonment of up to 20 years.[49]

From the above analysis, it is the clear that the bankruptcy regime in USA supports the notion that the existing management representing equity holders have greater incentives to maintain the firm as a going concern and therefore should be in control during the resolution process of the company.[50] While the bankruptcy regime in USA does penalise the directors and promoters for bankruptcy fraud, it does not disallow them and their connected parties from submitting the reorganisation plan on account of *inter-alia* default in repayment of any loan or guarantee obligations.

UK

In UK, the insolvency process for companies as well as individuals is regulated by the Insolvency Act 1986 (UK Insolvency Act) and Insolvency Rules, 2016. The UK Insolvency Act contains provisions relating to: (a) company voluntary arrangements (CVAs); (b) administrations (both court-based and out-of-court appointments); (c) winding up; and (d) administrative receiverships.

Administration under UK insolvency regime is the most prevalent procedure used for corporate insolvencies.[51] The administration proceedings can be initiated against the insolvent companies by way of an application to the court[52] made by the company itself, or a creditor; or in certain circumstances by a clerk of a magistrates court.[53] Upon initiation of administration proceedings, an Administrator (similar to RP under IBC) is appointed by the court.[54] The Administrator is vested with the power to take necessary measures for managing the affairs, business and property of a company during the administration process[55] and to sell the assets of the company. The Administrator can remove the existing directors of the company and make fresh appointments.[56] Further, the existing management requires prior consent of the Administrator before exercising any power under the charter documents (articles of association, memorandum of association) of the company or under the Companies Act which interfere with the Administrator's functions under the UK Insolvency Act.[57]

Under the scheme of UK Insolvency Act, the existing management of the company (including the erstwhile promoters, directors, and employees) is required to cooperate with the Administrator.[58] They are obligated to provide information to the Administrator concerning the promotion, formation, business, dealings, affairs, or property of the company.[59] The Administrator can approach the court if the existing management fails to cooperate with it.[60] Based on the application made by the Administrator, the court can summon the ex-management[61] and even pass order for arrest of the person and seizure of the books, papers and records.[62]

Apart from administration, CVAs are typically used as out of court restructurings between the company in stress and its creditors, which are taken on record by the court once approved by the creditors.[63] CVA's can be triggered by directors of a company[64] or, if the company is in administration or liquidation, its insolvency officer.[65] A CVA is binding once approved by minimum 50% of shareholders and a majority 75% in value of the claims of unsecured creditors voting at the CVA meeting.[66] However, a CVA cannot affect the rights of preferential or secured creditors without their consent and agreement.[67] Typically, a standalone CVA does not trigger a moratorium on creditors' actions (except for small companies).[68] However, a CVA is at times used after initiating administration to take advantage of the moratorium.[69] There is no express restriction on the promoters/shareholders to be part of the CVA and regain control of the company upon making payment to the creditors. Further, similar to CVA, even pre-pack sales are used under the administration process to sell business of the insolvent companies as a going concern.[70] The pre-pack sales are implemented by using Administrator's power to sell a company's assets without the approval of creditors.[71]

Typically, pre-pack sales are initiated once the company resolves to appoint an advisor (qualified to be insolvency practitioner).[72] Once the terms of sale are agreed, the advisor (i.e. insolvency practitioner) is then appointed as the Administrator under the administration process and the sale is concluded immediately.[73] Earlier, there were concerns of transparency and accountability in the sale of assets of insolvent companies to connected parties under the pre-pack process. In fact, the Graham Committee which was set up to examine issues related to connected party sale under pre-pack process, in its Report (Graham Report) noted that over two thirds of pre-packs involved sales to a connected party.[74] The Graham Report further noted that the sale of assets to a connected party under the pre-pack process had less probability of success *vis-à-vis* sale to an unconnected party.[75] However, still the Graham Report did not recommend for imposing a blanket prohibition on connected parties to acquire assets under the pre-pack process. Instead, it recommended for measures which could improve price discovery such as approval of pre-pack sale to connected parties by a pre-pack pool (consisting of independent insolvency practitioners) etc.[76] The recommendations made under the report have now been incorporated under the 'Statement of Insolvency Practice 16'. The SIP regulates the process of sale to connected parties.[77]

It is pertinent to note that while the UK insolvency regime does allow connected parties and promoters to participate in the resolution process (i.e. CAV, administration, pre-pack sales) of a company and submit resolution plans, it also imposes liability on the directors/promoters for committing offences related to insolvency of the company. Under the UK Insolvency Act, if any person who has taken part in the promotion, formation or management of the company has misapplied/ misappropriated/ wrongfully retained money or property of the company, then a Liquidator, creditor or shareholder, can file an application and seek an order from the court requiring them to repay or restore the property or contribute to the company's assets by way of compensation for breach of duty.[78] Similar reliefs are also available where the directors or promoters have been involved in fraudulent[79] or wrongful trading.[80] Additionally, the Company Directors Disqualification Act, 1986 (CDDA 1986) allows the courts to disqualify a director upto 15 years[81] on account of breach of fiduciary duty, misfeasance, misapplication of company's property, failure to comply with statutory provisions,[82] responsibility for causing insolvency of the company,[83] etc. Once the court disqualifies a person to be director under the CDDA 1986, it is a criminal offence for such person to be a director of a company or take certain other roles relating to company management.[84]

PRESENT LEGAL REGIME IN INDIA IN RELATION TO THE PARTICIPATION OF THE ERSTWHILE PROMOTER GROUPS IN RESOLUTION OF THE CD

Inception of section 29A

Prior to the inception of the IBC, the Bankruptcy Law Reforms Committee submitted its report dated November 4, 2015 (BLRC Report) to the Hon'ble Finance Minister which laid down the broad contours of the proposed insolvency regime in India.[85] The BLRC Report daftly explored the sensitive subject of participation of erstwhile promoters in the insolvency resolution process of the CD and warned that an insolvency regime should specifically draw a line between 'malfeasance' and 'business failure'.[86] The BLRC Report warned the legislature against subscribing to the stereotype of 'rich promoters of defaulting entities'. Subscribing to such a stereotype fosters two schools of thought, neither of which represent the complete and accurate picture of the state of affairs of the company, namely: (a) all defaults necessarily involve malfeasance; and (b) promoters should be held personally and financially responsible for defaults of the firms that they control.[87] The BLRC Report stipulated that to get a true and complete picture for the reasons of default in a CD and to evolve a legal regime for insolvency resolution of such firms, the legislature should also inter-alia take into account the following perspectives:[88]

> 1. **Some business plans will always go wrong.** In a growing economy, firms make risky plans of which some plans will fail, and will induce default. If default is equated to malfeasance, then this can hamper risk taking by firms. This is an undesirable outcome, as risk taking by firms is the wellspring of economic growth. Bankruptcy law must enshrine business failure as a normal and legitimate part of the working of the market economy.
>
> 2. **Limited liability corporations are an important mechanism that fosters risk taking.** Historically, limited liability corporations were created with the objective of

> taking risk. If liability was unlimited, fewer risky projects would be undertaken. With limited liability, shareholders have the ability to walk away, allowing for greater exploration of alternative business models. Since exploration benefits society through risk taking, it is important to protect the concept of limited liability, which bankruptcy law must aim to do.

In other words, the BLRC Report expressly highlighted that a legislature should refrain from making *a carte blanche* assumption that the financial strain in a CD is *ipso facto* by virtue of mismanagement/ fraudulent management of the CD by its erstwhile management.

In line with the observations in the BLRC Report, the scheme of the IBC in its original iteration enacted on May 28, 2016, did not disqualify the erstwhile promoters of the CD from submitting resolution plans for the CD. However, while none of the *travaux préparatoires* highlighted any immediate trigger for the same, the legislature subsequently felt the need to prohibit certain categories of persons from participating in the corporate insolvency resolution process (CIRP) of the CD. Accordingly, the Hon'ble President of India promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 (Ordinance) which introduced section 29A into the scheme of the IBC. As per the objects and reasons of the Ordinance, one of the key objectives for promulgation of the Ordinance was the necessity '*to provide for the prohibition of certain persons from submitting a resolution plan who, on account of their antecedents, may adversely impact the credibility of the processes under the Code*'.[89]

Subsequently, the Ordinance was replaced by the Insolvency and Bankruptcy Code (Amendment) Act, 2017 (Amendment Act). The object sought to be accomplished for the disqualification of erstwhile promoters was to prohibit persons who, with their misconduct contributed to defaults of the CD or are otherwise undesirable to submit a resolution plan. This is evidenced from para 2 of the Statement of Objects and Reasons to the Amendment Act, reproduced as under:[90]

> Concerns have been raised that persons who, with their misconduct contributed to defaults of companies or are otherwise undesirable, may misuse this situation due to lack of prohibition or restrictions to participate in the resolution or liquidation process, and gain or regain control of the corporate debtor. This may undermine the processes laid down in the Code as the unscrupulous person would be seen to be rewarded at the expense of creditors. In addition, in order to check that the undesirable persons who may have submitted their resolution plans in the absence of such a provision, responsibility is also being entrusted on the committee of creditors to give a reasonable period to repay overdue amounts and become eligible.

In other words, one of the primary objects of introducing section 29A into IBC was to prohibit persons who contributed to the default of the CD or are otherwise undesirable to regain control of the company at a discount in the insolvency resolution process of such company.

It is relevant to note that when the Insolvency and Bankruptcy Code (Amendment) Bill, 2017 (Amendment Bill), was tabled before the lower house of the Parliament, for enacting the Amendment Act, the then Hon'ble Finance Minister espoused the necessity to prohibit certain persons from submitting a resolution plan for CDs under IBC. Particularly with regards to section 29A(c) of the IBC, he submitted to the Parliament that *dehors* section 29A(c) of the IBC, persons who are in management and control of the CD and on whose account the CD has been rendered insolvent will have an opportunity to get the same enterprise back at a discounted value without discharging the payment obligations of the CD. He submitted that enabling errant promoters to acquire the CD at a discounted value is not the object of IBC.[91]

However, when the Amendment Bill was tabled before the Parliament, the members of the Parliament raised several reservations regarding the Amendment Bill, particularly around section 29A(c) of the IBC which is based on a default-based liability, and which may arise out of honest business decisions by the promoters and management of the CD. The primary concerns raised by the members of the Parliament in relation to section 29A(c) of the IBC are as under:

(a) Firstly, several members of the Parliament raised a concern that companies may suffer financial crises for many reasons such as downturn in the market, change in the overall economic scenario, strikes, labour problems, change in government policies etc.[92] In fact, the affairs of a company may turn non-performing on account of factors outside the control of the erstwhile management of the CD. Accordingly, making the erstwhile management of the CD ipso facto responsible for the financial crises of the CD and disqualifying such person to submit a resolution plan would be unfair and unjust;

(b) Secondly, it was submitted that section 29A(c) read with section 29A(j) of the IBC makes the net of connected persons extremely wide. Having such a broad category of persons disqualified from submitting a resolution plan would hamper the competitive bidding process for the company.[93] This increases the possibility of liquidation of the company which is against the very spirit of IBC. It was further argued that while there may be suitors for 'large insolvent firms which have been referred to bankruptcy courts', there would be no takers left to submit resolution plans for smaller firms, especially in light of the wide net of ineligibility cast under section 29A of the IBC;[94] and

(c) Thirdly, it was submitted that the grace period of one year given to the erstwhile promoters to regularise their defaults is too short a period. Many industry segments run in business cycles and if a company has a downturn at a low point in its business cycle, it may take more than a year (generally two to three years) for the business cycle to turn around.[95]

Notwithstanding the aforementioned reservations, the Amendment Bill was passed in the Lok Sabha on December 29, 2017. Subsequently it was passed in the Rajya Sabha on January 2, 2018 and finally received presidential assent on January 18, 2018.

Judicial interpretation post addition of section 29A to the IBC

Following the introduction of section 29A of the IBC, the ineligibility under section 29A(c) to submit a resolution plan on account of default to repay the debt was challenged before the Hon'ble Supreme Court of India in the matter of *Swiss Ribbons Private Limited and Another v. Union of India and Others*[96] (Swiss Ribbons). In Swiss Ribbons, while upholding the constitutional validity of section 29A(c) of the IBC, the Hon'ble Supreme Court held that the rationale of section 29A(c) is that a person who is unable to repay a loan taken, in whole or in part, within this period of one year and three months (which, in any case, is after an earlier period where the CD and its financial creditors sit together to resolve defaults that continue), shall be rendered ineligible to become a resolution applicant. The Hon'ble Supreme Court held that such a legislative policy which holds that 'a person who is unable to service its own debt beyond the grace period referred to above, is unfit to be eligible to become a resolution applicant' cannot be found fault with. The Supreme Court went on to hold as under:

> The saying of Jesus comes to mind – if the blind lead the blind, both shall fall into the ditch. The legislative policy, therefore, is that a person who is unable to service its own debt beyond the grace period referred to above, is unfit to be eligible to become a resolution applicant. This policy cannot be found fault with.

In addition to the above, the Hon'ble Supreme Court in the matter of *ArcelorMittal India Private Limited v. Satish Kumar Gupta and Others*[97] (Arcelor Mittal) interpreted the terms 'control' and 'promoter' in a wide ambit, thereby further broadening the already expansive latitude of section 29A(c) of the IBC. In Arcelor Mittal the Hon'ble Supreme Court observed that section 29A is a 'see through provision' which requires piercing the corporate veil and examination of the person who is actually in 'control' of the CD while evaluating a person's ineligibility to submit a resolution plan under IBC.[98] Finally, while analysing the scope and ambit of section 29A(c) of the IBC, the Hon'ble Supreme Court went on to hold that while identifying the persons who are promoters/in management/control of the CD for the purposes of section 29A(c) of the IBC', 'the corporate veil of the CD is not only pierced but is torn to tatters'.[99]

In addition to the above, the reach of section 29A of the IBC was extended legislatively as well, far beyond insolvency resolution processes of CDs. This aspect is analysed below.

Applicability of section 29A of the IBC to other processes

The interpretation of section 29A provided by the Hon'ble Supreme Court in *Swiss Ribbons* and *Arcelor Mittal*, supported the notion that persons who are in management of companies which have committed default on loan repayment and guarantee obligations should not be allowed to actively participate in the resolution process under IBC. Further, the credence provided by the Hon'ble Supreme Court to the legislative intent behind addition of section 29A of the IBC, had prompted the Reserve Bank of India (RBI) and the Insolvency and Bankruptcy Board of India (IBBI) to apply disqualification under section 29A of the IBC to even out of court workouts, loan transfers, liquidation, pre-packaged insolvency resolution process. At present, section 29A of the IBC is applicable to the following restructuring processes:

(a) **Out of court restructuring:** At present, the 'Prudential Framework for Resolution of Stressed Assets dated June 7, 2019 (Prudential Framework) issued by the RBI regulates the contractual out of court workout between the company and its creditors. The Prudential Framework does not permit for automatic upgradation of account as 'standard' without compliance with section 29A i.e., change of control and management of the CD unless 10% of the total outstanding debt is repaid post restructuring;[100]

(b) **Transfer of loan exposures:** The RBI (Transfer of Loan Exposures) Directions, 2021 (Transfer of Loan Exposure Directions), does not allow transfer of loan exposures by banks and financial institutions to erstwhile promoters of the CD disqualified under section 29A of the IBC.[101]

(c) **Liquidation:** Under IBC, the Liquidator is not allowed to sell the immovable and movable property or actionable claims of the CD in liquidation to any person who is not eligible to be a resolution applicant.[102] In other words, if a CD is subjected to liquidation under the IBC,[103] then the persons who are disqualified under section 29A of the IBC are also disqualified to acquire the assets of the said CD in such liquidation process. Further, the erstwhile promoters of the CD are disqualified from participating in any scheme of compromise or arrangement proposed under section 230 of the Companies Act, 2013 during the liquidation of the CD.[104]

(d) **Pre-pack:** Section 54A(2)(b) of the IBC stipulates that only a CD which is eligible to submit a resolution plan in terms of section 29A of the IBC is eligible to undergo a pre-packaged insolvency resolution process (pre-pack).

BLANKET EXCLUSION OF ERSTWHILE PROMOTERS – CONSEQUENCES

Impact on rescue financing at early stage of stress

The success of any debt restructuring is highly conditioned on the availability of credit which can be used to ensure survival of the CD during the insolvency resolution process (rescue finance).[105] In the absence of means to avail the rescue finance, an ailing CD runs the risk of being liquidated.[106] A liquidation of the company may result in the destruction of the going concern value of its business which has detrimental consequences for creditors as well as purchasers that benefit from the continuing existence of the distressed business.[107] Being cognizant of such risk, the 'UNCITRAL Legislative Guide on Insolvency Law' stipulates that during the insolvency resolution process, the CD must have access to funds which can enable it to meet the costs associated with maintaining the value of assets.[108]

Typically, at the early stages of stress, a company has a better potential for turnaround due to better value of its assets. However, obtaining funds for the CD at the early stage of stress (during the informal process) becomes problematic.[109] This is because, even though there may be some provision under the formal rescue law for some type of 'super priority' for a debtor's ongoing funding, that law normally does not extend to such an arrangement under the informal process.[110] However, at the informal stage of insolvency, one of the means by which the CD may obtain liquidity is through the extension of loans by the shareholders (or their family members or friends) to the debtor.[111]

In this context, it may be noted that the average shareholding of promoters in the Indian companies have been fairly stable at around 50%, since 2001.[112] Due to high concentration of equity ownership of promoters in the corporate governance structures in India, they may be well placed to provide financing/support to resolve financial distress in the company. However, given the applicability of section 29A to both formal (i.e., IBC) as well informal resolution process (i.e., June 7 restructurings) there is always high certainty that if the informal restructuring process fails then the promoters ultimately lose their control from management of the CD. Due to this risk, the promoters are often reluctant to fund at the informal stage of resolution of the CD which in turn leads to rise in initiation of CIRP against companies and increase the risk of liquidation.

Impact on entrepreneurship and decision-making process

Entrepreneurship involves innovation and risk-taking which are widely viewed as critical components for success of any economy.[113] Studies show that in high power distance countries (includes India),[114] it may be wise to enhance risk-taking propensity/ attitudes in order to foster engagement of people in innovative and entrepreneurial activities.[115]

Entrepreneurial activity can increase if the law and policy related to insolvency provide partial insurance or otherwise reduce the costs of failure.[116] However, excessive strong creditor rights in any insolvency regime can destroy companies' incentives to undertake value-enhancing but risky projects and may induce firms to do value-reducing diversifying acquisitions.[117] Further, to cope up with high creditor rights and risk of losing control over the company, the promoters may choose unprofitable diversifying investments that reduce the probability of distress.[118] Additionally, companies may be tempted to hoard high-recovery fixed assets which in spite of their low profitability would be easily converted into cash and deter bankruptcy application in situations of financial distress.[119]

In light of the above, it may be noted that one of the key objectives of the IBC is to promoter entrepreneurship.[120] However, due to risk of losing control on account of various ineligibilities created under section 29A of the IBC, the promoters may become sceptical to take risk and make investments in innovation, which is turn is affects the economic growth of the country. In this regard, it is pertinent to note that research and development (R&D) expenditures in India stood at 0.68% of the gross domestic product (GDP) between 2014 and 2018, compared with, for example, over 2% for both China and Singapore, and over 3% for Japan and Israel.[121] Authors have argued that one possible explanation of less R&D expenditure in India in relation to its GDP is the low participation of industries and corporates in the research and development activities.[122]

Impact on cooperation by promoters

It is unsurprising that out of all the stakeholders of the CD, one of the critical stakeholders whose cooperation is necessary for a successful resolution of CD is the erstwhile promoters. This is mainly on account of the fact that the promoters who have been in management and control over the affairs of a CD are more likely to possess the specific sectoral and micro level skills/knowledge required for managing the affairs of a concern the concerned CD in stress. However, given the disqualifications imposed on the CD read with inherent assumption made by the legislature *vis-à-vis* the culpability of promoters, it is unsurprising that the erstwhile promoters are disinclined to support the RPs/ members of the committee of creditors (CoC) in resolving the CD.

Admittedly, the IBC mandates cooperation from erstwhile management of the CD.[123] If the promoters fail to provide such cooperation then the RP has the right to approach the jurisdictional Adjudicating Authority (AA) for necessary directions.[124] Additionally, IBC[125] stipulates that if an officer of the CD fails to extend the requisite cooperation to the CD, such officer shall be punishable with imprisonment for a term between three to five years, or with fine ranging between ₹ 1 lakh to ₹ 1 crore.

However, notwithstanding these legal protections, there are practical challenges which makes the penal consequences[126] a weak deterrent against cooperating with the RP. Since, laws and formal rules are 'obligations backed by incentives', when obligations and incentives are combined, cooperation is strongly reinforced. The joint effect of incentives and obligations on contributions is significantly more positive than the impact of obligations alone.[127] Further, the level of 'cooperation' a person may extend is subjective and it cannot be judicially determined whether a promoter is extending necessary cooperation to fullest of his ability. Furthermore, extending cooperation by an individual is an exercise involving 'personal skill and knowledge'. As has been rightly acknowledged in the context of 'specific performance' under the Specific Reliefs Act, 1963, the courts cannot meaningfully direct a person to specifically perform an obligation which involves 'personal skill and knowledge'.

While it cannot be denied that in recent times the legislature has recognised that the resolution of the CD can be maximized if the erstwhile promoters get to actively participate in resolution process and have allowed them to make settlement offers under section 12A of the IBC, however, on account of continued restrictions under section 29A of the IBC, the erstwhile promoters find themselves in an ambivalent scenario, where while the IBC allows them to make settlement proposal and withdraw a company from IBC (i.e. 12A of the IBC) and at the same time also makes sure that they become incapacitated to submit the resolution plans for the CD both at insolvency as well as the pre-insolvency stage (i.e. restrictions under the Prudential Framework, Transfer of Loan Exposure Directions, section 29A of the IBC, pre-pack).

In view of the above, it is trite to mention that it has been regularly noticed that eliciting the cooperation of promoters has been one of the most difficult challenges for a RP while conducting a CIRP. The inevitable consequence of the lack of cooperation by promoters results in an information asymmetry which cannot be bridged by RP/CoC and impacts value maximization for creditors.

Value maximization and concerns over concentration

A number of US commentators have argued that the primary function of insolvency law is to maximize the collective return to creditors.[128] In fact, the IBC's key objective is to maximize the value of CD for the benefit of all the stakeholders. Driven by the objective of value maximization, matured jurisdictions such as the UK and USA have allowed promoters and their connected parties to submit a resolution plan for the company without any default-based ineligibility as provided under section 29A of the IBC (i.e., classification of account as NPA and default on guarantee obligations). Further, in these jurisdictions the promoters often get the benefit of discharge of debt and can start operations of the company without burden of past liabilities.

However, under the Indian insolvency regime, the restrictions imposed on the promoters and their connected person under section 29A and the judicial precedents surrounding the same have narrowed the pool of resolution applicants who are qualified to submit resolution plans for the CD. Narrower pool of resolution applicants is likely to translate to lower competitiveness in the resolution process of the CD and consequently lower resolution amount proposed under resolution plans for the CD. In fact, an argument can be made that several instances, especially in wherein promoters, despite their bona fide efforts, were unable to avert the CD's financial stress on account of factors beyond their control, the erstwhile promoters and their related parties would fight the hardest and offer the highest resolution amount to acquire a CD under the terms of a resolution plan.[129]

It is relevant to note that, as per the statistics published by the RBI in its Report on Trend and Progress of Banking in India,[130] in the year 2021-22, banks and financial institutions resolved NPAs aggregating to an amount of approximately ₹ 1,99,250 crore under the aegis of IBC whereby such banks and financial institutions recovered approximately ₹ 47,421 crore. In other words, on an average, the banks and financial institutions recovered approximately 23.8% of the amounts due and payable to them and took a haircut of more than 75% of their exposure in the CD under the scheme of the IBC. It is relevant to note that while IBC proved to be the most successful legal framework for the resolution of NPAs, its performance has only been marginally better than the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), which resolved NPAs aggregating to a sum of ₹ 1,21,642 crore whereby the concerned banks and financial institutions recovered an amount of ₹ 27,349 crore (i.e. 22.5% of their exposure). While there is no empirical evidence to demonstrate whether allowing erstwhile promoters to submit resolution plans would increase or reduce the recoveries by the lenders, there is an argument to be made that such recoveries could potentially be higher in case the erstwhile promoters are allowed to participate in the CIRP of the CD, for the reasons elucidated in the foregoing paragraphs.

DEFAULT BASED INELIGIBILITY UNDER SECTION 29A OF THE IBC – HAMMER IN PLACE OF SCALPEL?

At the outset, whether an economic legislation like the IBC should concern itself with moral considerations itself is a fundamental issue which requires some examination. While such examination is not the focus of this research paper, it is worthwhile to mention that several scholars on the subject have argued that 'Insolvency law is supposed to be an empty vessel according to the normative theory where all the economic and social goals are the problem of other laws'.[131] Accordingly, an argument can be made that under IBC, which has always styled itself as an 'economic legislation'[132] a resolution applicant who offers a resolution plan which inter-alia : (a) resolves the stress of the CD and maximises value to the stakeholders of the CD to the highest extent *vis-à-vis* the other resolution applicants; and (b) demonstrates that the resolution plan submitted by him is more feasible, viable and efficaciously implementable than the competing resolution plans, then the CoC, in its commercial wisdom should have the right to approve such a resolution plan for the CD notwithstanding the antecedents of the resolution applicant.

Admittedly, the Hon'ble Supreme Court in the matter of *Navtej Singh Johar and Others v. Union of India*[133] differentiated between 'social morality' and 'constitutional morality', the scheme of the constitution itself acknowledges the need to restrict a person's fundamental right to carry on trade, business and commerce *inter-alia* on considerations of public order, decency or morality.[134] Accordingly, it is not uncommon for economic legislations to stipulate provisions motivated heavily by moral considerations as opposed to mere economic considerations. For instance, section 23 of the Indian Contract Act, 1872, states that the consideration or object of an agreement is lawful, unless it is forbidden by law; or is of such a nature that, if permitted, it would defeat the provisions of any law; or is fraudulent; or involves or implies injury to the person or property of another, 'or the court regards it as immoral, or opposed to public policy'.[135] In light of this, the authors assume for the purposes of this paper that there is merit in economic legislations such as IBC for taking into account moral considerations.

In view of the above, the authors do find merit in disqualifying certain persons from submitting a resolution plan. For instance, there is a good reason to disqualify a promoter who has been classified as a wilful defaulter for having siphoned off monies borrowed from the banks or failed to discharge its payment obligations despite having the ability to do so, from submitting a resolution plan. Similarly, there are good reasons to disqualify persons who are serving imprisonment for having committed a crime or are disqualified from accessing securities markets from submitting a resolution plan.

However, with respect to default-based ineligibility under IBC, as was rightly mentioned in the Parliament during the debates on the Amendment Act, it needs to be borne in mind that 'there are good apples and then there are bad apples'[136] and the law is required to distinguish the same. Further, in the matter of *Venkatesan Sankaranarayanan, the Resolution Professional for RTIL Limited v. Nitin Shambhukumar Kasliwal & Others*,[137] in the context of section 66 of the IBC, the National Company Law Tribunal (NCLT) Mumbai expressly recognised the difference between 'fraudulent intent' and a 'bad commercial decision' and eschewed from penalising erstwhile promoters for 'bad commercial decisions' taken by them while running the affairs of the company. It is curious that while the scheme of the IBC itself recognises the need to avoid penalising promoters who have undertaken bad commercial decisions in the context of section 66 of the IBC, the same legislation ignores this approach in the context of section 29A(c) and section 29A(h) of the IBC.

However, the authors submit default-based ineligibility as prescribed under section 29A(c) and section 29A(h), makes no distinction whatsoever between a promoter who was in management of a CD at the time of a downward business cycle and a promoter who actively siphoned off monies from the CD leading to its financial stress. The statement of objects and reasons of the Amendment Act and the blanket ban on all the promoters who failed to regularise the defaults of their respective companies from participating in the CIRP of the CD demonstrates that the scheme of the IBC has made a presumption that the erstwhile promoters of the CD are *ipso facto* responsible for such state of affairs of the CD on account of their mismanagement/fraudulent management. The authors submit that by way of such presumption, the IBC appears to have subscribed to the same stereotype which the BLRC Report warned against.

In view of the above, the authors submit that while the underlying object of the Amendment Act is appreciable, it appears to have become a little too far reaching by virtue of default-based ineligibilities under section 29A(c) and section 29A(h) of the IBC. The authors submit that there is definitely a discernible logic to the idea of weeding out certain persons 'who, with their misconduct contributed to defaults of the CD or are otherwise undesirable to submit a resolution plan' from participating in the insolvency resolution process of a CD. However, rather than delicately excluding such persons who are genuinely undesirable to submit resolution plans for the CD on account of their past antecedents, the IBC has taken the approach of blanketly disqualifying all the erstwhile promoters of the CD by way of a presumption elucidated hereinabove. The authors see this as a classic example of using a hammer to do a scalpel's job.

WAY FORWARD

In developed jurisdiction the perception behind insolvency of a company has shifted from a moral failure to an economic failure. Today, it is recognised that despite bona-fide business decisions and viable risks taken by the promoters and management, the company may still suffer losses due to various extraneous factors such as change in technology, increase in competition, and change in economic policy of the government. To incentivize entrepreneurship various jurisdiction have adopted legal frameworks to support entrepreneurs and given them second chance to revive the operations of their companies. Further there is evidence that these entrepreneurs can use their experience and lessons from failures to grow their businesses at a faster pace in terms of turnover and jobs.[138] Considering this aspect, the authors submit that giving second chance to promoters who had not been involved in any fraudulent conduct of the insolvent company will increase entrepreneurship and improve resolution of distressed companies. To this end, it is proposed that default-based ineligibilities must be removed from the IBC. The authors argue that the mischief sought to be cured by way of section 29A(c) and section 29A(h) of the IBC was to disqualify persons who contributed to the defaults of the CD from participating in the resolution process of the CD. The authors argue that this mischief can be addressed by making suitable revisions to the extant provisions of law even *de hors* section 29A of the IBC:

Making a distinction between incorrect and fraudulent business decisions

The foregoing paragraphs of the paper demonstrate that the scheme of the IBC, particularly in sections 29A(c) and 29A(h) of the IBC adopt a principle of 'strict liability' based on default. In other words, if the CD has been classified as an NPA or if a company has failed to discharge its obligations towards the guarantee, then notwithstanding the intention or bona fides, such person/persons who are in management and control of such persons are rendered ineligible to submit a resolution plan in terms of section 29A.

At the outset, the authors submit that as has been rightly observed in the BLRC Report, a growing economy crucially depends on firms/entrepreneurs taking certain commercial risks in their business. If defaults on account of such honest business decisions are equated with and penalised at par with the conduct of fraudulent promoters, this will prejudicially hamper risk taking by firms/ entrepreneurs. It is trite to mention that this is an undesirable outcome, as risk taking by firms is the wellspring of economic growth. Accordingly, the authors submit that the IBC, along lines similar to the insolvency regime in the USA and UK, should only penalise erstwhile promoters who have indulged in fraud and allow honest promoters to redeem themselves by submitting resolution plan for CD. Accordingly, the authors submit that default based strict liability (as imposed under section 29A(c) and 29A(j) of the IBC), in terms of which a promoter by virtue of default by company is disqualified to submit a resolution plan without any inquiry into the intention/bona fides of the promoter should be done away with under the scheme of the IBC.

Admittedly, in this context, an argument may be made that it is impracticable to 'separate the wheat from the chaff' i.e., to make a distinction between promoters who have been conducting their businesses in a bona fide manner; and promoters who have conducted the business of the CD in a fraudulent manner. However, the authors submit that even if section 29A(c) and 29A(h) are repealed from the scheme of the IBC, the mischief sought to be cured by way of these amendments are in any event getting addressed by the extent provisions of the IBC.

As regards, section 29A(b) of the IBC, it is noteworthy that in the event any person/entity deliberately and in a mala fide manner fails to discharge any of its payment obligations (including under a contract of guarantee[139]), then such person and the persons who are in management and control of such person would be classified as 'wilful defaulters' in terms of the RBI's 'Master Circular on Wilful Defaulters' dated July 1, 2015. *A fortiori,* such person would be disqualified would be disqualified to submit a resolution plan in terms of section 29A(b) of the IBC. Accordingly, even if section 29A(h) is repealed from the scheme of the IBC, any person who has deliberately and in a *mala fide* manner failed to discharge its payment obligations (including under the terms of a guarantee) or has been in management/control of such borrower *ipso facto* stands disqualified under section 29A(b) of the IBC.

Similarly, as regards section 29(c) of the IBC, it is relevant to note that under the out of court restructuring process, the borrowers who have committed frauds/ malfeasance/ wilful default are ineligible for restructuring, unless the existing promoters are replaced by new promoters, and the borrower company is completely delinked from such erstwhile promoters/management.[140] Further, under the formal insolvency resolution process, regulation 35A of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) already stipulates that an RP is required to examine if the CD and the persons who are engaged in managing the affairs of the CD are engaged in fraudulent transactions under section 66 of the IBC and file an application before the AA within a period of 135 days of commencement of insolvency praying for appropriate directions.[141] If the AA holds that the erstwhile management of the CD has entered into fraudulent transactions, then not only will such erstwhile management be liable to incur the consequences set out in sections 66 and 67 of the IBC but also stand disqualified to submit a resolution plan in terms of section 29A(g) of the IBC. In other words, section 29A(g) of the IBC already ensures that a person who has acted with malfeasance by entering into an avoidance transaction and contributed to the financial strain of the CD is excluded from submitting a resolution plan for the CD. This approach is somewhat similar to the legal position in the UK where directors who are disqualified by the court for committing bankruptcy frauds and are prohibited from holding directorship in companies for upto a period of 15 years.

In view of the foregoing paragraphs, the authors recommend the repeal of sections 29A(c) and 29A(j) of the IBC. However, in order to strengthen the rigour of section 29A(g) of the IBC, suitable amendments may be introduced into the scheme of the IBC and CIRP Regulations which stipulates that the timelines required to be followed by the RP under regulation 35A of the CIRP Regulations for examining whether the CD has entered into avoidance transactions are mandatory in nature and not directory and are required to be complied with. This will ensure that the AA expeditiously makes a determination on whether the erstwhile management of the CD indeed managed the affairs of the CD with malfeasance and hence deserve to be disqualified to submit a resolution plan in terms of section 29A(g) of the IBC.

While the authors recommend the repeal of sections 29A(c) and 29A(h) of IBC, it is submitted that in case the aforementioned provisions are retained in the scheme of the IBC, they should atleast undergo the following modifications:

(a) Increasing the grace period from one year to three years

As has also been suggested in the Insolvency Law Committee Report,[142] the legislature should consider increasing the grace period for regularising the defaults of a CD whose account has been declared an NPA, from one year to three years. This will provide sufficient opportunity for genuine promoters to regularise the defaults of the CD. This will ensure that erstwhile promoters who are legitimately instilling the necessary efforts to resolve the stress in the CD are not tarred with the same brush as errant promoters who have conducted the business of the CD fraudulently.

(b) Removal of default-based disqualification under section 29A of the IBC from liquidation

The authors argue that section 29A(c) and 29A(h) of the IBC should not be made applicable at least at the stage of liquidation of the CD. It is relevant to note that the IBBI issued a discussion paper dated November 3, 2022 recommending the insertion of a clarification into the scheme of IBC which makes the provisions of section 29A applicable even to schemes of compromises and arrangement under section 230 of the Companies Act, 2013 during liquidation. Under the scheme of the IBC, liquidation is a matter of last resort for a distressed company's revival and accordingly, it has been argued that no/minimal restrictions should be imposed at this stage.[143] Accordingly, for the reasons mentioned in this paper, there is merit in excluding persons who have engaged in fraudulent/mala fide conduct from participating even in the stage of liquidation of the CDs. However, in the interest of maximisation of value and considering that liquidation is the last possible opportunity to ensure such value maximisation, the authors submit that genuine promoters should be given an opportunity to participate in the liquidation process.

[1] Hanan N. (2017), "Cross Border Insolvency: Enactment and interpretation of UNCITRAL Model law", Springer, p. 5.

[2] World Bank (2021), Principles for Effective Insolvency and Creditor/ Debtor Regimes, p. 1.

[3] Pomerleano M. and Shaw W. (2005), "Corporate Restructuring: Lesson from Experience", World Bank, p. 38.

[4] *Ibid.*

[5] McGowan M. and Andrews D. (2016), "Insolvency Regimes and Productivity Growth: A Framework for Analysis", OECD Working Paper no. 1309, p. 14.

[6] UNCITRAL Legislative Guide on Insolvency Law, 2005, p. 20.

[7] Supra Note 5, p. 14.

[8] *Ibid.*, p. 16.

[9] Ayottee K. and Yun H. (2005), "Matching Bankruptcy Laws to Legal Environment", The Journal of Law, Economics, and Organization, Vol.25, p. 17.

[10] Gilson S. and Vetsuypens M. (1994), "Creditor Control in Financially Distressed Firms: Empirical Evidence", Wash. U. L. Q., Vol. 72, p. 1005, 1008.

[11] Hart O. (1995), "Firms, Contracts, and Financial Structure", *Oxford University Press*, p. 172

[12] *Ibid.*

[13] Supra Note 5, p. 17.

[14] Acharya V. and Subramanian K. (2009), "Bankruptcy Codes and Innovation", The Review of Financial Studies, Vol. 22, p. 4949.

[15] Supra Note 9, p. 17.

[16] Aghion P. et. al. (1995), "Improving Bankruptcy Procedure", Washington University Quarterly 849, Vol. 72, p. 854.

[17] Supra Note 9, p. 17.

[18] Section 29A, IBC.

[19] The term 'connected person' used under section 29A(j) of the IBC means the following persons: (a) any person who is the promoter or in the management or control of the resolution applicant; or (b) any person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; or (c) the holding company, subsidiary company, associate company or related party of a person referred to in clauses (a) and (c). Provided that the ineligibility under point (c) is not applicable to a financial entity which includes any investment vehicle, registered foreign institutional investor, registered foreign portfolio investor or a foreign venture capital investor, where the terms shall have the meaning assigned to them in regulation 2 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 made under the Foreign Exchange Management Act, 1999 (42 of 1999).

[20] Sections 54A and 54P, IBC.

[21] Regulations 2B, 37A, 37(8), IBBI (Liquidation Process) Regulations, 2016.

[22] Reserve Bank of India, (Transfer of Loan Exposure) Directions, 2021, para 9(I).

[23] Reserve Bank of India, Prudential Framework for Resolution of Stressed Assets, para 34.

[24] Sahoo M. and Guru A. (2020), "Indian Insolvency Law", 45 Vikalpa - Journal of Decision Makers 1, p. 5.

[25] Insolvency and Bankruptcy Board of India, Discussion Paper on changes in the corporate insolvency resolution process to reduce delays and improve the resolution value, at 1, June 27, 2022.

[26] Insolvency and Bankruptcy Board of India and International Finance Corporation, Understanding the IBC- Key Jurisprudence and Practical Considerations, 53 (2019) ["Moreover, the loyalty of the workforce may remain with the promoters or former management team. Employees may have been working with them for a considerable time and may feel both confused and threatened by the change in circumstances. The employees are informed that an IP is now in charge of the business, but they may also hear that in a matter of months, the promoter may return to the boardroom. This can cause a clash of loyalties and an atmosphere of disquiet. It is amid this atmosphere that the IP will have to seek information, documentation, and cooperation from the management and employees and run the CD as a going concern."]

[27] U.S. Const. art. I, § 8.

[28] Congressional Research Service (2012), "Bankruptcy Basics: A Primer", pp. 1-5.

[29]Federal Rules of Bankruptcy Procedure (U.S. Government Publishing Office Washington: 2018).

[30] Official Commissioner of Unsecured Creditors of Cybergenics Corporation v. Chinery (Re Cybergenics Corporation) 330 F3d 548, 573 (3rd Cir. 2003).

[31] 11 U.S.C §1106, 1107.

[32] The term 'Debtor' under Chapter 11 of the US Code includes both the individuals as well as companies. See, 11 U.S.C §101 (13) ["The term "debtor" means person or municipality concerning which a case under this title has been commenced.] and 11 U.S.C §101(41) ["The term "person" includes individual, partnership, and corporation, but does not include governmental unit, except that a governmental unit that— (A) acquires an asset from a person— (i) as a result of the operation of a loan guarantee agreement; or (ii) as receiver or liquidating agent of a person; (B) is a guarantor of a pension benefit payable by or on behalf of the debtor or an affiliate of the debtor; or (C) is the legal or beneficial owner of an asset of— (i) an employee pension benefit plan that is a governmental plan, as defined in section 414(d) of the Internal Revenue Code of 1986; or (ii) an eligible deferred compensation plan, as defined in section 457(b) of the Internal Revenue Code of 1986; shall be considered, for purposes of section 1102 of this title, to be a person with respect to such asset or such benefit."].

[33] 11 U.S.C §1121.

[34] *Ibid*.

[35] 11 U.S.C. § 1121(c)(3); David H. Buchbinder, Basic Bankruptcy Law for Paralegals, 304 (Wolters Kluwer 2017).

[36] See, 11 U.S.C. §1121© ['any party in interest', includes the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee.].

[37] 11 U.S.C. § 1121(c); 11 U.S.C. §307.

[38] 11 U.S.C. § 1104(a)(1).

[39] 11 U.S.C. § 1104(a)(2).

[40] 11 U.S.C. § 1121.

[41] 11 U.S.C. § 1121(c).

[42] Supra Note 35, p. 142.

[43] 11 U.S.C. § 1141.

[44] 11 U.S.C. § 1330; 11 U.S.C. § 1328(e).

[45] 11 U.S.C. § 727(a)(2), (4) (2012).

[46] 11 U.S.C. § 1328(e).

[47] 18 U.S.C. § 152(1).

[48] 18 U.S.C. § 152; Peterson R. (2006), "Criminal Liability for the Bankruptcy Practitioner" at Chapter XVI, p. 309 in Attorney's Liability in Bankruptcy by Corrine Cooper.

[49] 18 U.S.C. §§ 152, 1341, 1519, 3571.

[50] Franks J. et. al. (1996), "A Comparison of US, UK, and German Insolvency Codes", 25 European Corporate Finance, pp. 86-101.

[51] Kelly S. et. al., A Practical Guide to UK Insolvency Proceedings.

[52] UK Insolvency Act, 1986, § 9(1).

[53] *Ibid*.

[54] UK Insolvency Act, 1986, § 13(1).

[55] UK Insolvency Act, 1986, § 14(1).

[56] UK Insolvency Act, 1986, § 14(2).

[57] UK Insolvency Act, 1986, § 14(4).

[58] UK Insolvency Act 1986, § 235.

[59] UK Insolvency Act 1986, § 235(2)(b).

[60] UK Insolvency Act 1986, § 237.

[61] UK Insolvency Act 1986, § 237(1).

[62] UK Insolvency Act 1986, § 236(5).

[63] UK Insolvency Act 1986, § 5.

[64] UK Insolvency Act 1986, § 1(1).

[65] UK Insolvency Act 1986, § 1(2).

[66] Walton P. et. al. (2020), "A snapshot of company voluntary arrangements: Success, failure and proposals for reform", International Insolvency Review, Vol. 29, p. 269.

[67] Dr Kubi (2021), An Overview of Company Voluntary Arrangements in CAMA 2020, 3.

[68] UK Insolvency Act 1986, para 3(2) of Schedule A1.

[69] Supra Note 66, p. 269.
[70] *Ibid*.
[71] Ram Mohan M. and Raj V. (2020), "Pre-packs in the Indian Insolvency Regime", W. P. No. 2020-08-03.
[72] Xie B. (2016), Comparative Insolvency law, Edward Elgar Publishing, p. 73.
[73] *Ibid.*
[74] Supra Note 72, p. 73.
[75] Graham T. (2014), Graham Review Into Pre-Pack Administration, UK.
[76] *Ibid.*, para 9.1, p. 59.
[77] Insolvency Practitioner Association, Statement of Insolvency Practice 16 (Pre-Packaged Sales in Administration).
[78] UK Insolvency Act 1986, § 212.
[79] UK Insolvency Act 1986, § 213.
[80] UK Insolvency Act 1986, § 214.
[81] CDDA 1986, § 10(2).
[82] CDDA 1986, § 3.
[83] CDDA 1986, § 9.
[84] CDDA 1986, § 13.
[85] Report of the Bankruptcy Law Reforms Committee, Volume I: Rationale and Design, 2015.
[86] *Ibid*. para 3.2.3, p. 23.
[87] *Ibid*.
[88] *Ibid.*
[89] Statement of Purpose of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017.
[90] Statement of Objects and Reasons, Insolvency and Bankruptcy Code (Amendment) Act, 2017, para 2.
[91] Lok Sabha Debates (Original Version), 16th Series, Volume XXVII, 13th Session, 2017-18/1939 (Saka) No.9, at pages 98-99, Friday, December 29, 2017/ Pausha 8, 1939 (Saka).
[92] *Ibid.* p. 103.
[93] Supra Note 5, pp. 118-119.
[94] *Ibid.*
[95] Supra Note 5, p. 126.
[96] Writ Petition (Civil) No. 99 of 2018.
[97] Civil Appeal Nos. 9402-9405 of 2018.
[98] Supra Note 97, para 29.
[99] *Ibid.*, para 29.
[100] Supra Note 23, para 24.
[101] Supra Note 22, para 9(m).
[102] Section 35(1)(f), IBC.
[103] Section 33, IBC.
[104] Supra Note 21, Regulation 2B.
[105] Mba S. (2019), "New Financing for Distressed Businesses in the Context of Business Restructuring", Springer, p. 1.
[106] Zhang D. (2020), Rescue of multinational groups of companies 13, Routledge.
[107] Finch V. (2009), Corporate Insolvency Law- Perspective and Insights, *Cambridge Press* 29.
[108] UNCITRAL Legislative Guide on Insolvency Law, para 97, p. 114.
[109] A Tool Kit for Out of Court Workouts, World Bank Group, para 2.11, p. 22.
[110] *Ibid.*
[111] Supra Note 105, p. 42.
[112] OECD (2020), Ownership Structure of Listed Companies in India, p. 5.
[113] XU Peng (2015), "Risk Taking and Firm Growth", RIETI Discussion Paper Series 15-E-061, p. 2
[114] Clearly Cultural, Power Distance Index.
[115] Antoncic J. et. al. (2018), "Risk-Taking Propensity and Entrepreneurship: The Role of Power Distance", 26 Journal of Enterprising Culture 1, p. 20.
[116] Primo D. and Green W. (2011), "Bankruptcy Law and Entrepreneurship", Entrepreneurship Research Journal, Vol. 1 Iss. 2, p. 1.
[117] Acharya V. et. al (2009), "Creditor Rights and Corporate Risk-Taking", Working Paper 15569, p. 42.

[118] *Ibid.*, p. 3.

[119] Kind A. et. al., "The Effect of Creditor Rights on Capital Structure, Investment, Profitability, and Risk: Evidence from a Natural Experiment".

[120] See, preamble to the IBC.

[121] Nath S. et al. (2021), "India's Innovation Ecosystem for Productivity-led Growth: Opportunities and Challenges", Reserve Bank of India Occasional Papers, Vol. 42, No. 2, p. 74.

[122] *Ibid*.

[123] Section 19(1), IBC.

[124] Section 19(2), IBC.

[125] Section 70, IBC.

[126] Sections 19 and 70, IBC.

[127] Galbiati R. and Vertova P. (2014), "How laws affect behavior: Obligations, incentives and cooperative behavior. International Review of Law and Economics", International Review of Law and Economics, pp. 48 -57.

[128] Jackson T. (1986), The Logic and Limits of Bankruptcy Law, Harvard University Press, 1986; and Baird D. (1986), "The Uneasy Case for Corporate Reorganisations", 15 Journal of Legal Studies, p. 127.

[129] In the case of *R. Vijay Kumar v. Kasi Viswanathan* (2019 SCC OnLine NCLAT 227) and *C. Mahendra International Ltd. v. Naren Sheth* (2019 SCC OnLine NCLAT 332), the promoters had offered higher amount then the liquidation value of the corporate debtor, but their offers were rejected due to prohibition under section 29A(c) of the IBC. Ultimately, liquidation order was passed in these cases by the NCLT.

[130] Report on Trend and Progress of Banking in India, Reserve Bank of India, 2020-21.

[131] Brunstad G. et al., "The Three Faces of Bankruptcy Law" 408.

[132] Pardhasaradhi S. et. al (2020), "IBC - A Pathbreaking Economic Legislation: A Diagnostic Study", International Journal of Engineering Development and Research ,Vol. 8 Issue 3, p. 225.

[133] Navtej Singh Johar and Others v. Union of India, AIR 2018 SC 4321.

[134] Article 19(2), The Constitution of India, 1950.

[135] Section 23, The Indian Contract Act, 1872.

[136] Supra Note 5, p. 126.

[137] M.A 05/2019 in the matter of CP No. 382/I&BP/MB/2018.

[138] Ecorys (2014), "Bankruptcy and Second Chance for Honest Bankrupt Entrepreneurs", p. 8.

[139] *Kotak Mahindra Bank Limited and others.* v. *Hindustan National Glass and Ind. Limited and others* (2013) 7SC C 369.

[140] Supra Note 23, para 34.

[141] Regulation 35A(c), CIRP regulations.

[142] The Report of the Insolvency Law Committee, 2018, para 14.8, p. 50.

[143] Ram Mohan M. and Raj V. (2021), "Section 29A of India's Insolvency and Bankruptcy Code: An Instance of Hard Cases Making Bad Law?", IIMA Working Paper, W.P No. 2021-07-01.

19 IBC AND HARD CASES: THE INDIAN INSOLVENCY JURISPRUDENCE FACES CHALLENGES

-L Viswanathan, Animesh Bisht and Karan Sangani

EXECUTIVE SUMMARY

The unique factual environment of each resolution, the balancing of conflicting interests of the stakeholders, and the inherent incongruities arising in the implementation of an economic legislation, have resulted in a number of 'hard cases' under the Insolvency and Bankruptcy Code, 2016 (IBC/Code), where often the applicable rule to the case is uncertain or generates conflicting views. While discussing the jurisprudential debate around hard cases, this paper advocates a principle-based approach to adjudicating hard cases and further evaluates the 'hard cases' under the Code, which, in the authors' view, have digressed from the core principles of the Code.

Keywords: Code, Hard Cases Principle-based Approach, Rainbow Papers case, Vidarbha Industries case, Jaypee Kensington case.

INTRODUCTION

'*Great cases, like hard cases, make bad law*'.

- Justice Oliver Wendell Holmes, Jr.[1]

The Code was enacted with the object of completely overhauling the Indian insolvency landscape, replacing what was otherwise a fragmented and ineffective insolvency framework. The Code enshrines certain core principles necessary for a robust and effective insolvency regime, namely: (a) preservation and maximisation of the value of the assets of the debtor; (b) fair and equitable treatment to all stakeholders; (c) resolution of the debtor in a time-bound manner; (d) promotion of entrepreneurship; (e) availability of credit.[2] These principles form the 'grundnorm' of the Code, permeating and informing the underlying logic of various provisions of the Code.

The Code and the subordinate legislation framed thereunder provide for an extensive legislative/ regulatory framework for the insolvency resolution process. However, the Code has, in its short history, witnessed several nuanced and intricate cases, which have shaped and further evolved the provisions of the Code. While the evolving jurisprudence has served to further flesh out the substantive provisions of the Code, the unique factual environment of each resolution, the balancing of conflicting interests of the stakeholders, and the inherent incongruities that arise in the implementation of economic legislation, have led to the emergence of certain cases, where there is no direct rule applicable to the case at hand or where the rule applicable to the case at hand is uncertain and generates conflicting views. This has resulted in a number of 'hard cases' under the Code, which have required adjudication by the courts.

'Hard cases' generally refer to cases that are deemed to be complex in scope or nature, or cases that are unconventional to a particular legal system.[3] As will be discussed in this paper, legal philosophers and courts have advocated a principle-based approach for deciding hard cases, i.e., placing reliance on the 'principles' that underlie and are embedded in the statutory provisions in order to construe the scheme and the rationale behind the statutory provisions.

This paper aims to identify and evaluate such 'hard cases' in the context of the Code in order to examine if the courts have applied the core principles of the Code while dealing with such cases. This paper also aims to study whether these 'hard cases' have generated inconsistencies in the insolvency jurisprudence. This paper further intends to propose how the inconsistencies generated through the interpretation of these hard cases can be reconciled with the core principles of the Code.

This paper first briefly discusses the legal philosophy around 'hard cases' and judicial discretion. Subsequently, this paper focuses on the approach adopted by Indian courts in the adjudication of hard cases. Thereafter, this paper attempts to identify certain principles that define and form the foundation of the Code. Against the backdrop of these key principles, this paper shall examine certain 'hard cases', which have arisen under the Code and which, in our opinion, have digressed from the fundamental principles of the Code. This paper discusses the findings in and the outcomes of such cases in light of the identified principles or objects of the Code, keeping in view the broader legal philosophy most suited in the Indian context in the adjudication of such 'hard cases'.

JUDICIAL DISCRETION IN HARD CASES

The scope of 'judicial discretion', i.e., the discretion available to judges while deciding cases, has been the subject of interminable debate, eliciting varying and conflicting views and responses from legal scholars. The genesis of the dispute can be traced back to the cardinal question of whether judges 'make' law or merely 'apply' the law.[4] The ambiguity pertaining to the scope of discretion available to judges is further compounded when judges are confronted with 'hard cases'.

What are 'Hard Cases'?

In common parlance, 'hard cases' refer to cases that are deemed to be complex in scope or nature, or cases that are unconventional to a particular legal system.[5] Different scholars have provided varying interpretations to the term 'hard cases'.[6] Professor Ronald Dworkin has defined 'hard cases' as those cases where there is no direct rule applicable to the case at hand or where the rule applicable to the case at hand is uncertain and generates conflicting views.[7] As per Twining and Miers, hard cases are those where the provision of the statute is clear, however, there are reservations about the application of the relevant provision to the case at hand. As per Twining and Miers, 'hard cases' are distinguishable from 'difficult cases', where the relevant provision of the statute is uncertain and ambiguous.[8] Some scholars have also included 'important cases' – cases wherein an immediate overwhelming interest in the case acquires greater significance than the legal aspects of the case – within the ambit of hard cases.[9]

This paper adopts a wide definition of 'hard cases' that includes the nuances set out above and identifies 'hard cases' as: (a) cases which are not covered directly by any statute; (b) cases where the applicable rule generates conflicting outcomes; and (c) important cases, wherein the dispute at hand rather than the question of law assumes larger significance on account of an immediate overwhelming interest.

The legal philosophy on hard cases: Outlining the Hart-Dworkin debate

The scope of judicial discretion in adjudicating hard cases was one of the key elements of the debate between Professor H.L.A Hart and Professor Dworkin – a debate which continues to shape and influence the legal philosophy on the theory of adjudication process.[10] While this debate between Hart and Dworkin encompasses and traverses various aspects of legal philosophy on identification of law and its meaning, this paper intends to briefly discuss the debate on the adjudication of hard cases to lay the foundation for the examination to be followed in this paper.

As per Hart's account of law, the union of 'primary rules' and 'secondary rules' forms the core of the legal system. 'Primary rules' are rules imposing obligations, i.e., requiring people to undertake or abstain from certain acts. Whereas secondary rules refer to rules by which new primary rules can be introduced, repealed, altered, and their contravention can be conclusively ascertained, such as: (a) rules providing for recognition of valid rules of a legal system (rule of recognition); (b) rules enabling legislators to introduce new rules (rules of change); and (c) rules empowering courts to determine the breach of any primary rule (rules of adjudication).[11]

However, Hart clarifies that the legal rules would not, by any means, exhaustively cover every behaviour and uncertainties may emerge in its application to certain forms of behaviour. Hart attributes this outcome to 'open texture of legal rules', as the rules are drafted in general terms and language. As per Hart, while the application of rules would function aptly in ordinary cases, there would be certain cases, where its application would be indeterminate, owing to the open texture of the language of the rule. Hart distinguishes between 'core' and 'penumbra' cases. As per Hart, a general term has a core of settled meaning, with a penumbra of uncertainty attached to it. For instance, it is settled that the general expression of 'vehicle' would include motor cars within its ambit, however, it is uncertain whether the expression would also include bicycles, airplanes, roller skates.[12]

As per Hart's account, the penumbra cases constitute 'hard cases'. Hart notes that such cases are hard, as not only reasonable lawyers disagree regarding the correct answer to such cases, but also the applicable law in such cases is incomplete. Accordingly, as per Hart, the open texture of the legal rules necessarily results in certain spheres of conduct that are left to be further developed by courts. In such instances, the courts in order to adjudicate the case, must undertake a limited 'law-making' function, i.e., exercise 'discretion'.[13] While exercising discretion in hard cases, the judge is required to provide '*the best moral judgment he can on any moral issues he may have to decide*'.[14] However, the judge should not exercise his discretion arbitrarily and should act as a 'conscientious legislator'.[15]

Thus, Hart conceptualises the phenomenon of hard cases from a linguistic perspective on account of the vagueness in and the open texture of legal rules, which invariably result in judges exercising law-making functions as per their own principles and values.

Dworkin has critiqued Hart's theory of adjudication on two major grounds. First, as per Dworkin, Hart's account of system of rules fails to take into account the role of 'principles' in adjudication. Rules operate in an 'all or nothing' manner. If the rule provides for a particular factual matrix, then the answer provided by the rule must be adopted. In case of a conflict between two rules, only one of them can be deemed to be valid.[16] On the other hand, principles are a '*requirement of justice, fairness or some other dimension of morality*.'[17] The principles are identified in terms of their level of compatibility with the institutional history and the support garnered by them within the institution. As opposed to rules, principles have an element of 'importance' or 'weight' attached to it, such that when two principles contradict, the resolution of the conflict can be undertaken by taking into consideration the relative importance or weight of each principle.[18]

Second, Dworkin has rebuked Hart's proposition that judges while exercising discretion when the law is uncertain, undertake law-making functions and make new laws. In this regard, Dworkin differentiates between two types of discretion, namely weak discretion and strong discretion. As per Dworkin, in hard cases, a judge, relying on principles, exercises a weak form of discretion. Whereas Hart's account of discretion reflects a strong form of discretion – wherein the discretion of the judge is unfettered and unbound by any legal principles stemming from the authority of law.[19]

As per Dworkin, a judge is required to reconstruct the underlying principles embedded in the legal rules in order to decide hard cases. Dworkin conceptualises a philosophical judge that draws upon a scheme of abstract and concrete principles and constructs a theory, which best justifies the theory of institutional history of the legal system (constitution, statutes, precedents, etc.) and which provides the best moral justification of it. His role is not limited to opting for between two competing arguments but entails constructing a theory which not only reconciles the past, the present, and the future, but also provides a coherent justification for the legal system as a whole. As per Dworkin, this theory of construction cannot be termed as an act supplementing the legislature but is an answer to what the legislature intends in respect of the particular case at hand. Thus, as per Dworkin, one right answer is possible for every hard case and posits that judges merely apply the law (understood to include principles in hard cases).[20]

In Hart's response to Dworkin's critique, which was published posthumously by way of a postscript to his book 'The Concept of Law', Hart clarifies the position of principles in his account of law.[21] Hart elucidates principles as a '*vast array of theoretical and practical considerations*', which are broad and general in nature, and refer to a desirable object or goal providing the underlying rationale or justification for the rules.[22] While maintaining that a judge exercises limited and interstitial law-making powers in hard cases, Hart clarifies that a judge has to rely on certain principles informing that particular area of law in order to find a determinate answer to the hard case.[23]

While asserting their disagreement on whether a judge 'discovers' or 'invents' law in hard cases, both Hart and Dworkin concur on foregrounding hard cases on principles. The philosophical debate between Hart and Dworkin emphasises the importance of following a principle-based approach in the adjudication of hard cases. It, therefore, provides a compelling justification for reconstruction of law as a principle-based unitary system in hard cases, i.e., undertaking a principle-based approach to decide hard cases. Such an analytical approach helps resolve the jurisprudential uncertainty arising in hard cases by illuminating the scheme and the scope of the embedded principles of the case.

This paper utilises a principle-based approach to examine the outcomes of certain hard cases decided under the Code, which, in our view, are not in harmony with the scheme and the principles of the Code. The discussion above, therefore, would serve as a philosophical underpinning for our discussion on adjudication of hard cases under the Code.

Such a principle-based approach also finds a strong foundation in the Indian jurisprudence on statutory interpretation including the Indian insolvency jurisprudence. As will be evident from below, the courts have regularly relied on the principles and objects of a statute to construe the applicable legal provision, where such applicable legal provision is ambiguous in nature or generates conflicting outcomes.

Preference for principle-based approach in Indian insolvency jurisprudence

The existing jurisprudence pertaining to statutory interpretation clearly reflects a preference for a principle-based approach to statutory interpretation. The courts have rejected a mechanical approach to statutory interpretation without considering the underlying principles.[24] In the words of Justice Krishna Iyer: '*To be literal in meaning is to see the skin and miss the soul. The judicial key to construction is the composite perception of the deha and the dehi of the provision*'.[25]

It has also been settled by the courts that even when the provision of the statute is uncertain or ambiguous, a judge only acts as an interpreter, according meaning to the statutory provision, which is in consonance with the statutory framework and furthers the purpose of the statute. In the words of Justice D.Y. Chandrachud:

> But when the words are capable of bearing two or more constructions, they should be construed in light of the object and purpose of the enactment. The purposive construction of the provision must be "illumined by the goal, though guided by the word."...Before we engage in the exercise of purposive construction, we must caution that a court's power to purposively interpret a statutory text does not imply that a judge can substitute legislative intent with their own individual notions. The alternative construction propounded by the judge must be within the ambit of the statute and should help carry out the purpose and object of the Act in question.[26]

The Supreme Court has further held that in case of uncertainty in the provision of the statute, the courts can rely on '*the historical background, the Parliamentary debates, the aims and objects of the Act including the long title*' in order to provide an interpretation that promotes the purpose of the statute.[27]

In order to avoid the pitfalls of the earlier insolvency regime, which was highly fragmented in nature due to the operation of multiple statutes in respect of the subject-matter, the Code has been envisaged as an exhaustive and complete code in itself, encompassing the entire gamut of laws pertaining to insolvency of corporate entities and others.[28] The report of the Bankruptcy Law Reforms Committee (BLRC Report) had acknowledged that the highly fragmented nature of the erstwhile insolvency framework had resulted in uncertainty in the insolvency jurisprudence including creation of new substantive law by the courts where the statute was silent.[29]

Presently, the courts under the Code, i.e., National Company Law Tribunals (NCLTs) and National Company Law Appellate Tribunals (NCLATs), have been conferred with jurisdiction as provided under the Code and have not been provided with equitable or plenary powers.[30] Further, the courts have also held that the NCLTs/ NCLATs have not been conferred with any power to declare any provision of the Code or the rules and regulations made thereunder as void.[31] The Supreme Court has further held that the residuary powers of the courts under the Code or even the discretionary powers of the Supreme Court under Article 142 of the Indian Constitution should be strictly examined for its conformity to the insolvency framework and its fundamental objectives.[32] Further, in the case of *Ebix Singapore Private Limited v. Committee of Creditors of Educomp Solutions Limited & Another* (Ebix),[33] the Supreme Court has cautioned against judicial creation of substantive or procedural remedies under the Code in the following terms:

> Any judicial creation of a procedural or substantive remedy that is not envisaged by the statute would not only violate the principle of separation of powers, but also run the risk of altering the delicate coordination that is designed by the IBC framework and have grave implications on the outcome of the CIRP, the economy of the country and the lives of the workers and other allied parties who are statutorily bound by the impact of a resolution or liquidation of a Corporate Debtor.

A principle-based approach adopted by the Supreme Court in some of the landmark hard cases has laid down a strong foundation for the Code and has shaped the jurisprudence in furtherance of the stated objectives of the Code. For instance, in *Innoventive Industries Ltd. v. ICICI Bank and Others* (Innoventive) (being the first application moved under the Code),[34] the Supreme Court, while extensively elucidating the scheme and the operation of the Code by referencing the legislative and institutional history, underscored the 'paradigm shift' in law by introducing the creditor-in-possession model under the Code, and categorically held that the entrenched management has no vested right to continue in management upon default. The Supreme Court, while emphasising that 'speed is of essence' for an effective insolvency resolution, held that the NCLT's scope of examination is limited to ascertaining default and once it is established, the NCLT must admit the application, if complete. The judgment in *Innoventive* was a shot in the arm for the nascent Code and brought in significant expeditiousness and clarity in the admission of insolvency proceedings.

The Supreme Court's decision in *Essar Steel India Limited through Authorised Signatory v. Satish Kumar Gupta* (Essar Steel),[35] was another landmark decision, which expounded the principle of equitable treatment under the Code by holding that similarly situated creditors are to be treated equally and unequal creditors cannot be given equal treatment. The Supreme Court, while ruling out the possibility of treating undecided, 'hydra-headed popping up' liabilities after the submission of the resolution plan, emphasised the 'clean slate theory' and preserved the interests of a successful resolution applicant.

In *K. Sashidhar v. Indian Overseas Bank and Others*,[36] the Supreme Court elucidated that the Code envisages providing deference to the commercial wisdom of the creditors in respect of evaluating the resolution of the company and limiting the scope of judicial interference. The clarity provided by this judgment laid to rest several extraneous objections being taken against resolution plans and significantly expedited the process of approval of resolution plan under the Code.

The Supreme Court, in *Swiss Ribbons Private Limited & Another v. Union of India & Others* (Swiss Ribbons),[37] while upholding the constitutional validity of the Code, held that the economic experiment under the Code, which has direct implications on the economy of the nation, should be judged by the generality of its provisions rather than the inequities and crudities produced by it. The Supreme Court also noted that the economic experiment under the Code has been 'largely successful' and has abolished the 'defaulter's paradise'.

In the landmark case of *Ebix*,[38] the Supreme Court constructed a principle-based account of the Code to determine the issues relating to: (a) the nature of the resolution plan; (b) the scope of withdrawal or modification of the resolution plan under the Code after its approval by the committee of creditors (CoC); and (c) the validity of terms under the resolution plan, providing for withdrawal, renegotiation or modification of such plan after its approval by the CoC. The Supreme Court held that while certain actions under the corporate insolvency resolution process (CIRP) bear a resemblance to the stages of formation of a contract, a resolution plan cannot be equated with a traditional contract. As per the Supreme Court, the binding nature of a resolution plan distinguishes it from a contract, as unlike a contract, a resolution plan binds even those stakeholders who have not consented to the plan. The Supreme Court held that the scheme of the Code confers legal validity on the resolution plan approved by the CoC.

With respect to the withdrawal or modification of a resolution plan approved by the CoC under the Code, the Supreme Court held that the absence of any 'exit route' available to a successful resolution applicant under the Code reflects the scheme of the Code to prevent any withdrawal or modification of a resolution plan. The Supreme Court also held that open-ended clauses in a resolution plan, providing for '*further negotiations, modification or withdrawal*' after the approval of a resolution plan by the CoC, cannot be given effect to, as such clauses would result in the plan becoming indeterminate, uncertain and subject to failure at an undefined stage. This would introduce uncertainty in the resolution process and would run contrary to the principles of time-bound and predictable resolution under the Code. However, it is pertinent to note that the Supreme Court has not rejected incorporation of clauses in the resolution plan in the nature of 'commercial conditions' and 'business arrangements' with the CoC, which do not result in the plan becoming indeterminate.

Thus, the Supreme Court in shaping the Indian insolvency jurisprudence has demonstrated a strong preference for a principle-based approach. The objects and principles of the Code have been, by and large, kept paramount and the economic experiment under the Code protected and preserved despite the same resulting in certain inequities and incongruities. To a large extent, the experiment under the Code has been successful and has produced tangible results. The report of the Standing Committee on Finance on 'Implementation of Insolvency and Bankruptcy Code: Pitfalls and Solutions', while observing certain shortcomings in the workings of the Code, has noted that: (a) India's ranking in 'resolving insolvency' has enhanced from 136 in 2017 to 52 in 2020; (b) India's ranking in 'ease of doing business' has jumped to 63 in 2020 from 155 in 2017; (c) the average time taken for resolution has reduced from 4.3 years in 2017 to 1.6 years in 2020; and (d) India's ranking in 'getting credit' has enhanced to 25 in 2020 from 62 in 2017.[39]

The above discussion emphasises the role and influence of courts on the functioning and operation of the insolvency framework. It reinforces that any digression from the espoused principles of the insolvency framework by the courts would severely impair and jeopardise the operation and functioning of the Code.

The adverse influence of the courts, particularly through 'judicial innovations', in delaying the liquidation proceedings under the Companies Act, 1956 and the rescue proceedings under the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), has been documented by Professor Kristin van Zwieten in her thesis 'The demise of corporate insolvency law in India'.[40]

Reformative legislations such as the Recovery of Debts and Bankruptcy Act, 1993 (RDB Act), and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), which were introduced to empower creditors and to provide for expeditious debt recovery and security enforcement mechanisms, have also witnessed certain judicial dilutions to their effectiveness. For instance, the decision of the Supreme Court in *Mardia Chemicals Ltd. v. Union of India and Other*[41] carved out an exception to section 34 of the SARFAESI Act (which provided for a bar on the jurisdiction of civil courts in respect of any matter under the SARFAESI Act) and held that the jurisdiction of civil courts can be invoked in case '*the action of the secured creditor is alleged to be fraudulent or their claim may be so absurd and untenable which may not require any probe*.' This judicial finding diluted the scope of the SARFAESI Act, as it enabled debtors to derail and protract the enforcement proceedings under the SARFAESI Act by approaching civil courts.

Similarly, the decision of the Supreme Court in *KSL & Industries Ltd. v. Arihant Threads Ltd. & Others*[42] held that the SICA would take precedence over the RDB Act even though the RDB Act was a later enactment. This enabled debtors to delay recovery proceedings under the RDB Act by initiating rescue proceedings under the SICA.

The courts have also taken a technical view to hold that a demand notice under section 13(2) of the SARFAESI Act would be deemed to be defective if it does not provide the bifurcation between the principal amount and the interest amount, resulting in the entire process under the SARFAESI Act up to that moment becoming null and void.[43] The courts failed to take into account that such a restrictive interpretation would require the creditor to restart the process of security enforcement from the stage of issuance of notice under section 13(2) of the SARFAESI Act, resulting in inordinate delay and jeopardising the security interest.

Recently, the Bombay High Court has also held that an auction purchaser under the SARFAESI Act would be liable to clear all encumbrances, including statutory charges on account of government dues if the sale is on 'as is where is' basis and if the purchaser had constructive notice of such encumbrance. Such an interpretation has the potential to deter auction sale under the SARFAESI Act, as an auction purchaser can be saddled with liabilities even after the sale has concluded and would be required to clear the liabilities by paying an amount exceeding the auction amount.[44]

While these decisions may provide for plausible statutory interpretations for their conclusions, they appear to *ex facie* take away the foundations of the relevant statutes in meeting their desired objectives. In contrast, some of the landmark decisions under the Code that have been discussed above, have preserved and strengthened the functioning of the Code by giving due importance to the principles and objects of the Code, which not only provided an impetus to the Indian insolvency framework, but also produced tangible benefits for the economy as a whole. In the following chapters, this paper evaluates the underlying principles of the Code against the backdrop of the institutional history of the Code, and examines the outcomes of certain hard cases, which, in our view, have deviated from the core principles of the Code and diluted the efficacy of the Code.

THE UNDERLYING PRINCIPLES OF THE CODE

This chapter aims to briefly analyse the scope and the contours of the fundamental principles of the Code by evaluating the institutional history, existing caselaw, various committee reports, and legislative material on the subject-matter.

Institutional history

In order to contextualise the contours of the underlying principles of the Code, it becomes vital to understand the institutional history (in terms of the earlier insolvency regime) that propelled the need to introduce the Code. The BLRC Report noted that the insolvency resolution process under the erstwhile regime was housed under multiple statutes and the adjudication process was bifurcated in multiple fora. The resultant uncertain and inconsistent jurisprudence resulted in, *inter alia*, protracted proceedings for insolvency resolution, destruction in value of the debtor, and lack of credit availability.[45] The Supreme Court has also noted that while the statutes under the earlier regime had provided for expeditious disposal of cases, the provisions were availed by defaulting borrowers to take advantage of the extended moratorium period and prolong the proceedings, which resulted in lack of recovery of stressed assets.[46] While introducing the bill for the Code in the Rajya Sabha, the then Minister of Finance, Mr. Arun Jaitley had highlighted that under the now repealed SICA, non-performing assets had turned further non-performing on account of the lack of revival of companies and inability of banks to pursue any demand in respect of those companies.[47]

In the light of the shortcomings of the former regime, the BLRC Report had recommended that the new insolvency framework should provide for a unified and comprehensive Code to deal with the insolvency of corporate entities, partnerships, and individuals, with the following key principles informing its design: (a) the Code should enable the assessment of the viability of the debtor at the inception stage, and the power to make such commercial decisions should be vested with the creditors and not the courts; (b) the Code should facilitate symmetry of information between debtors, creditors, and other third parties interested in the resolution process; (c) the Code should provide for resolution in a time-bound manner in order to preserve the value of the debtor; (d) the Code should provide for certainty in the order of priority and should uphold the rights of all stakeholders.[48] The above principles were designed to achieve the objectives of: (a) lowering the time undertaken for resolution; (b) lowering the loss in recovery to creditors; and (c) achieving increased levels of debt financing.[49]

Scope of principles under the Code

Against the backdrop of the above-discussed institutional history, the Code incorporates certain intrinsic principles that permeate and inform the underlying logic of various provisions of the Code. Many of these principles have also been set out in the preamble of the Code. The foundational principles of the Code have been outlined below:

a) **Early identification of stress:** A key principle identified under the BLRC Report was that the code should enable the assessment of the viability of the debtor at the inception stage and that the power to make such commercial decisions should be vested with the creditors and not the courts. Accordingly, the BLRC Report had proposed that a creditor should only provide the record of debt and the evidence of default to trigger insolvency proceedings, which position has been adopted under the Code.[50] This also marked a departure from the 'balance sheet test' or the 'inability to pay' test under the erstwhile regime, where the courts were required to examine the balance sheet of the debtor to assess whether the debtor is unable to pay its debts on account of its assets being less than its liabilities, including prospective and contingent liabilities.[51] The balance sheet test had resulted in uncertainty in the jurisprudence regarding creditors' rights, thereby causing inordinate delays and deterioration in the value of the assets.[52] The BLRC Report had explicitly rejected the balance sheet test.[53] The landmark judgment of *Swiss Ribbons* also notes the change in the legislative scheme from the notion of 'inability to pay debts' to 'determination of default' under the Code.[54]

b) **Creditor in possession:** One of the key 'paradigm shifts' under the Code was the shift from the debtor-in-possession model to the creditor-in-possession model. The BLRC Report had found that the promoters continued to stay in control of the company even after default under the erstwhile framework and had recommended that the control should shift to the creditors on default.[55] The report of the Standing Committee of Finance for 2019-20 notes that the change in the model has resulted in better credit discipline and generated positive behavioural attitudes in both debtors and lenders.[56]

c) **Limited judicial intervention:** The Code provides for a calm period by way of moratorium during the insolvency resolution process, whereby any form of enforcement action by the creditor is prohibited so that the negotiations mediated and managed by a neutral, third party, i.e., the Resolution Professional, can take place between the creditors for the resolution of the debt and the continuation of the debtor as a going concern.[57] The Code envisages providing deference to the commercial wisdom of the creditors in respect of evaluating the resolution of the company and limits the scope of judicial interference.[58] Thus, the Code has been envisioned as a beneficial legislation for the revival and resolution of the corporate debtor (CD) and not a recovery mechanism for the lenders.[59] Accordingly, the insolvency proceedings before the NCLT are not adversarial in nature.

d) **Resolution in a time-bound manner:** This principle encompasses two aspects, namely: (a) preference for resolution over liquidation of the debtor; and (b) completion of the resolution process in a time-bound manner. With respect to (a), the reference to the term 'resolution' and not 'liquidation' in the preamble of the Code has been interpreted by the Supreme Court to mean that liquidation should be availed as a last resort only if the resolution process is unsuccessful.[60] With respect to (b), the BLRC Report and the Supreme Court have highlighted that time-bound resolution is essential for effective functioning of an insolvency legislation, as delays in the insolvency resolution process result in depreciation in the value of the assets of the debtor and lower rates of recovery for the creditors, thereby increasing the likelihood of liquidation of the debtor and producing adverse effects on the economy at large.[61]

e) **Maximisation of value of assets:** The object of maximisation of the value of assets of the debtor is required to be understood with reference to the object of resolution in a time-bound manner. The economic value of the debtor and the time-period of the resolution process are inversely related, and thus, a time-bound resolution is pivotal for the maximisation of the value of the assets of the debtor.[62] Against this backdrop, the Code prefers the resolution of a debtor as a going concern in order to maximise the going concern gains. However, there can be no-straight jacket formula for the maximisation of the value of assets of the debtor, as the Supreme Court has also held that in certain cases, a swift liquidation may be desirable over a protracted resolution process.[63] This may be particularly relevant when the debtor is defunct and has no going concern business.

f) **Promotion of entrepreneurship and availability of credit:** The BLRC Report had underscored the adverse consequences of the fragmented nature of the erstwhile insolvency framework in terms of India having one of the lowest levels of credit availability in comparison to the size of its economy, as creditors were saddled with low recovery rates.[64] In light of this, the Code, by enabling creditors to have higher recovery rates, endeavours to increase the credit available in the hands of banks and financial institutions for extension of loans to entrepreneurs.[65]

g) **Alteration in the order of priority of payment of government dues**: The BLRC Report has provided the rationale for altering the order of priority of payment of government dues and according it a priority lower than unsecured financial creditors (FCs) in the distribution waterfall mechanism. The BLRC Report has noted that such an approach would enhance credit availability, result in lowering the cost of capital, and spur entrepreneurism and economic growth. The government, in turn, would benefit from the growth in the economy and increase in revenues to the exchequer.[66] The report of the Insolvency Law Committee also justifies altering the order of priority of payment of government dues in order to ensure that creditors, who have extended loans to the debtor, benefit from the payment.[67] The Supreme Court has also elucidated that crown debts cannot take precedence over the debts of secured creditors, who are private persons.[68]

h) **Balance the interests of all stakeholders**: The Code also seeks to take into account and balance the interests of all stakeholders in order to ensure fair and equitable treatment to all stakeholders.[69] In this context, the Supreme Court has held that the principle of equitable treatment requires equal treatment to be accorded to creditors belonging to the same class, and the same cannot be expanded to treat unequal creditors equally.[70]

i) **Binding nature of the resolution plan:** The UNCITRAL Legislative Guide on Insolvency Law (UNCITRAL Legislative Guide) notes that certain insolvency systems enable a resolution plan approved by a certain class to be binding on all other classes that do not approve the resolution plan.[71] The BLRC Report had noted that a resolution plan approved by a majority would entail a *'cram down option'*, making such a plan binding on dissenting creditors.[72] The scope of the cram down option provided under the Code is much broader in nature, as it makes the resolution plan binding on *'the corporate debtor and its employees, members, creditors, including the Central Government, any State Government or any local authority.., guarantors and other stakeholders involved in the resolution plan.'*[73] The Supreme Court has noted that the Code makes the resolution plan binding on even those stakeholders who have not directly participated in the resolution process.[74]

The above principles, which underlie and inform the provisions of the Code, form the 'grundnorm' of the Code, and therefore, it is desirable that any interpretation provided to the provisions of the Code in hard cases should be in furtherance of the said principles. In the next chapter, we examine certain 'hard cases' against these fundamental principles of the Code.

EXAMINING THE HARD CASES UNDER THE CODE

In this chapter, the paper discusses certain recent 'hard cases' under the Code, which, in our view, have deviated from the fundamental principles of the Code. A study of such cases against the philosophy of principle-based approach would be useful in examining whether the embedded principles of the Code, its object as well as its institutional history have been duly considered with appropriate 'weight'.

State Tax Officer (1) v. Rainbow Papers Limited, Supreme Court

In the case of *State Tax Officer (1) v. Rainbow Papers Limited* (Rainbow Papers),[75] the Supreme Court has provided its ruling on the crucial issue of priority of government dues secured by a statutory charge.

Key facts

In this case, the appellant (State Tax Officer (1)) had contended that it is a 'secured creditor' within the meaning of the Code, as it had a first charge on the property of the CD on account of section 48 of the Gujarat Value Added Tax, 2003 (GVAT Act). The said section 48 of the GVAT Act provides that any amount payable by a person under the GVAT Act shall be first charge on the property of such person. The Supreme Court, thus, dealt with the fundamental question of whether a government authority should be treated as 'secured creditor' under the Code on account of a statutory charge. The Supreme Court further considered if section 53 of the Code would override section 48 of the GVAT Act.

The ruling

The Supreme Court, in this case, held that the definition of the term 'secured creditor' under the Code is broad and expansive to include all forms of security interests, including a statutory charge as provided under section 48 of the GVAT Act. The Supreme Court held that 'security interest' includes a security created by the operation of law and that a government authority with a statutory charge would be treated as a 'secured creditor' under the Code. The Supreme Court further noted that the definition of 'secured creditor' under the Code does not provide for any exclusion of government authorities. Accordingly, the claims of government authorities with a statutory charge would be accorded priority as 'secured creditors' in terms of section 53(1)(b)(ii) of the Code. The Supreme Court also did not find any inconsistency between section 48 of the GVAT Act and any provision of the Code, including section 53. The Supreme Court held that if a resolution plan excludes statutory dues payable to the government or a government authority or a legal authority, altogether, the NCLT is bound to reject such a resolution plan.

Examination

Under the Code, 'secured creditor' has been defined as '*a creditor in favour of whom security interest is created.*' Whereas 'security interest' has been defined as the '*right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation*.' As the definition of the term 'security interest' only refers to creation of security interest by way of a 'transaction', which has been defined to include an '*agreement or arrangement in writing for the transfer of assets, or funds, goods or services, from or to the corporate debtor*', it has been argued that a government authority having a security pursuant to a statutory charge, cannot be deemed to be included under the definition of a 'secured creditor'. On the other hand, it may be argued that the definition of 'transaction' is inclusive in nature and does not negate the possibility of including an arrangement creating a statutory charge. Further, the definition of the term 'secured creditor', as provided under the Code, is broad and expansive, and thus, should include a government authority holding a security pursuant to a statutory charge. While there are two plausible interpretations applicable in respect of the scope of the term 'secured creditor', *Rainbow Papers* did not consider the definition of 'transaction' under the Code while providing a broad and expansive definition to the term 'secured creditor', to include government authority holding security interest created by the operation of law.

Notably, this case also failed to consider and appreciate the specific inclusion of 'government dues' under section 53(1)(e)(i) of the Code, providing for a lower priority to payment of government dues, i.e., after payment of, *inter alia*, workmen's dues, debts owed to secured creditors, wages, and unsecured financial debts, adding further complexity on arriving at a correct textual construction on what the intended priority for such secured government dues is under the Code.

In our view, the intended effect of the provisions of the Code on the issue of priority to such secured government dues is best discernible keeping in view certain key principles of the Code, namely according a lower priority to the payment of government dues and increasing the availability of credit in the economy.

The Code itself under section 53(1)(e)(i) specifically provides for priority to be accorded to government dues. The expression 'any amount due to the Central Government and the State Government' used in section 53(1)(e)(i) will include any amounts owed to the government regardless of whether they are secured or not. Further, the said provision makes no distinction between secured or unsecured government dues, and therefore, in our view, it must necessarily include 'secured government dues' pursuant to a statutory charge. Such an interpretation finds justification and support in the preamble of the Code and its legislative history.

The Preamble to Code provides:

> 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.[76]

The BLRC Report also provides the rationale behind altering the order of priority of payment of government dues in the following terms:

> The Committee has recommended to keep the right of the Central and State Government in the distribution waterfall in liquidation at a priority below the unsecured financial creditors in addition to all kinds of secured creditors for promoting the availability of credit and developing a market for unsecured financing (including the development of bond markets). In the long run, this would increase the availability of finance, reduce the cost of capital, promote entrepreneurship and lead to faster economic growth. The government also will be the beneficiary of this process as economic growth will increase revenues. Further, efficiency enhancement and consequent greater value capture through the proposed insolvency regime will bring in additional gains to both the economy and the exchequer.[77]

Further, the then Minister of State in the Ministry of Finance, Mr. Jayant Sinha, while introducing the bill for the Code on the floor of Lok Sabha, had provided the justification for according a lower priority to government dues in the following terms:

> There was another question that was asked is this. Why is it that the Government comes after employees in secured creditors in this waterfall? The answer to that is because we want the people to come first with secured creditors because after all it is depositors' money; it is tax payers' money as Shri Satpathy was pointing out. Obviously, employees are most dependent and most vulnerable. So, we put the most dependent and the most vulnerable tax payers' money ahead of the Government which has other ways of borrowing money and we put the Government next after these two creditors in the waterfall.[78]

The report of the Insolvency Law Committee dated March, 2018 also notes the following, in response to the subject of according a lower priority to government dues:

> The present priority given to debts owed to Central and State Governments in section 53 is in line with the recommendation provided in the BLRC Report and has been stated to be in line with the global best practices. Further, the UNCITRAL Legislative Guide on Insolvency Law also provides that many jurisdictions give low priority to state dues. The intention behind this is to give benefit of payment to other creditors who have taken risks while giving loans or providing debts.[79]

From the above, the intention of the legislature is clear. Government dues were intended to be accorded a lower priority in the distribution waterfall mechanism, especially in order to stimulate the availability of credit and promote entrepreneurship. In fact, one of the fundamental purposes for the introduction of the Code was to enhance the credit availability in view of our economy having one of the lowest levels of credit availability in comparison to its size. The specific inclusion of government dues in section 53(1)(e)(i) clearly reflects this intention in the statutory provisions of the Code.[80] Once due recognition is given to this object, it is clear that section 53(1)(e)(i) puts the ranking of any government dues including secured government dues pursuant to statutory charge, firmly below that of secured creditors who have extended credit in any form to the CD.

Further, section 53(1)(e)(i) is a special provision governing statutory creditors, including secured statutory creditors, whereas section 53(1)(b)(ii) is intended to be the general provision governing secured creditors. It is a settled principle of law that in case of a conflict between a special provision and a general provision within the same statute, the special provision must prevail.[81] In addition, any statute that seeks to disturb this ranking must necessarily be in conflict with the Code, and the Code would override such provision of the statute in light of section 238 of the Code.[82]

The construction provided in *Rainbow Papers* appears to have limited itself to the literal examination of the definition clause of 'secured creditor' and appears to have failed to appreciate the legislative history and the stated objects of the Code. However, if a principle-based approach, taking into account the object and purpose of the Code as well as the reflection of this intent in section 53(1)(e)(i), is adopted, then the term 'secured creditors' cannot be provided with an expansive meaning to include statutory creditors holding security pursuant to a statutory charge, as such an interpretation is directly incompatible with the principles and the scheme of the Code.

In this regard, it is pertinent to note that as on March 15, 2023, a review petition has been filed against the judgment of the Supreme Court in *Rainbow Papers*.[83] Further, on January 18, 2023, the Ministry of Corporate Affairs invited public comments on 'changes being considered to the Insolvency and Bankruptcy Code, 2016' (MCA discussion paper), wherein, *inter alia*, it has been proposed that a clarification can be included in the Code that statutory dues secured by a statutory charge, should be treated equally with other unsecured creditors in order to nullify the effect of *Rainbow Papers*.[84]

Vidarbha Industries Power Limited v. Axis Bank Limited, Supreme Court

In the case of *Vidarbha Industries Power Limited v. Axis Bank Limited* (Vidarbha Industries),[85] the Supreme Court has dealt with the issue of discretion available with the NCLT in admission of an application for initiation of the CIRP by a FC.

Key facts

An application for initiation of the CIRP of Vidarbha Industries Power Limited was filed by Axis Bank Limited under section 7 of the Code on account of a default of approximately ₹ 553 crore. The CD had sought a stay of the said proceedings, *inter alia*, on the grounds that an amount of ₹ 1730 crore was realisable by the CD pursuant to an order passed by the Appellate Tribunal for Electricity in favour of the CD. In this regard, the Supreme Court formulated the question of whether section 7(5)(a) of the Code confers discretion on the NCLT to admit an application of a FC for initiation of the CIRP.

The ruling

In this case, the Supreme Court, on a literal interpretation, held that the use of the term 'may' in section 7(5)(a) of the Code indicates that the provision is not mandatory in nature, and the NCLT may not admit an application in its discretion under section 7 of the Code. Such discretion cannot be exercised in an arbitrary manner, and the NCLT is required to examine the desirability of the CIRP after considering the facts and circumstances of the case including the 'financial health' and the 'viability' of the debtor.

Examination

The Supreme Court, in its landmark decisions of *Innoventive* and *Swiss Ribbons*,[86] has held that if the NCLT is satisfied of the existence of 'debt' and 'default', then the application, if complete, under section 7 of the Code, must be admitted. These landmark rulings, especially in *Innoventive*, made the process and the scope of examination by the NCLT clear in respect of admission of applications under section 7 of the Code. It was expressly held by the Supreme Court that only the existence of default was to be examined and ascertained and not the reasons thereof.[87] Hence, once the existence of debt and default was determined by the NCLT and if the application was complete, the Supreme Court was of the view that the NCLT 'must' admit such an application. In the case of *Vidarbha Industries*, the language of section 7(5)(a) was revisited, and the term 'may' contained therein was relied upon to hold that the NCLT has the discretion to admit or not admit an application for the initiation of the CIRP even where the existence of a default has been made out.

It is a settled principle of statutory interpretation that the usage of the term 'may' in a provision does not necessarily mean that it is discretionary in nature and the true purport of the provision is to be construed in light of the intention of the legislature and the consequences that would follow on interpreting it either way.[88] However, in *Vidarbha Industries*, the Supreme Court appears to have preferred a literal construction of section 7(5)(a) of the Code and has ignored the construction found in the earlier decisions as well as from the objects and principles of the Code.

By holding that it is within the NCLT's discretion to examine the financial health of the CD while considering an application under section 7 of the Code, the Supreme Court has brought back the outmoded concept of 'balance sheet test' or 'inability to pay' into the insolvency jurisprudence. In this context, it is pertinent to note that the BLRC Report had explicitly rejected the balance sheet test as a trigger for insolvency proceedings. The BLRC Report had proposed that a creditor should only provide the record of debt and the evidence of default to trigger insolvency proceedings.[89] Accordingly, the Code enables a FC to demonstrate default by furnishing a '*record of default with the information utility*' or '*such other evidence as may be specified*', which includes '*copies of entries in a bankers book in accordance with the Bankers Books Evidence Act, 1891*'.[90]

Further, the landmark judgment in *Swiss Ribbons* also notes the change in the legislative scheme from the notion of 'inability to pay debts' to 'determination of default' under the Code. The judgment also records the legislative rationale behind the change in the scheme as put forth by the Solicitor General on behalf of the Union of India:

> Legislative policy now is to move away from the concept of - inability to pay debts to- determination of default…Four policy reasons have been stated by the learned Solicitor General for this shift in legislative policy. First is predictability and certainty. Secondly, the paramount interest to be safeguarded is that of the corporate debtor and admission into the insolvency resolution process does not prejudice such interest but, in fact, protects it. Thirdly, in a situation of financial stress, the cause of default is not relevant; protecting the economic interest of the corporate debtor is more relevant. Fourthly, the trigger that would lead to liquidation can only be upon failure of the resolution process.[91]

From the above, it is amply clear that the Code does not concern itself with the cause of default, and the initiation of insolvency proceedings should not hinge on the cause of default, as it may imperil the economic interests of the debtor.

Further, the interim report by the Bankruptcy Law Reforms Committee had cited the study of Professor Kristin van Zwieten, who found that the wide discretion available with the courts in India under the erstwhile framework to assess whether a debtor was 'unable to pay debts' had not only resulted in inordinate delays but also generated ambiguity in respect of creditors' rights. This, in turn, had affected the efficiency of the process as a whole.[92] Accordingly, the BLRC Report had recommended that the process for initiation of the insolvency proceedings should place the least cost on the NCLT and that the creditor should be able to initiate the proceedings using the evidence of default.[93] In this light, the Code envisions limited judicial intervention by the NCLT, as the cause of default has not been spelt out as a requirement to be examined by the NCLT at the stage of initiation of the CIRP.[94]

However, the judgment in *Vidarbha Industries* digresses from the position under the Code by providing a wide judicial discretion to the NCLT to admit an application under section 7 of the Code. This will enable the debtor to protract the proceedings for initiation of the CIRP by pleading, *inter alia*, that the debtor is financially viable and the default was on account of extraneous factors. Such a judicial approach would require the NCLT to examine the financial statements and the balance sheets of the debtor and decide the commercial question of the financial viability of the debtor in order to admit the application. In effect, there would be new judicial standards that would evolve for assessing the financial viability of a debtor, which, in turn, would generate uncertainty regarding the rights of FCs in respect of initiating insolvency proceedings. Further, such an approach usurps the commercial decision of the viability of the enterprise from the domain of the creditors to the domain of the NCLTs in complete disregard of the BLRC Report, which had stated that '*the viability of the enterprise is a matter of business, and that matters of business can only be negotiated between creditors and debtor*.'[95]

In addition, the BLRC Report had identified early recognition of stress in a company as one of the fundamental principles of the insolvency framework. The BLRC Report had further noted that '*the appropriate disposition of a defaulting firm is a business decision, and only the creditors should make it*'.[96] The BLRC Report had found that the promoters continued to stay in control of the company even after default under the erstwhile framework and had recommended that the control should shift to creditors on default.[97] Accordingly, the Code provides for a creditor-in-possession model in order to enable the creditors to resolve the debt of the company in a time-bound manner with an intent to maximise the value of the assets of the debtor.[98] However, the decision in *Vidarbha Industries* may enable the promoters of a company to stay in control even after default by citing that the company is solvent and that the default is on account of extraneous factors. This would not only impede the ability of creditors to resolve stress at the inception stage but also result in erosion of the value of the debtor.

In light of the above, in our view, the position established by *Vidarbha Industries* would significantly delay the insolvency proceedings and result in erosion of the value of the debtor, and thereby, severely undermine the principles of time-bound resolution of the debtor and maximisation of the value of the assets of the debtor. Therefore, keeping in view the objects and principles of the Code, it would be apposite for the legislature to amend the term 'may' in section 7(5)(a) of the Code with 'shall'.

In this context, it is to be noted that while the review petition against *Vidarbha Industries* has been rejected by the Supreme Court,[99] as on March 15, 2023, the decision in *Vidarbha Industries* is being reconsidered by the Supreme Court in the case of *Maganlal Daga HUF & Another v. Jag Mohan Daga & Others*.[100] In addition, the MCA discussion paper, with an intent to nullify the effect of *Vidarbha Industries*, also proposes that section 7 of the Code may be amended to clarify that for the admission of an application under section 7 of the Code, the NCLT is only required to be satisfied about the occurrence of a default and the fulfilment of procedural requirements in this regard.[101]

Jaypee Kensington Boulevard Apartments Welfare Association & Others v. NBCC (India) Ltd. & Others, Supreme Court

While the Supreme Court in *Jaypee Kensington Boulevard Apartments Welfare Association & Others v. NBCC (India) Ltd. & Others* (Jaypee Kensington),[102] dealt with several aspects of the insolvency law, this paper focuses on the aspect of the mode of payment to dissenting FCs. While section 30(2) of the Code provides that dissenting FCs should be paid the minimum of the liquidation value of their debt and regulation 38 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) provides that dissenting FCs should be paid in priority of assenting FCs, the Code is silent on the mode of payment to dissenting FCs.[103]

Key facts and the ruling

In this case, the resolution plan provided for payment of liquidation value of their debt to dissenting FCs through the mode of transfer of equity and land parcels. A dissenting FC had challenged this payment mechanism and had contended that payment to dissenting FC can only be in the mode of cash. The Supreme Court held that as per the framework of the Code, the term 'payment' used in the context of section 30(2) of the Code is indicative of the requirement to discharge the obligation owed towards dissenting FCs by the mode of payment in cash or to permit 'recovery' of debt by enforcement of their security interest in accordance with the entitlement of dissenting FCs. The Supreme Court further held that dissenting FCs cannot be compelled to be associated with the CD by payment in terms of equity or other security and that the Code permits dissenting FCs to not take the 'voyage' of sailing with the resolution, but to 'disembark' by seeking payment in cash in accordance with their entitlement.

Examination

This paper examines the quandary of the mode of payment to dissenting FCs by seeking to examine and balance the principles of 'binding nature of the resolution plan' and 'minimum assurance to dissenting FCs'. As discussed, section 31 of the Code makes the resolution plan binding on all stakeholders, including creditors, who have not directly participated in the resolution process.[104] Dissenting FCs, who participate in the resolution process, but do not approve the mechanism under the resolution plan, also come within the ambit of section 31 of the Code and are bound by the resolution plan. Section 30(2)(b) of the Code embodies the minimum guarantee of liquidation value assured to dissenting FCs.[105] Section 30(2)(b) does not, in any manner, dislodge the binding nature of the resolution plan in respect of dissenting FCs and does not enable dissenting FCs to opt out of the resolution plan and undertake recovery action to the extent of their liquidation value. However, the judgment in Jaypee Kensington has the unintended consequence of enabling dissenting FCs to opt out of or 'disembark' from the resolution plan and undertake recovery action either in terms of: (a) seeking cash payment (irrespective of the conceived mode of payment to assenting FCs); or (b) enforcing security interest, in complete disregard of the spirt of the Code, which has been envisioned not as a recovery forum but as a beneficial legislation for the resolution of debt.

Such an interpretation not only incentivises dissent, but also has the potential to derail the resolution plan and the operation of the debtor as a going concern, particularly in case of enforcement of security interest over assets that are vital for the functioning of the debtor. Further, as the quantum of payment in cash to be made to dissenting FCs or the securities that would be enforced by dissenting FCs can be known only after the resolution plan has been formulated and voted upon, the resolution process can be jeopardised and derailed if the resolution applicant is subsequently required to make provision for substantial payment in cash or take into account that certain critical assets will not be available for the continued operations of the debtor. Further, such an interpretation also violates the principle of equitable treatment, as it allows certain creditors within the same class of 'FCs' to be treated differently regarding the mode of payment merely on the basis of their manner of voting on the resolution plan.

In this light, regulation 38 of the CIRP Regulations, providing dissenting FCs to be paid in priority of assenting FCs, should be interpreted as a safeguard mechanism to ensure that the rights of dissenting FCs are not impaired by assenting FCs, and whenever any payment is to be made to FCs as per the payment schedule under the resolution plan, the payment should be first applied to discharge the obligations towards dissenting FCs. However, it does not enable dissenting FCs to seek a mode of payment at variance from the one provided under the resolution plan for FCs and seek payment prior to the repayment schedule provided under the resolution plan for FCs. In this context, it may be noted that the UNCITRAL Legislative Guide also envisages that dissenting creditors, who do not support the plan, can be paid as per their entitlement in *'money or property, such as stock or other securities'.*[106]

Thus, the judgment in *Jaypee Kensington* is not in consonance with the principles of binding nature of the resolution plan, resolution of debtor as a going concern, and equitable treatment of creditors.

Small Industries Development Bank of India v. Vivek Raheja & Others, NCLAT; Union Bank of India v. Mr. Rajender Kumar Jain, Resolution Professional of M/s Kudos Chemie Ltd. & Others, NCLAT; Andhra Pradesh State Financial Corporation v. Kalptaru Steel Rolling Mills Ltd. & Another, NCLAT.

The cases of: (a) *Small Industries Development Bank of India v. Vivek Raheja & Others* (Vivek Raheja)*; (b) Union Bank of India v. Mr. Rajender Kumar Jain, Resolution Professional of M/s Kudos Chemie Ltd. & Others* (Kudos Chemie)*; and (c) Andhra Pradesh State Financial Corporation v. Kalptaru Steel Rolling Mills Ltd. & Another* (Kalptaru), concern the right of payment to dissenting FCs holding security interest under the CIRP.[107]

Key facts

In all these cases, the appellants, being dissenting and secured FCs, had challenged the resolution plan on the grounds that the amount being offered to each appellant was as per its voting share and not as per the liquidation value of its 'security interest', in violation of section 30(2)(b) of the Code. For instance, in *Vivek Raheja*, the appellant had contended that it was entitled to receive the liquidation value of the securities exclusively charged to it, i.e., ₹ 5.64 crore, which was 6.93% of the liquidation value of the CD. However, the resolution plan had provided for a payment of ₹ 1.65 crore to the appellant as per its voting share of 2.03% in the CoC by completely disregarding the provision of section 30(2)(b) of the Code.

The rulings

In all these cases, the NCLAT, New Delhi upheld the resolution plan providing for payments to dissenting and secured FCs as per their voting share rather than the liquidation value of their security interest. The NCLAT, New Delhi relied on the decision of the Supreme Court in *India Resurgent ARC Private Limited v. Amit Metaliks* (Amit Metaliks),[108] and held that the CoC has the discretion to decide the amounts of payments to be made to different classes or sub-classes of creditors as per its commercial wisdom under section 30(4) of the Code. In *Vivek Raheja*, the NCLAT, New Delhi, also held that as per section 30(2)(b) of the Code, a dissenting FC is entitled to receive the liquidation value of its 'debt', which refers to the entitlement of a dissenting FC computed as per its 'voting share' and not as per the liquidation value of its 'security interest'.

Examination

Section 30(2)(b) of the Code provides that dissenting FCs shall be paid an amount, which shall not be less than the amount payable in the event of liquidation of the CD, i.e., the liquidation value of their debt.[109] Section 30(4) of the Code provides that the CoC may approve a resolution plan after taking into account its '*feasibility and viability, the manner of distribution proposed, which may take into account the order of priority amongst creditors as laid down in sub-section (1) of section 53, including the priority and value of the security interest of a secured creditor*.'[110]

In the case of Essar Steel, the Supreme Court, while upholding the constitutional validity of the amendment to section 30(4), requiring the CoC to consider the 'manner of distribution' while approving a resolution plan, had noted that the term 'may', employed in section 30(4) indicates that a discretion has been conferred upon the CoC to consider the 'manner of distribution' while taking the business decision of acceptance or rejection of a resolution plan. However, it is pertinent to note that in Essar Steel, the Supreme Court had not considered the interplay between section 30(2) and section 30(4) of the Code.[111]

Further, the reliance on *Amit Metaliks* by the NCLAT, New Delhi, is not apt in the facts and circumstances of these cases. In Amit Metaliks, while the Supreme Court had noted that section 30(4) is a mere guideline, which only amplifies the considerations to be taken into account by the CoC while exercising its commercial wisdom, the Supreme Court had also clarified that the amount to be paid to a dissenting FC is innate in section 30(2)(b) of the Code and that a dissenting FC is entitled to receive the liquidation value. The case of Amit Metaliks does not elucidate the manner of computation of liquidation value of debt. While the Supreme Court in *Amit Metaliks*, had rejected the contention of the appellant, a secured and dissenting FC, to receive payment as per the 'valuation of its security interest', the judgment was silent on whether the appellant had sought the 'liquidation valuation of its security interest.' It is to be noted here that the liquidation value of an asset, which refers to the value an asset would fetch if it is to be sold immediately with limited exposure to potential purchasers, is typically lower than the fair value of the asset.[112] In our view, the decision in *Amit Metaliks* upholds the right of dissenting FCs to receive minimum liquidation value as per section 30(2)(b) of the Code, and should be restricted to the facts of that particular case, given that it renders no finding on computing entitlement of dissenting FCs as per the liquidation value of their security interest.

In light of the above, in order to discern the mode of computation of the liquidation value of the debt of dissenting FCs, it is useful to discuss the treatment of secured creditors and dissenting creditors as discussed under the UNCITRAL Legislative Guide, which was instructive in drafting the Code and has been referred to in numerous landmark decisions.[113] The UNCITRAL Legislative Guide provides that it is paramount to 'recognise' and 'enforce' in insolvency proceedings the differing rights that creditors have in respect of the debtor and its assets prior to the initiation of the insolvency proceedings, particularly in respect of the rights and priorities of secured creditors, as it would not only generate 'certainty in the market' but also ensure 'provision of credit'.[114] The UNCITRAL Legislative Guide further states that any measure that has the potential to diminish the ability of secured creditors to recover their debt, should be carefully examined, as it would not only impinge upon the sanctity of commercial bargains but also affect the cost of affordable credit, as a decline in the value of the protection provided to security interest would increase the risk as well as the price of extending credit.[115] In this context, the UNCITRAL Legislative Guide also elucidates the concept of equitable treatment as recognising that all creditors need not be treated identically but in a way that 'reflects the different bargains they have struck with the debtor'.[116] This notion of equitable treatment, as provided under the UNCITRAL Legislative Guide, was also discussed in the case of *Swiss Ribbons*.[117]

In respect of treatment to dissenting creditors, the UNCITRAL Legislative Guide provides that it should be ensured that the rights of dissenting creditors are not undermined. It states that:

> As a general principle, that treatment might be that the creditors will receive at least as much under the plan as they would have received in liquidation proceedings. If the creditors are secured, the treatment required may be that the creditor receives payment of the value of its security interest…

Against this backdrop, it becomes pertinent to review the statement of objects and reasons of the Insolvency and Bankruptcy Code (Amendment) Act, 2019, pursuant to which section 30(2) was amended to provide for payment of liquidation value of debt to dissenting FCs and section 30(4) was amended to provide for the CoC to consider the manner of distribution, including 'priority and value of security interest of a secured creditor' while approving the resolution plan. The statement of objects and reasons notes the need to amend the aforementioned provisions in the following terms: *'Various* *stakeholders have suggested that if the creditors were treated on an equal footing when they have different pre-insolvency entitlements, it would adversely impact the cost and availability of credit.*'[118]

From the above, it is amply clear that the legislature recognised the need to ensure that the rights of the creditors prior to the commencement of insolvency proceedings, i.e., 'pre-insolvency entitlements', are recognised and enforced as per the commercial bargain with the debtor instead of treating them all on an equal footing, as a uniform treatment would affect the cost and availability of credit.

When examined against the above theory of insolvency law, it becomes evident that the liquidation value of a dissenting FC under section 30(2) is to be determined in reference to the liquidation value of the 'security interest' available to the creditor as opposed to its 'voting share', as the security interest provided to secure the debt is an essential element of the commercial bargain between the parties and only such an interpretation would be able to recognise the commercial bargain struck by each creditor with the debtor.

Further, the term 'may' used in section 30(4), as held by *Essar Steel,* certainly indicates that a discretion has been conferred upon the CoC to consider the manner of distribution, including priority and value of security interest of a secured creditor. However, such a discretionary power cannot be extended to altering the priority or value of security interest of a dissenting creditor, as that would essentially amount to relinquishment of its security interest without its explicit consent, which is not permissible under law.[119] In *Essar Steel*, the Supreme Court had not considered the interplay between section 30(2) and section 30(4) of the Code.[120] On a constructive interpretation, the discretionary powers under section 30(4) cannot be extended to unilaterally alter the priority or value of security of dissenting secured FCs, as it would be contrary to the minimum guarantee of liquidation value assured under section 30(2)(b) of the Code and would also violate the principle of equitable treatment of recognising the different bargains struck by the creditors with the debtor.

Thus, in our view, the interpretation provided in the cases of *Vivek Raheja, Kudos Chemie, and Kalptaru* is at odds with the principles of availability of credit, promotion of entrepreneurship, and equitable treatment of creditors embedded in the Code.

In this regard, it is to be noted that as on March 15, 2023, an appeal has been preferred before the Supreme Court against the decision of the NCLAT, New Delhi in *Vivek Raheja*, and the same is currently pending adjudication.[121]

CONCLUSION

A meaningful understanding of the insolvency framework is incomplete without appreciating the compelling circumstances which necessitated the introduction of the Code. The construction and interpretation of the Code must, therefore, necessarily remain firmly rooted in and guided by its institutional history, its objects as well as its core principles. Losing sight of these objects and principles would result in the Code becoming ineffective and suffering from the same malaise as the earlier framework it sought to replace. Uncertainty related to the rights of creditors, protraction of insolvency proceedings, delays resulting in value erosion of the assets of the debtor, low recovery rates of lenders, and low credit availability in the Indian economy, were some of the problems in the earlier regime that the Code sought to address.[122] Against this backdrop, the Code was ushered in as an 'economic reform' to enable resolution of stressed companies, and thereby spur availability of credit, promote entrepreneurship, and stimulate economic growth. Justice R.F. Nariman had aptly noted the significance and the economic import of the Code in the following words: '*The Insolvency Code is a legislation which deals with economic matters and, in the larger sense, deals with the economy of the country as a whole.*'[123]

Being a legislation targeted at strengthening the economic health of the nation, it is inevitable that the Code would produce certain inequities and crudities in its application. However, such inequities created under the Code must be accepted in view of the stated objects of the Code. Inequities and crudities in economic legislations have always been acceptable when weighed against the broader public goals sought to be achieved by such legislations,[124] and the Code is no exception.[125] The Supreme Court has in fact cautioned that interference with the economic experiment under the Code can have severe ramifications on the nation.[126]

In hard cases, where there is uncertainty regarding the applicable rule, there is a likelihood that the case-specific equities rather than the embedded principles of the statute will have an overbearing influence on the outcome of the case. In such hard cases, particularly hard cases pertaining to economic legislations, it becomes indispensable to construct a principle-based account of law in order to maintain the special equities created under the economic legislation for the purposes of the larger public goals and to avoid the tendencies to yield into the case-specific equities.

The hard cases reviewed in this paper have generated outcomes, which are incongruous with the objects and principles of the Code. In such cases, the interpretation and construction of the provisions of the Code appears to be in favour of the case-specific equities often at the cost of the embedded principles, which, in our view, has resulted in inconsistencies as well as affected the efficacy of the Code. As far apart as Professors Hart and Dworkin were in their philosophies of law, they both found common ground on the importance of the principles and objects of a statute as being part of the 'law' and their critical role in guiding the interpretation of the text of any legislation in adjudication of hard cases. This position also finds support in the Indian jurisprudence.

In the short history of the Code, our courts and the legislature have taken a proactive role in advancing the nascent insolvency law and resolving the inequities in favour of the objects of the insolvency framework. This paper attempts to highlight a few of these inconsistencies in the interest of wider discussion on the subject, with the optimism that they are resolved at the earliest in order to strengthen the Code.

[1] *Northern Securities Co v. United States*, 193 US 197,400 (1904) (Holmes dissenting).

[2] The Insolvency and Bankruptcy Code, 2016 (Code).

[3] Zygmunt T. (2020), "An Intuitive Approach to Hard Cases", 16(1), Utrecht Law Review, pp. 21-38.

[4] Hoffmaster B. (1982), "Understanding Judicial Discretion", 1(1) Law & Philosophy, pp. 21-55.

[5] Supra Note 3.

[6] Galeza D. (2013), "Hard Cases", 2 Manchester Student Law Review, pp. 240-266.

[7] Dworkin R. (1978), "Taking Rights Seriously", Harvard University Press, pp. 81-131.

[8] Supra Note 6.

[9] Shahshahani S. (2022), "Hard Cases Make Bad Law? A Theoretical Investigation", 51(1) Journal of Legal Studies, pp. 133-175.

[10] Shapiro S. (2007), "The "Hart-Dworkin" Debate: A Short Guide For The Perplexed", Working Paper No. 77, Public Law and Legal Theory Working Paper Series.

[11] Hart H. (2012), "The Concept of Law", Oxford University Press, 3rd ed., pp. 79-99.

[12] *Ibid.*, pp. 124-154.

[13] *Ibid.,* pp. 124-154, 238-276.

[14] *Ibid.,* pp. 238-276.

[15] *Ibid.*

[16] Supra Note 7, pp. 14-45.

[17] *Ibid.*

[18] *Ibid.*

[19] Supra Note 7.

[20] *Ibid.*

[21] Supra Note 11, pp. 238-276.

[22] *Ibid.*

[23] *Ibid.*

[24] *Phoenix Arc Private Limited v. Spade Financial Services Limited and Others*, (2021) 3 SCC 475; *Reserve Bank of India v. Peerless General Finance and Investment Co. Limited*, (1987) 1 SCC 424.

[25] *Chairman, Board of Mining Examination and Chief Inspector of Mines v. Ramjee*, AIR 1977 SC 965. 'Deha' and 'dehi' are Sanskrit terms for 'body' and 'soul' respectively.

[26] *X v. The Principal Secretary, Health and Family Welfare Department, Govt. of NCT of Delhi & Another*, Supreme Court, Civil Appeal No. 5802 of 2022.

[27] *Indian Social Action Forum v. Union of India, AIR 2020 SC 1363; Chiranjit Lal Chowduri v. Union of India*, (1950) SCR 869; *Union of India v. Elphinstone Spinning and Weaving Co. Ltd.*, (2001) 4 SCC 139.

[28] *Innoventive Industries Ltd. v. ICICI Bank and Others*, (2018) 1 SCC 407; *Embassy Property Developments Pvt. Ltd. v. State of Karnataka and Others*, (2020) 13 SCC 308; *E.S. Krishnamurthy and Others v. Bharath Hi Tech Builders Pvt. Ltd.*, (2022) 3 SCC 161.

[29] The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design, Bankruptcy Law Reforms Committee, November, 2015.

[30] *Pratap Technocrats (P) Ltd & Others v. Monitoring Committee of Reliance Infratel Ltd and Another*, (2021) 10 SCC 623; *K. Sashidhar v. Indian Overseas Bank and Others*, (2019) 12 SCC 150.

[31] *Insolvency and Bankruptcy Board of India v. State Bank of India & Others*, Delhi High Court, W.P. (C) No. 10189/2018 & CM Appeal No. 39715/2018; *M/s Mohan Gems & Jewels Pvt. Ltd. v. Vijay Verma & Another,* NCLAT, New Delhi, Company Appeal (Insolvency) No. 849 of 2020.

[32] *Ebix Singapore Private Limited v. Committee of Creditors of Educomp Solutions Limited & Another*, (2022) 2 SCC 401; *Gujarat Urja Vikas Nigam Limited v. Amit Gupta*, (2021) 7 SCC 209.

[33] *Ebix Singapore Private Limited v. Committee of Creditors of Educomp Solutions Limited & Another*, (2022) 2 SCC 401.

[34] *Innoventive Industries Ltd. v. ICICI Bank and Others*, (2018) 1 SCC 407.

[35] *Essar Steel India Limited through Authorised Signatory v. Satish Kumar Gupta*, (2020) 8 SCC 531.

[36] *K. Sashidhar v. Indian Overseas Bank and Others*, (2019) 12 SCC 150.

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

[38] Supra Note 33.

[39] Implementation of Insolvency and Bankruptcy Code: Pitfalls and Solutions, Standing Committee on Finance, Ministry of Corporate Affairs, August 2021

[40] Zwieten K. (2012), "The demise of corporate insolvency law in India", PhD thesis, University of Oxford.

[41] *Mardia Chemicals Ltd. v. Union of India and Other*, (2004) 4 SCC 311.

[42] *KSL & Industries Ltd. v. Arihant Threads Ltd. & Others*, (2015) 1 SCC 166.

[43] *Bhavdipbhai Arunbhai Dave v. Kotak Mahindra Bank Limited*, AIR 2022 Guj 53; *Punjab National Bank v. Mithilanchal Industries Pvt. Ltd.*, 2020 GLH (4) 531.

[44] *Jalgaon Janta Sahakari Bank Ltd. & Another v. Joint Commissioner of Sales Tax Nodal 9, Mumbai, & Another*, 2022 SCC OnLine Bom 1767.

[45] Supra Note 29.

[46] Supra Note 33.

[47] The Insolvency and Bankruptcy Code, 2016, Session No. 239, Rajya Sabha, Parliament of India, May, 2016.

[48] Supra Note 29.

[49] *Ibid.*

[50] Supra Note 29; Section 7 of the Code.

[51] Interim report of the Bankruptcy Law Reforms Committee, Bankruptcy Law Reforms Committee, February, 2015.

[52] *Ibid.*

[53] Supra Note 29.

[54] Supra Note 37.

[55] Supra Note 29.

[56] The Insolvency and Bankruptcy (Second Amendment) Bill, 2019, Standing Committee on Finance, Ministry of Corporate Affairs, March, 2020.

[57] Supra Note 29; Section 14 of the Code.

[58] Supra Note 36; *Kalparaj Dharamshi & Another v. Kotak Investment Advisors Limited & Another*, (2021) 10 SCC 401.

[59] Supra Note 37.

[60] *Ibid., Pioneer Urban Land and Infrastructure Ltd. and Another v. Union of India and Others*, (2019) 8 SCC 416.

[61] Supra Notes 29 and 37.

[62] Supra Notes 33 and 37.

[63] Supra Note 33.

[64] Supra Note 29.

[65] Supra Note 37.

[66] Supra Note 29.

[67] The Report of the Insolvency Law Committee, Ministry of Corporate Affairs, March, 2018.

[68] *Principal Commissioner of Income Tax v. Monnet Ispat and Energy Limited*, (2018) 18 SCC 786.

[69] Supra Note 37.

[70] Supra Note 35.

[71] Legislative Guide on Insolvency Law, United Nations Commission on International Trade Law, 2005.

[72] Supra Note 29.

[73] Section 31 of the Code.

[74] Supra Note 33.

[75] *State Tax Officer (1) vs. Rainbow Papers Limited*, 2022 SCC OnLine SC 1162.

[76] Preamble of the Code.

[77] Supra Note 29.

[78] Insolvency and Bankruptcy Code, 2016, Session No. 16, Lok Sabha, Parliament of India, May, 2016.

[79] Supra Note 67.

[80] The High Court of Andhra Pradesh and Telangana, in *Leo Edibles & Fats Limited v. The Tax Recovery Officer (Central), Income Tax Department, Hyderabad and Others* (Writ Petition No. 8560 of 2018), has held as follows: '*Tax dues, being an input to the Consolidated Fund of India and of the States, clearly come within the ambit of Section 53(1)(e) of the Code. If the Legislature, in its wisdom, assigned the fifth position in the order of priority to such dues, it is not for this Court to delve into or belittle the rationale underlying the same*'.

[81] *J.K. Cotton Spinning and Weaving Mills Co. Ltd. v. State of U.P.*, AIR 1961 SC 1170; *Commercial Tax Officer, Rajasthan vs. Binani Cements Limited. and Others*, (2014) 8 SCC 319.

[82] Section 238 of the Code.

[83] *Sanjay Kumar Agarwal v. State Tax Officer (1) & Another*, Supreme Court, Review Petition (Civil) Diary No. 32268/2022 in Civil Appeal No. 1661/2020.

[84] Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016, Ministry of Corporate Affairs, Government of India, January 18, 2023.

[85] *Vidarbha Industries Power Limited v. Axis Bank Limited*, (2022) 8 SCC 352.

[86] Supra Notes 34 and 37.

[87] Supra Note 37.

[88] *Mohan Singh and Others v. International Airport Authority of India and Others*, (1997) 9 SCC 132; *Sarla Goel and Others vs. Kishan Chand*, (2009) 7 SCC 658.

[89] Supra Note 29.

[90] Section 7 of the Code; The Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016; Supra Notes 34 and 37.

[91] Supra Note 37.

[92] Supra Note 51.

[93] Supra Note 29.

[94] Section 7 of the Code; Supra Note 37.

[95] Supra Note 29.

[96] *Ibid.*

[97] *Ibid.*

[98] Supra Note 2.

[99] *Axis Bank Limited v. Vidarbha Industries Power Limited*, 2022 SCC OnLine SC 1339.

[100] *Maganlal Daga HUF & Another v. Jag Mohan Daga & Others*, Supreme Court, Civil Appeal Diary No.38798 of 2022.

[101] Supra Note 84.

[102] *Jaypee Kensington Boulevard Apartments Welfare Association & Others v. NBCC (India) Ltd. & Others,* (2022) 1 SCC 401.

[103] Section 30(2) of the Code; Regulation 38 of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations).

[104] Section 31 of the Code; Supra Note 33.

[105] Section 30(2) of the Code.

[106] Supra Note 71.

[107] *Small Industries Development Bank of India v. Vivek Raheja & Others,* Company Appeal (AT) (Insolvency) No. 570 of 2022 (NCLAT, New Delhi, Order dated September 16, 2022); *Union Bank of India v. Mr. Rajender Kumar Jain, Resolution Professional of M/s Kudos Chemie Ltd. & Others*, Company Appeal (AT) (Insolvency) No. 665 of 2022 (NCLAT, New Delhi, Order dated July 20, 2022); *Andhra Pradesh State Financial Corporation v. Kalptaru Steel Rolling Mills Ltd. & Another*, Company Appeal (AT) (Insolvency) No. 584 of 2020 (NCLAT, New Delhi, Order dated December 13, 2022).

[108] Supra Note 35.

[109] Supra Note 105.

[110] Section 30(4) of the Code.

[111] Supra Note 35.

[112] Regulation 2(hb) of CIRP Regulations defines 'fair value' as '*the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion*', whereas Regulation 2(k) of CIRP Regulations defines 'liquidation value' as '*the estimated realizable value of the assets of the corporate debtor, if the corporate debtor were to be liquidated on the insolvency commencement date*'.

[113] Supra Notes 29, 33 and 37.

[114] Supra Note 71.

[115] *Ibid.*

[116] *Ibid.*

[117] Supra Note 37.

[118] The Insolvency and Bankruptcy Code (Amendment) Act, 2019, Act No. 26 of 2019, Parliament of India.

[119] *ICICI* Bank Limited v. Sidco Leathers *Ltd. & Others*, (2006) 10 SCC 452.

[120] Supra Note 35.

[121] *Small Industries Development Bank of India v. Vivek Raheja & Others*, Supreme Court, C.A. No. 008645 of 2022.

[122] Supra Notes 29 and 47.

[123] Supra Note 37.

[124] *R.K. Garg & Others v. Union of India & Others*, (1981) 4 SCC 675; *Mardia Chemicals Limited and Others v. Union of India and Others*, (2004) 4 SCC 311.

[125] Supra Note 37.

[126] Supra Notes 33 and 37.

20 THE CONSEQUENCES OF CHIMERAS: AN ANALYSIS OF THE NEED FOR CROSS-BORDER INSOLVENCY LAWS IN INDIA, IMPLICATIONS OF ITS ENACTMENT, AND THE ROLE OF DOMESTIC COURTS

- Mayannk Sharma, Ryan Joseph and Sanjitha Ravi

EXECUTIVE SUMMARY

The accelerating influx of foreign investment in India paves the way for Indian insolvency regulators' entry into a globalised economy in the 21st Century. While certain developments such as the introduction of Draft Part Z based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (Model Law) are praiseworthy and offer a starting point for the Insolvency and Bankruptcy Code, 2016 (IBC/Code) to converge with global insolvency practices, there is an apparent lacuna in achieving the same which this paper highlights and offers solutions towards. Further, the importance of courts in exercising their inherent powers in inculcating universalism has been illustrated and the powers of National Company Law Tribunal (NCLT) were assessed to examine whether they would be enough to address the aforementioned complexities. Emphasis has been placed on the importance of court-to-court communication whilst dealing with cross-border insolvency cases and the adoption of Judicial Insolvency Network (JIN) Guidelines has been recommended to preserve judicial comity and promote cross-court harmony.

Keywords: IBC, Draft Part Z, International Insolvency, JIN Guidelines, Universalism

INTRODUCTION

In today's day and age, there has been a herculean expansion in international investments and trade which has established the prevalence of corporates having assets, businesses, creditors, and debtors situated in more countries than one.[1] Nevertheless, much like prayer is incomplete without penance, today's global marketplace comes with the added disadvantage of business risk failure[2] as a consequence of which cross-border insolvencies (CBIs) tend to occur. This has been established in the cases of Bank of Credit and Commerce International,[3] Maxwell Communications Corporation[4] and the Lehman Brothers;[5] all of which involve a large corporate entity with assets located in multiple jurisdictions. The UNCITRAL has introduced the Model Law to facilitate the resolution of CBIs in a smooth manner. Countries that adopt the Model Law have the leeway to enact it with a few modifications. In India, a CBI framework is yet to be enacted, but the Ministry of Corporate Affairs (MCA) has made an attempt to this end by constituting committees to suggest a CBI framework for India and published the committees' reports suggesting the adoption of the Model Law along with provisions for CBI laws and recommendations therein. Unfortunately, however, CBI laws have not been enacted in India as yet, making it a dream that is long overdue for international business. This move appears to be in line with the emerging international consensus on the adoption of the Model Law to enhance the existing global economy. With the rise in the amplitude of voices of scholars such as Deana and Mason on the benefits of adopting the Model Law in furthering the rule of law in transnational insolvency disputes and its effect on promoting 'transparency, accountability and predictability',[6] recommending India adopt the Model Law, manifold views have been offered views on the substance of Draft Part Z. However, very little research has been conducted to assess the practical implications of actually adopting the Draft Part Z. Scholars such as Gerber have highlighted that notwithstanding the adoption of the Model Law, the overbearing effect of the domestic statute has led jurisdictions such as the US, *inter alia*, to merely adopt the Model Law as a negligible topping to the domestic insolvency law sundae.[7] This, in effect, shackles the universalistic benefits accruable from the adoption of the Model Law. Godwin, Howse and Ramsay have explained this phenomenon by propounding that there are various 'doors to ancillary assistance' such as judicial, contractual and legislative assistance. However, certain jurisdictions adopt legislative assistance as the exclusive door of assistance, which places cumbersome restrictions on courts administering CBIs in exercising their inherent powers to adjudicate disputes in a manner that furthers comity and universalism.[8] As a caveat to equipping the judiciary with unbridled powers, Shetye has flagged the vices of non-uniformity and unpredictability as the risk of excessive judicial leeway in CBI litigation.[9] However, this research has been limited to international jurisdictions and very little has been done on the Indian front barring the notable contribution of Misra and Feibelman.[10] This paper attempts to fill this lacuna by highlighting the practical implications of adopting the Model Law, in the form of Draft Part Z in India.

The paper first delves into the problems arising out of CBIs, how the Model Law emerges as a successful solution through the modifications that are possible in its adoption, and its consequential reliance on institutions for its implementation. It then presents the scenario qua CBIs in India and the detriment suffered by domestic creditors due to the dithering of the legislature in the enactment of CBI laws, followed by the discussion of certain complexities in determinations that would arise and how such complexities have been addressed in the framework published by the MCA as well as the gaps therein – thereby establishing the monumental responsibility of insolvency courts to interpret CBI laws and adjudicate accordingly. The paper will thereafter highlight the importance of courts in exercising their inherent powers in furthering universalism, it will further assess the powers of NCLT under the Code and will attempt to find whether it is enough to address the complexities that may arise in CBI. Finally, the paper will attempt to reconcile the existing theoretical viewpoints and advocate for a modified universalist approach while balancing the problem pertaining to the public policy exception. Emphasis has been placed on the importance of court-to-court communication whilst dealing with CBI cases and the adoption of JIN Guidelines has been recommended to preserve judicial comity and promote cross-court harmony. The alterations of Singapore's existing insolvency regimen to accommodate JIN Guidelines serves as a stellar example for the authorities in India to modify Draft Part Z on similar lines.

THE ORIGIN OF CROSS-BORDER INSOLVENCY AND THE MODEL LAW

Before addressing the elephant, the room it is in ought to be read. A herd of questions would have to be answered in this regard: at the forefront of which is what the problem surrounding CBIs is. The most predominant problem with CBIs is inconsistency. They are prolonged and costly owing to insolvency rules and regulations in different countries being in different languages and under different traditions and legal systems[11] – these almost always lack a sense of congruency and various conflicts of laws issues[12] manifest themselves. Insolvency orders are predominantly monetary court judgements, and it becomes irrational to expect that courts are not particular about the enforcement of orders from numerous countries with non-uniform legal systems and laws therein. Debates as to the merits and demerits of varying methods of insolvency resolution which include territorialism, universalism, contractualism, and modified universalism have been ongoing for the past few decades.[13] These terms are elucidated in the latter parts of this paper.[14]

In the wake of these uncertainties and inconsistencies surrounding CBIs, the Working Group on insolvency law was charged with the development of legal instrument on CBI by the UNCITRAL Congress in May 1995.[15] This commission reached its culmination in 1997 when the United Nations recommended that member states, as a part of their respective domestic legislation, adopt the Model Law.[16] States were allowed to implement the Model Law into their domestic legal regimes to facilitate the coordination and resolution of complex CBI cases.[17] It is pertinent to note that the Model Law is different from a United Nations convention in that a State, upon adopting the Model Law, does not need to notify the United Nations or other member States of its decision to do so.[18] As of today, the Model Law has been adopted across 56 jurisdictions in 53 countries including, *inter alia*, United Kingdom, Canada, South Africa, US, Korea, Japan, Australia, and Singapore.[19] In the first few years since its inception, legal scholars and academics expressed doubts about the longevity and success of the Model Law.[20] As of 2012, out of the 193 members of the United Nations and 60 Member States of UNCITRAL, only 18 and 11 member entities respectively had adopted the Model Law.[21] The following examples are cited to better elucidate the relevance of the aforementioned figures: the Model Law on Electronic Commerce (1996) had 44 adoptees in 2012 and the same on International Commercial Arbitration (1985) had 67.[22] Professor Ian Fletcher, rather profoundly, opined in 1999,[23] *'The proof of the Model Law will be in the enactment. The crucial question is not the number of States which take a conscious decision to enact the law but the extent to which they do so, both individually and collectively'.*

Therefore, much like it is the thunder that follows lightning which has the power to scare children despite the much more harmful nature of the latter; the quality of the adoption of the Model Law emerges with materiality. The Model Law comprises of, for the most part, legal standards and not strict rules which allows for its provisions to be open to judicial construction by member states.[24] It even explicitly states, *'a State may modify or leave out some of its provisions;' with the accompanied limitation by recommending, 'that States make as few changes as possible in incorporating the Model Law into their legal systems'*.[25] There exists a need to restore a balance between the individual interest of the State and the collective interest of ensuring predictability vide uniformity. Multiple attempts to achieve multilateral treaties in the insolvency area have been unsuccessful in the past due to their rigidity.[26] As Fletcher so eloquently states:

> All [successful treaties] are examples of co-operation between states sharing generally close legal and cultural affinities. In the absence of such established interstate relationships the difficulties of achieving a satisfactory agreement are of a very high order. This is attributable in large part to the special nature of insolvency proceedings, with their comprehensive effects upon the debtor's status and patrimony. The individualised characteristics of the nation's bankruptcy laws can be shown to be intimately linked to many aspects of the economic and social culture of that community so that vital, interlocking provisions exist between the insolvency law and the general law of the system in question.[27]

The quality of the adoption, therefore, does not mean the complete unencumbered adoption of the Model Law; rather, the preservation of its core traits. The pillars of access, recognition, co-operation, and co-ordination that fortify the Model Law,[28] accordingly, must be present in its enactment by States. The principle aim of the Model Law is to inculcate as much predictability and uniformity an international set of standards can possibly have, and the UNCITRAL mechanism encourages countries implementing it to formally sanction an 'international' approach to the aforesaid implementation of it.[29] Additionally, the practice guide by UNCITRAL with regards to the Model Law states that 'the absence of predictability as to how [cross-border insolvency laws] will be applied and the potential cost and delay involved in application' builds 'a further layer of uncertainty that can impact capital flows and cross-border investment,' irrespective of the design of the existing legal regime in a particular country.[30] The manner of enactment by countries that have adopted the Model Law and its contribution to the collective interest of predictability will be illustrated in the latter part[31] of this paper that discusses the co-operation of courts. The Model Law heavily relies on institutions for its implementation, making courts *sine qua non* to the process. It is an amalgamation of true universalism as it recognizes the authority of the insolvency framework of each State, and territorialism as it brings all cross-border proceedings under its umbrella – thereby rising as a hybrid of modified universalism with a territorialist foundation which has ultimately led to its wide implementation across member states.[32]

INDIA AND CROSS-BORDER INSOLVENCY

Now that the room has been read, the focus can be shifted to the elephant. The landmark judgement of the National Company Law Appellate Tribunal (NCLAT) in *Jet Airways (India) v. State Bank of India*[33] was the first case in which a CBI protocol was developed and implemented in India. The Jet Group had been facing insolvency proceedings simultaneously in Netherlands and in India. Hence, the Dutch Court-appointed Administrator approached the Mumbai Bench of the NCLT and moved them to recognize the Dutch proceedings. However, the NCLT ruled that since there was no existing provision under the IBC to recognize the judgement of insolvency courts of foreign countries, it cannot be taken on record even upon verification *sans* the existence of the aforesaid provisions.[34] The Dutch Court-appointed Administrator subsequently approached the NCLAT, which permitted the first CBI proceeding in the country.[35] The Indian proceedings were the 'foreign main proceedings' where the debtor had its 'centre of main interests' (COMI),[36] and the Dutch proceedings were deemed the 'non-main insolvency proceedings',[37] i.e., where the debtor has an 'establishment'[38] which is 'any place of operations where the debtor carries out a non- transitory economic activity with human means and goods or services', as per the Model Law. It is through the aforementioned 'protocol' that the Resolution Professional (RP) in India and the Dutch court Administrator agreed on terms and conditions on which they would co-operate in the insolvency process with the Dutch court Administrators being allowed by the NCLAT to attend the committee of creditors (CoC) meetings with the right to observe alone so as to prevent the overlap of powers.[39] Such an agreement was built on the principle of true universalism.

Subsequently, the *Videocon*[40] insolvency chronicles saw the corporate debtor (CD) requesting the NCLT to include its overseas assets in the corporate insolvency resolution process (CIRP) in India which was permitted. Currently, India has no framework in place for CBI cases. In India, the IBC[41] only provides for the creation of bilateral agreements between countries through sections 234[42] and 235,[43] and these are used as the foundation for the aforementioned 'protocol.' The NCLT in India has been dealing with CBI cases on an ad hoc basis, which leads to significant delays in the insolvency proceedings as identified by the Ministry of Finance.[44] The status of CBI laws in India qua the IBC and the Code of Civil Procedure, 1908[45] (CPC) – in relation to the enforcement of foreign judgements – have been discussed in greater detail in later parts[46] of this paper.

The sad story of Indian creditors

With the legislature dithering on the enactment of a CBI framework, myriads of insolvency proceedings have been affected. Six subsidiaries of Rolta India Ltd. (RI), namely, Rolta UK, Rolta LLC, Rolta Middle East, Rolta Global BV, Rolta Americas and Rolta International (Rolta Debtors) filed for reorganisation under Chapter 11[47] of the United States Bankruptcy Code[48] (USBC).[49] The New York court had awarded a judgement in favour of the creditors (bondholders) of Rolta amounting to US$180 million in September, 2020.[50] The filing of Chapter 11 was an attempt by the Rolta Debtors to get a stay on this order of the Court as permissible under the USBC in section 362.[51] The Court in New York had passed a turnover order and directed Rolta entities to turnover cash and shares to the bondholders.[52] However, the Chapter 11 application by the Rolta Debtors was dismissed as it could not be demonstrated that a successful reorganisation was possible and a few subsidiaries were turned over to the creditors.[53] RI's proceedings in India in the meanwhile have not commenced. Union Bank of India had filed an application before the Mumbai Bench of the NCLT for admission which is pending.[54]

In the aforementioned scenario, had there been a CBI framework in place, the RP would be able to file for insolvency as a group of companies overseas with the consent of the CoC. The COMI could have been India, although this is not a certainty as there are complexities in place to determine the COMI which will be illustrated in the next section. Alternatively, if liquidation had commenced, Indian creditors could have filed for claims against a larger pool of assets. Additionally, the Rolta example reiterates the pertinence of timely admission into CIRP under the IBC.

Another example is of the infamous Firestar International Limited in which only the [part] claim of Punjab National Bank – US$ 3.25 million – was allowed by the US Court.[55] The claims of Union Bank of India and Bank of India were rejected.[56] However, if there had been a timely admission under the IBC in India and a CBI framework had been in existence, there could have been the high possibility to recognize the Indian proceedings as the foreign main proceedings, i.e., where the COMI is. Firestar was admitted under the IBC in September, 2019, over one year post the US proceedings.[57] Thereafter, the NCLT passed an order commencing the liquidation of Firestar.[58] Furthermore, the US proceedings revealed that there are 12 other Firestar entities spread across India, US, Belgium and United Arab Emirates (UAE) along with 16 shadow entities.[59] Had there been a CBI framework in India, the CoC could have filed across jurisdictions and this would have yielded higher recovery. The Indian approach to CBI so far can be gathered from Draft Part Z[60] of the Report (Draft Part Z) by the Insolvency Law Committee[61] (ILC) constituted by the MCA in March, 2018, part of which is legal reciprocity.[62] This means that the domestic court would only recognize the foreign court's judgement if the latter also has adopted the Model Law. Accordingly, a caveat exists in the Firestar scenario, only countries which have adopted the Model Law could participate in the suggested CBI proceedings and creditors would only recover debt from this pool.

A case wherein proceedings under the IBC had commenced prior to foreign proceedings was that of GCX Ltd., a subsidiary of Reliance Communications Ltd.[63] CIRP had commenced against Reliance Communications Ltd. In May, 2018,[64] and an order to continue CIRP was issued in May, 2019[65] by the NCLT. Whilst it is true that the subsidiary is a separate legal entity, the shares owned by Reliance Communications Ltd. in GCX can be subject to IBC proceedings as per the *Vodafone* case.[66] GCX filed for reorganisation under Chapter 11 of the USBC in the US Court which consisted of 16 entities regulated under the laws of Bermuda, Ireland, France, Australia, Germany, UK and the US.[67] The attempt by GCX was successful and resulted in a debt-to-equity swap by senior noteholders who became shareholders.[68] This begs the following question: could the RP in India have filed an application under Chapter 15[69] of the USBC for CBI arguing that the foreign main-proceedings had to take place in India as it was the COMI along with a filing for the group of companies? This question would be answered in the affirmative had CBI laws existed in India. This could have benefitted Indian creditors as proceedings under the IBC were ongoing with the concomitant challenge of its pendency for the CoC and RPs.

The aforementioned cases are only a few needles in a stack of other ones which are just as sharp and prone to rusting if left unattended for a prolonged time. There exists an abundance of cases in which the lack of an adequate CBI framework has proved detrimental to Indian creditors and delving into every single one of them would be beyond the scope of this paper.

The complexities in cross-border insolvency

In the Indian context, the adoption of the Model Law would entail the existing tribunals to develop a substantial understanding of the new legal regime in all its extensivity, and establish a domestic jurisprudence elucidating its rules by making use of leading global jurisprudential approaches and legal precedents.[70] Some of the complexities that could arise in a CBI are discussed in this section in order to encapsulate the convoluted nature of CBIs and demonstrate the need for clarity within CBI laws. As stated in the previous section, these concerns, for the most part, have been addressed in the

Draft Part Z by the ILC. Thereafter, the MCA constituted the Cross-Border Insolvency Rules/ Regulations Committee (CBIRC) to facilitate the unencumbered implementation of the provisions of Draft Part Z. The CBIRC studied the Model Law for Enterprise Group Insolvency and make recommendations on CBI and resolution of enterprises and published its Report in 2020.[71] Both the ILC and CBIRC included provisions based on existing legal precedents from countries that have adopted the Model Law, the *Jet Airways* and *Videocon* cases, as well as the UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation.[72]

a) How to ascertain discretionary reliefs and a particular debtor's COMI

Clause 18(1)(e)[73] and (f)[74] of Draft Part Z include discretionary reliefs such as participation in proceedings pertaining to the CD, information sharing, protection, collection of claims, and realisation of assets. The CBIRC in its report[75] recommended that provisions as to the powers of the Adjudicating Authority (AA) in passing orders in the exercise of its powers under clause 18(1)[76] be included in the CBI Rules.

Further, the determination of the COMI as per clause 14[77] of Draft Part Z establishes a hierarchy which begins with the registered office of the CD, its place of central administration and finally 'other factors'. The CBIRC has detailed other factors in its report[78] and recommended that the said hierarchy be done away with and a consideration of the date of commencement of foreign proceedings be included, as a 'main interest' cannot be just gathered from a registered office and other factors ought to be considered in this regard. Such an approach is apparent in the CBI frameworks of the US and Singapore.[79]

b) Recognition of a foreign proceeding and foreign main proceeding

The Draft Part Z has provided for the mechanism for recognition of a foreign proceeding in clauses 12 to 18.[80] Upon recognition, reliefs are allowed to be granted regardless of whether a foreign proceeding is a main proceeding or not. Clause 2(e)[81] defines foreign main proceedings as where the debtor has its COMI and clause 2(f)[82] defines non-main proceedings where the debtor has an establishment, same as under the Model Law and the *Jet Airways* case. Establishment under clause 2(c)[83] of Draft Part Z entails the same definition as under the UNCITRAL Model Law. The CBIRC has further issued an indicative list of foreign assets and liabilities to ascertain whether a particular proceeding is a main proceeding or not.[84] However, reliefs such as moratorium or transfer or sale of assets are mandatorily granted for main proceedings, whilst the same is at the discretion of the Court for non-main proceedings.[85] A doubt that rises upon the perusal of the clauses qua the recognition of a foreign proceeding under the Draft Part Z is whether it would have the same effect as initiation of CIRP under the IBC. This is the impression one can gather from clauses 17[86] and 18[87] of Draft Part Z which seem to suggest this as the clauses refer to provisions of the IBC for reliefs that shall and may be granted upon recognition. Since the Draft Part Z includes legal reciprocity,[88] the two provisions read together would elucidate the impression that the provisions of clauses 17 and 18 would only be enforced whilst recognising foreign proceedings in countries that have a corresponding provision in their insolvency laws. Nonetheless, the aforementioned is merely a consolidated understanding of the provisions of Part Z – neither the ILC, the MCA nor the CBIRC has issued any clarification in this regard, courts will have to clarify this interpretation if CBI laws are enacted based on the aforementioned recommendations.

c) The definition of a 'Debtor'

The Draft Part Z, at this stage, only applies to CDs as defined under the IBC and not individual debtors.[89] The rationale behind this decision has to do with the fact that there is currently limited ground knowledge of the technical hindrances that could arise which would result in the difficulty of full-fledged implementation.[90] As it stands, the definition of CDs under the IBC[91] includes companies incorporated under the Companies Act, 2013,[92] Limited Liability Partnerships incorporated under the Limited Liability Partnership Act, 2008[93] or any other person incorporated with limited liability under any law in India not inclusive of financial service providers. This excludes companies incorporated outside India from the purview of the IBC. Draft Part Z, however, has included such companies by stating that the provisions of Draft Part Z would apply to foreign companies.[94] Neither the IBC nor Draft Part Z has defined foreign companies, but the former allows the adoption of definitions from other laws such as the Companies Act, 2013.[95] Foreign companies are defined in section 2(42)[96] of the Companies Act, 2013 as companies incorporated outside India with a place of business or conducts any business activity in India.

There exists an ambiguity in the Companies Act, 2013 surrounding foreign companies qua debt recovery due to their exclusion from the purview of the IBC. The MCA has not clarified whether foreign companies would be regarded as unregistered companies under the Companies Act, in which case the remedy for domestic creditors lies in section 375[97] of the aforesaid Act. If Draft Part Z is enforced as it stands, however, it would result in a duality of proceedings if the company unable to pay its debt does not undergo insolvency out of its own volition. The only possible way through this would be registering and incorporating a subsidiary in India, in which case the shares held by the holding company can be subject to the CBI proceedings.[98]

In the event that the foreign debtor has no place of business or business activity in India, they would fall outside the purview of Draft Part Z and consequently the IBC. The domestic creditor would be left with no remedy under the CBI framework. It is for these reasons that the CBIRC recommended the inclusion of the definition for foreign companies under the IBC as limited liability entities incorporated in foreign countries as envisaged in the proviso to clause 1(2)[99] of Draft Part Z.[100] The MCA and the Insolvency and Bankruptcy Board of India (IBBI) would have to amend the Companies Act, 2013 and the IBC respectively to prevent any and all overlaps.

d) Who is a foreign representative?

Clause 2(h)[101] of Draft Part Z includes a definition for foreign representatives and the CBIRC has provided extensive recommendations and guidelines on the rights and regulations surrounding them. A recommendation, in particular, has been made towards a code of conduct for foreign representatives regulated by the IBBI along with an online mechanism through which foreign representatives would have to submit an application to the IBBI for authorisation at the time of applying to the NCLT under Part Z or immediately thereafter.[102] The provisions of code of conduct for Insolvency Professionals in the IBBI (Insolvency Professionals) Regulations, 2016[103] would be enacted *mutatis mutandis* to foreign representatives as per the CBIRC recommendations.[104] The IBBI would then have 10 days to reject the application if there is any misconduct in a previous proceeding conducted by the IBBI or a pending disciplinary proceeding before the IBBI.[105] The IBBI's authorisation is by no means a condition precedent to approaching the NCLT and if there is a rejection of the representative by the IBBI, it would be reported to the NCLT which will issue orders as it sees fit including requiring a fresh application to be made with a new representative.[106] Additionally, the IBBI is time-bound, and it would be a deemed authorization after the expiry of 10 days.[107]

In the event that CBI laws based on the Draft Part Z and CBIRC Report is enacted in India with certain clarifications (as illustrated above), there would be a statutory framework in place that would facilitate the mitigation of the complexities involved in the aforementioned determinations.

Nevertheless, there are uncertainties accompanying such clarifications which buttresses the need for courts to step in. As the interpreter of laws, courts have a mammoth task ahead of them and would need to be endowed with considerable authority to pass orders and judgements in this regard – a concern that will be dealt with in the subsequent parts[108] of this paper.

CROSS-BORDER INSOLVENCY AND ITS INEXTRICABLE LINK WITH COURTS

Historically, CBI was never birthed into existence in the cradle of the legislature; rather it was an expedient system that was molded by judges to address procedural issues that arose when foreign creditors sought to access the CD's assets that were in other jurisdictions. CBI is a process that has been developed over centuries, with the earliest model being crafted in the case of *Solomons v. Ross,*[109] where the courts of Great Britain took cognizance of the extra-territorial implications of the bankruptcy of a company with assets in foreign jurisdictions. The court granted recognition to the foreign insolvency proceeding and allowed foreign representatives (trustees appointed for the bankruptcy) from Amsterdam to collect assets situated in Britain. At its heart, CBI is a process that was necessitated by increasing interconnectedness among economies caused by the growing international trade.[110] The Model Law, unlike other international treaties, does not aim to attempt a substantive unification of insolvency laws of states rather, it aims to create uniform procedural laws.[111] It is important to have uniform laws because insolvency does not happen in silos, but functions as a collective process where all the stakeholders come together to form a consensus over the reorganisation of the debtor or over the distribution of its realisable value as per the priority accorded to each stakeholder under the law. For this consensus-building to be truly efficacious and efficient, it must happen in a single proceeding.[112] If every jurisdiction conducted a separate insolvency proceeding, it would result in a chaotic distribution of value among all creditors, which may be very inequitable.

While the need to conduct a unified insolvency proceeding is palpable, most legislations that provide for CBIs have been developed only in the last few decades, notwithstanding the fact that issues of CBI have existed for centuries. Therefore, before legislation, courts would rely on their inherent common law power to cooperate with foreign courts. *Solomons v. Ross* has been viewed as the earliest instance of courts upholding the principle of the comity of nations and furthering universalism.[113] Civil law jurisdictions may charge such developments with the sin of judicial encroachment; however, under common law, courts tend to have more power in delivering justice to the specific facts before them. Lord Sumption explicitly recognised this power of common law courts in his ratio in *Singularis Holdings Limited v. PricewaterhouseCoopers.*[114] He recognised that courts under common law have the power to recognise and grant assistance to foreign insolvency proceedings. Moreover, those powers can be extended or developed from existing powers through the traditional judicial law-making techniques of the common law.[115] Therefore, to satisfy the need to uphold universalism, in an interconnected global economy, courts around the world began to respect the principle of comity[116] and started recognising foreign insolvency proceedings even in the absence of statutory recognition to that effect.[117] In the case of *In re African Farms Ltd.*, where an English company with assets in the Transvaal was under liquidation, Chief Justice Innes noted that there was no statutory recourse to guide the insolvency; however, concomitant to the recognition of a foreign proceeding is the court's active assistance and issued a declaration to allow the liquidation of the assets in the transvaal as if they were under the jurisdiction of the courts of England.[118] In doing so, the Justice even remarked that,

> If we are able… to recognise and assist the liquidator, then I think we should do so; because in that way only will the assets here be duly divided and properly applied in satisfaction of the company's debts … Unnecessary expenses will be incurred, and the estate will be left to be scrambled for among those creditors who are in a position to enforce their claims.

The principle of universalism in the context of international bankruptcy soon evolved into modified universalism where cooperation from ancillary courts was required by a court where the 'main proceeding' occurred.[119] This was first judicially recognised in *In re Commercial Bank of South Australia*, where North J commented the following on the English insolvency proceeding;

> I will say this, that I think the winding-up here will be ancillary to a winding-up in Australia, and, if I have the control of the proceedings here, I will take care that there shall be no conflict between the two Courts, and I shall have regard to the interests of all the creditors and all the contributories, and shall endeavour to keep down the expenses of the winding-up so far as is possible.[120]

In the case of *HIH Casualty & General Insurance Ltd*, Lord Hoffman called modern universalism the golden thread running through international insolvencies.[121] In fact, even the Model Law and myriad domestic international insolvency legislations recognise modern universalism and are entirely based on it. This statutory recognition only crystallised the concept of modern universalism that was developed by courts long before. Therefore, courts not only had a pivotal role in birthing the process of CBI, but the subsequent advancements have also been catalysed by their efforts. It is indeed a curious case of how courts developed a system of their own to administer a process of palpable consequence to numerous stakeholders, such as international insolvency in the absence of a tether of support in legislation.

Revisiting inherent common law power in light of growing legislation

Contrary to the foregoing discussion on universalism, it would be misleading to presume that the trajectory of CBI has been only in the direction of universalism. Even in common law jurisdictions such as Singapore and the UK, there have been instances where courts have refused to take a universalist approach and have adopted territorialism, citing a lack of support in domestic legislation. In the case of *Rubin v. Eurofinance,*[122] the Supreme Court of England was tasked with answering the question of whether the court should devise a rule for the recognition and enforcement of judgments in foreign insolvency proceedings which is more expansive and favourable to foreign representatives than the dicey rule, or should it be left to legislation?[123] The court answered the question in the negative and left the determination to be made by the legislature. In doing so, the court had either clamped down on the inherent power of common law courts to cooperate with foreign courts or had done so to the limited extent of enforcement of foreign judgments.[124] Either way, the court's ruling was subjected to considerable vituperation and was remarked as an anathema to judicial cooperation in CBI.[125] Likewise, Singapore provides an interesting example of a common law jurisdiction where courts choose not to exercise their inherent power, but rather are extremely dependent on the legislature for exercising their powers.[126] Section 377(3)(c) of Singapore's Companies Act, further adds to the lack of cooperation by providing for a ring-fencing mechanism where assets in Singapore must first be used to satisfy the obligations of Singaporean creditors before they are used for creditors outside.[127] For example, *in Re Opti-Medix Ltd*, the Singaporean court approved the remission of assets resting in Singapore as long as the debt obligations in Singapore are satisfied before any other obligations.[128] Albeit, recent cases seem to suggest that Singapore is reconsidering its position. The Singaporean Court of Appeals in *Beluga Chartering* opined that the power of a common law court to cooperate with foreign courts under the ancillary liquidation doctrine, modified universalism, exists in tandem with the powers enshrined in the legislation of Singapore.[129]

Closer to the focus of this paper, in India, the powers of the NCLT, have been circumscribed by a catena of judgments that have required NCLTs to strictly abide by the statute. As of now, the principal function of the NCLT under the IBC, *inter alia,* is to kickstart the CIRP under sections 7, 9 or 10[130] and to approve resolution plans under section 31.[131] However, even when performing these functions, NCLTs have a very limited role to play independently as their actions are largely governed by the statutory framework. The Supreme Court of India in *Innoventive Industries v. ICICI Bank*[132] held that NCLTs have a very limited scope of inquiry when hearing insolvency petitions under section 7, 9 or

10 it must restrict itself to ascertaining the existence of a debt. In *Pratap Technocrats (P) Limited and Others v. Monitoring Committee of Reliance Infratel Limited*[133] the SC considered NCLTs scope of powers when approving a resolution plan under section 31. J. Chandrachud speaking for the Hon'ble Supreme Court held that the nature of enquiry under section 31 is extremely limited to merely ensuring whether the resolution plan in contention is in compliance with section 30(2)[134] and once again curtailed the powers of the NCLT. The court particularly remarked that NCLTs must abide by the purport of the statute and should not venture into any sort of judicial innovation, which does not find a tether of support in the statute, by relying on supposed powers in equity, which it does not have. Then in the case of *Arun Kumar Jagatmramka v. Jindal Steel and Power Ltd. & ors.*, the Supreme Court chided the practice of NCLTs unnecessarily interfering in the CIRP and delaying it.[135] In its obiter, the Supreme Court issued guiding principles that NCLTs must consider when adjudicating IBC disputes. At the outset, NCLTs should keep judicial innovation in check and should always adhere to the foundational principles of IBC. Furthermore, even when the facts of a case necessitate a change or expose a limitation in the IBC framework for it is not the role of NCLTs to fill such lacunae for such changes must come from the legislature. Finally,in *EbixSingapore Private Limited and Ors. v. Committee of Creditors of Educomp Solutions Limited and Ors.*[136] the SC was considering the enforceability of a force majeure clause in a resolution plan. The court noted that the IBC did not provide for the withdrawal of resolution plans once they were approved by the CoC, nor did it provide for the existence of a force majeure clause in resolution plans. In the absence of any such express provisions, the court ruled that NCLTs lack the powers to enforce a force majeure clause in a resolution plan. In doing so, the court expressly noted that NCLTs lack the inherent power to grant procedural reliefs, which are not envisaged in the statute and have a substantive effect on the CIRP. It is worth mentioning that in *Gujarat Urja Vikas Nigam Limited v. Mr. Amit Gupta*[137] the SC did recognise that NCLTs have jurisdiction under section 60(5)(c) of the IBC to adjudicate questions of law or fact in relation to the insolvency resolution proceedings and the jurisdiction of NCLTs cannot be confined to actions provided under certain sections of the statute. The Supreme Court even tried to discern the legislative intent to draw the contours of NCLTs jurisdiction and opined that if the legislature had intended to restrict the jurisdiction of NCLTs to certain sections, the legislature would not have accorded NCLTs with discretionary powers under section 60(5)(c).[138] However, the Supreme Court chose to not ruffle any feathers and chose to draw tall guardrails around NCLTs' discretionary powers by restricting its ratio to the facts before it and the Court explicitly stated that this ruling should not be construed as a general principle of the NCLTs' power.[139]

Therefore, unlike the courts in England, which used their inherent powers to establish ad hoc CBI frameworks, through these rulings, the Supreme Court rejected the idea that NCLTs, have any inherent power alongside the powers they draw from the statute.

Importance of inherent insolvency powers in Indian context

Clause 2(a) of the Draft Part Z of the IBC bestows upon the NCLT the status of the AA.[140] In furtherance of this role, the NCLT is expected to do all functions necessary to ensure a smooth recognition of foreign proceedings and streamlined communication with foreign courts and foreign representatives in order to maximise the value of the corporate debtor during the insolvency process. The NCLT is thus, one of the most important cogs in the Indian CBI machinery, and it is very difficult to conduct a smooth resolution of insolvencies without the cooperation of NCLTs.[141] Albeit, once enforced, Draft Part Z would govern the entire process of CBI in India; as discussed previously in this paper,[142] Draft Part Z only provides a broad overarching framework instead of specific regulations on how to conduct CBI.[143]As illustrated in the previous part, while clause 14 provides that *'the corporate debtor's registered office is presumed to be the corporate debtor's centre of main interest'*,[144] this presumption can be rebutted in the existence of contradictory proof. In case of a conflict, clause 14(3) requires the NCLTs to conduct an assessment to determine the CD's centre of main interest. The later section highlights other determinations such as the recognition of a foreign proceeding and foreign main proceeding,[145]defining a debtor,[146]defining a foreign representative[147]that are marred with uncertainty and would require the NCLT to develop its own jurisprudence on adjudicating CBI. The NCLT would most certainly first have to look at the statute; however, the complexity of CBI is such that no amount of codification can truly capture all the complexities that may arise in the process. At certain moments, as the English Supreme Court was in the case of *Rubin*, may encounter a set of facts for which the Indian law does not provide a remedy, in such a scenario, ideally, the NCLT will have to rely on international jurisprudence to further the principle of modified universalism and respect the commit of nations. However, it is unclear whether at this juncture the NCLT will find itself powerless or will it be allowed to take the gumption and align the Indian CBI framework with the international jurisprudence even in the absence of domestic law. The Mumbai NCLT was faced with a similar conundrum in the *Jet Airways insolvency*[148] where alongside the Indian insolvency proceeding, a proceeding had started before the Noord- Holland District Court in the Netherlands. The foreign representative thus petitioned Mumbai NCLT to recognise the foreign proceeding. However, at the time, section 234, which allowed the Central Government of India to enter into CBI agreements with foreign jurisdictions was not enforced. Therefore, the Mumbai NCLT ruled that it lacked the power to recognise foreign proceedings. Furthermore, the Mumbai NCLT went so far as to rule that in the absence of a notified provision in the IBC, even the foreign insolvency proceeding in the Netherlands was void ab initio. It is only in the appeal to the NCLAT that the tribunal directed the Indian RP to cooperate with the foreign representative pursuant to which they entered into a cross-border insolvency protocol, which in substance was similar to the UNCITRAL Model Law.

Apart from avoiding blushes of being perceived as a business hub that is perverse to the idea of universalism and cooperation, there are many other benefits of allowing NCLTs to exercise greater inherent powers at least in the international insolvency framework. To begin with, typically the legislature has to go through far too many steps than courts to bring amendments to existing positions of law. This cumbersome process often makes Governments wait for major developments to occur before they bring an amendment into motion. On the other hand, courts have far greater flexibility to mould common law in a manner that suits the needs of the changing times.[149] Millet LJ in *Credit Suisse Fides Trust v. Cuoghi*, remarked that 'commercial necessity has encouraged national courts to provide assistance to each other without waiting for such co-operation to be sanctioned by international convention'.[150] Lastly, as the authors established at the beginning of this part, as the AA, the NCLT will be at the forefront of CBI's in India and the pace and smoothness of CBI resolution will be entirely contingent on NCLT's institutional capacity and competence to adjudication over the process. If the NCLT is shackled and is required to wait for the matter to be appealed to the Supreme Court or wait for the legislature to act, CBI's will inevitably get delayed and the principal objective of insolvency laws, maximising value of the CD, will be lost. Granted, at times as the domestic insolvency landscape has suggested, allowing NCLTs to exercise greater inherent power may lead to delays and unnecessary complications. Yet, the very nature of CBI's is so complex that NCLTs may find themselves powerless in addressing those complexities and may soon be reduced to a body that is so powerless that it only acts as an additional hurdle in resolving insolvencies.

INTER-COURT COOPERATION: CHALLENGES AND OPPORTUNITIES

An efficient implementation of the Model Law on CBI is contingent on cooperation among the member states, particularly between the domestic and foreign courts centred around the dispute. It is essential that the differences among procedural laws of the member states are respected; more importantly, the adoption of the Model Law should entail a framework for cooperation that promotes a uniform approach to CBI.[151] A time-bound and successful resolution of domestic and foreign creditors' dues is deep-seated in a high degree of cooperation among member states. Thus, the underlying premise of this section will focus on the adoption of a formalised cooperation mechanism, with an emphasis on inter-court cooperation primarily guided by the existing frameworks on judicial communication and cooperation.

The initial question before exploring inter-court cooperation is whether the existing statutory framework adequately caters to the requirement for facilitating coordination between foreign and domestic courts and if so, why would then a need for exploring an alternative cooperation mechanism arise.

Existing statutory mechanism

Barring a few exceptions, section 13 of the CPC,[152] allows a foreign judgement to be conclusively binding on the litigating parties which should ideally suffice for recognition of CBI proceedings. However, owing to complexity and administrative constraints, the CPC is ill-equipped to deal with CBI matters since they involve passing of 'orders regarding reorganisation processes, administrative and interim orders, etc'[153] that might render a lot of judgement and orders eventually unenforceable in India for want of non-compliance.[154] Similarly, the NCLAT in *Usha Holdings LL.C. & Anr v. Francorp Advisors Pvt Ltd*[155] held that the NCLT cannot adjudicate upon the legality or enforceability of a foreign decree while admitting or rejecting a claim as a debt under section 5 of the Code. In the said appeal, the NCLAT clarified the status of the AA to hold that the initiation of the CIRP does not allow the AA to assume the role of a Court.[156] Consequentially, it cannot adjudicate the validity of a decree even if the same is not in compliance with section 13 of the CPC. Therefore, it is immaterial whether a foreign decree has been executed in India or not since the Code does not confer authority on the NCLT to adjudicate its enforceability in the first place.

While sections 234 and 235 of the Code do regulate bilateral insolvency agreements with any country outside India by way of a letter of request, it is however, insufficient and outdated to deal with the dynamism of CBI cases. An economic survey released in 2022 by the MCA of the present regime according to which, 'the current provisions under IBC are ad-hoc in nature and are susceptible to delay. Entering into mutual (reciprocal) agreements require individual long-drawn-out negotiations with each country. This leads to uncertainty of outcomes of claims for creditors, debtors and other stakeholders as well'.[157] The procedure for entering into a reciprocal agreement is also absent in the IBC which would mean that reliance will have to be placed on general provisions such as section 44A of the CPC[158] which brings us back to square one in terms of expediency of proceedings. Further, entering into multiple agreements under sections 234 and 235 where the CD's assets are located in numerous jurisdictions is detrimental to the object of speedy resolution as the same would require reciprocal agreements with each and every nation where the CD's assets are situated. There is a need to revamp the existing statutory mechanism since the CPC and the IBC, in their present state are inadequate to accommodate the competing interests of stakeholders and ensure that speedy resolution of cross-border transactions is not hampered.

The disconnect of the current insolvency regimen with the necessary framework for facilitating cross-border transactions is apparent on a bare perusal of the existing statutory mechanisms. The need for bridging this disconnect rests on cooperation among member states. The primary reason behind the failure of the current mechanism is its inability to officiate a clear communication framework that would not require individual multilateral agreements for CBI for the sake of efficiency and expediency.[159] There are certain other problems with cross-border cases concerning the public policy exception to the recognition of a foreign court's decision and the necessity to align the public policy restriction in the narrowest possible manner similar to the practice in the US.[160] Lending the CD an opportunity to indulge in forum shopping is also prejudicial to the creditor's interest since it allows the CD to interpret the same set of rules in a different country's court giving him access to an altogether different set of remedies.[161] It also undermines the object of the Model Law which is to maintain harmony and comity among member states.

JIN Guidelines and inter-court communication

The JIN Guidelines were conceived in 2016 in its inaugural conference in Singapore which concluded with the issuance of guidelines titled 'guidelines for communication and cooperation between courts in CBI matters' also known as the JIN Guidelines.[162] According to Justice Steven Chong of the Supreme Court of Singapore, the JIN guidelines envisage a network of insolvency judges around the globe in view of addressing challenges specifically posed by CBI.[163] While giving an example of the *InverWorld*case,[164] Justice Chong underscores the importance of cross-court communication to preserve judicial comity and harmony. *InverWorld*, a North American company duped investors of hundreds of millions of dollars in the US as well as in Latin America pursuant to which insolvency proceedings commenced against it in the US, the Cayman Islands, and England. With the intent of avoiding parallel proceedings, the Courts agreed to allocate different functions to each of the courts and that every decision taken by a court would be binding on others.[165] This not only led to significant reduction of costs that incurred during the process against a tri-partite jurisdictional battle, but also became a cornerstone of the JIN guidelines 14 years before they formally came into existence.

Nonetheless, harmonisation of the Model Law with the JIN guidelines still needs to be incorporated within the proposed Draft Part Z, which will require significant modifications to the draft itself. For example, there needs to be a defined policy approach by clarifying whether the legislature intends to adopt a universalist approach or a territorial approach towards CBI. However, existing literature indicates that instead of pursuing either of the two approaches, a 'modified universalist' approach has emerged as the best practice in various insolvency regimens.[166] This is due to the fact that this approach aims at avoiding multiplicity of proceedings by considering the proceedings in a debtor's home country to be mutually recognised in other jurisdictions where the debtor's assets are located.

The public policy exception

Theoretical underpinnings aside, modified universalism also restricts the scope of a public policy exception since it does not allow a decision to be invalidated unless it is manifestly contrary to the local laws of another jurisdiction.[167] It is essential that the broad contours of a public policy exception are well defined and there are only a limited situations where a decision is not recognised. There is a further need to refine 'public policy' since the Model Law (Article 6) does not attempt to define 'public policy' as it is based on national law and hence differs from one jurisdiction to the other. The 'settled' law on the public policy debate in India is far from settled, but the general consensus is to confer wide discretionary powers on the courts towards interpreting judicial precedents and selectively rendering its decision regarding a public policy violation.[168] Clause 4 of Draft Part Z confers discretion upon the AA to refuse to abide by a decision or take any action in case the decision would be prejudicial to the public policy of India.[169] Moreover, there is also a risk of bureaucratic interference since clause 4(3) empowers the Central Government to apply to the AA for an order against the implementation of any action if it feels that the said order may be contrary to India's public policy.[170] This is a serious setback to the implementation of the Model Law since instead of reducing the intermediaries between jurisdictions for the enforcement of a decision. It rather gives a say to the government itself which may be prejudiced to give an opinion in favour of a public policy violation in case it has a disagreement over the foreign court's award. Needless to say, it would also be a grave violation of separation of powers since it would amount to an outsourcing of an essential judicial function of interpretation of law.[171]

A domestic point of view

The prevailing jurisprudence in section 1506 of the USBC (Public Policy Exception) may serve as inspiration for the policy makers to reconsider the public policy angle and refine it to a limited extent. A tripartite test laid down in the *Qimonda AG* case delineates specific instances which would not warrant a public policy exception. These include firstly, that a mere conflict of laws between foreign and domestic law without any other considerations is insufficient to invoke the public policy exception. Secondly, that foreign proceedings should not be entered into in case the procedural fairness is in jeopardy and thirdly, that actions should not be taken where doing so would frustrate the application of a constitutional or statutory right.[172] Some instances of an application of the public policy exception include the one in *Jaffé v. Samsung Elecs. Co.*[173] where the fourth circuit court of appeal refused to recognise a decision that would have made relief on other creditors not available as per US Law. While considering the abovementioned factors, there is a need to focus on the semantics of the text as well. Article 6 of the Model Law opens up a possibility for the member states to either adopt the text 'as is' laid down in the Model Law or omit the word 'manifestly' in Article 6 and expand the scope of interpretation of the public policy debate. The former interpretation is desirable since it suggests that the exception be interpreted as narrowly as possible whereas an omission of the word 'manifestly' may not lead to a situation where a domestically unenforceable contract is enforceable from the lens of 'international comity.'[174]

Incorporating the JIN Guidelines by adopting the existing best practices

With the public policy exception out of the way, the success of a CBI proceeding hinges upon the efficacy of court-to-court communication. Harmonising JIN guidelines with the Model Law to come up with a robust national legislation on CBI is a formidable task. Yet, some prominent jurisdictions have managed to do so. These include Singapore, multiple districts of the US, England, Brazil, Seoul, Australia etc.[175] While the COVID-19 pandemic was devastating for the global economy, there did emerge a silver lining in the form of ready adoption of the JIN guidelines by the Brazilian authorities.[176] Recognising the shortcomings of the pandemic in terms of travel restrictions and COVID appropriate behaviour, the Brazilian authorities were cognisant of the importance of video conferencing and even approved a resolution allowing state courts to adopt 100% digital courts.[177] This was a significant modification of the JIN guidelines to overcome the blues of the gloomy pandemic days and fostering communication and cooperation among courtrooms. The guidelines adopted by the Brazilian authorities even took into account the technical modalities surrounding video conferencing by recording the inter-court communication and making it freely accessible to the parties to the suit. Additionally, like the *Jet Airways* case, the resolution also allowed joint meetings to be conducted for achieving cooperation among the courts as and when required. Similarly, adoption of the JIN guidelines has transformed Singapore into a global restructuring hub.[178] This is evident due the successful management of Ezra Holdings Ltd.'s insolvency as well as in the case of *Re: Zetta.* In Ezra Holdings Ltd., the debtor had applied for a Chapter 11 bankruptcy in the US, whereas the meeting for creditors was convened in Singapore. The JIN guidelines allowed Ezra Holdings to gain approval from both the bankruptcy courts and facilitate the cross-border protocols harmoniously between the two jurisdictions.[179] This essentially opens another avenue for adopting JIN guidelines by leveraging multiple jurisdictions to receive the best option for the restructuring plan.[180] Similarly, *Re: Zetta* is another instance of inter-court cooperation. Here, the Singapore High Court was tasked with determining the COMI in insolvency proceedings pending before Singapore and the US which was resolved by the Singapore High Court adopting the US position by prioritising the date at which the application for recognition was made.[181]

CONCLUSION

The downside to building castles in the air is that they will remain in the air if not executed with the utmost prudence: as nothing but mere chimeras with no hope of metamorphosing into a reality. The agenda of this paper, accordingly, was to fill a gap in the existing scholarly work which only critiqued the substance of the Model Law and left the practical implications largely untouched. In furtherance of this agenda, the paper began by underscoring the importance of India adopting the Model Law as manifested in Draft Part Z. Then, certain limitations of the Draft Part Z were identified to resolve niche complexities that may arise during CBI litigation and the importance of NCLTs to rise as the protagonist offering bespoke solutions was established. However, while assessing the powers of the NCLT in acting as the adjudicator of transnational insolvency litigation it was found that while NCLTs are powerful in addressing any dispute that is covered by the statute, they are left wanting for power when an unprecedented dispute arises. Therefore, the paper recommended that along with the powers that NCLTs draw from the statute, NCLTs should have greater leeway at least in cases of CBI to exercise its powers to come up with innovative solutions. Further, the paper remarked that to uphold the principles enshrined under the Model Law, NCLTs would have to cooperate with foreign courts like never before and offered adoption of JIN Guidelines albeit with the necessary changes reflecting a higher threshold for availing the public policy exception as a prospective solution to this problem.

'*If you have built castles in the air, your work need not be lost; that is where they should be. Now put foundations under them.'*[182]

- Henry David Thoreau

The construction of the castle of cross-border insolvency laws in India began way back in 2018 with the ILC's Draft Part Z. Whether that castle will find itself on the ground upon its enactment post the consideration of pertinent factors or stay adrift in the air as it is now remains to be seen.

[1] Harmer M. (1997), "The UNCITRAL Model Law on Cross-Border Insolvency", 6 Int'l. insolv. rev. 145, p. 146.

[2] Anderson K. (2000), "The cross-border insolvency paradigm: a defense of the modified universal approach considering the Japanese experience", 21 u. pa. j. int'l. econ. L. 679.

[3] [1992] BCC 757.

[4] [1992] BCC 83.

[5] Altman J. (2011), "A test case in international bankruptcy protocols: the Lehman Brothers insolvency", 12 SAN DIEGO INTL. L.J., pp. 463-495.

[6] Deane F. (2016), "The UNCITRAL Model Law on Cross-border Insolvency and the Rule of Law", 25 INT'L. INSOLV. REV. 145, pp. 138-159.

[7] Gerber E. (2003), "Not All Politics is Local: The New Chapter 15 to Govern Cross-Border Insolvencies", 71 FORDHAM L. REV. 5, pp. 2051-2099.

[8] Godwin A., et. al. (2017), "The Inherent Power of Common Law Courts to Provide Assistance in Cross-Border Insolvencies: From Comity to Complexity", 26 INT'L. INSOLV. REV. 5, 9.

[9] Shetye N. (2016), "International Insolvency: An Indian Perspective on Cross-Border Treatment of Cases", 39 Fordham int'l. L.J. 1045.

[10] Misra P. and Feibelman A. (2021), "The Institutional Challenges of a Cross-Border Insolvency Regime", 2 CORP. & Bus. L.J. 329.

[11] World Bank, Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, April, 2001.

[12] Fletcher I. (2009), "The Law of Insolvency", 4th edition, Sweet & Maxwell.

[13] Pottow J. (2005), "Procedural Incrementalism: a model for international bankruptcy", 45 VIR. J. INTL. L. 935 & Anderson K. (2000), "The cross-border insolvency paradigm: a defense of the modified universal approach considering the Japanese experience", 21 U. PA. J. INT'L. ECON. L. 679.

[14] See the section titled "Cross-Border insolvency and its inextricable link with courts & Inter-court operations: challenges and opportunities".

[15] Report of the 30th session of UNCITRAL, "Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency", Annex 1, para 8.

[16]The Model Law is published in Official Records of the General Assembly, Fifty-second Session, Supplement No. 17 (A/52/17, annex I) (UNCITRAL Yearbook, Vol. XXVIII (1997), part three). The discussion at the thirtieth session concerning the Model Law is reproduced in doc. A/52/17, para 12-225 (UNCITRAL Yearbook, vol. XXVIII (1997), part one, A.

[17]U.N. Comm'n On International Trade Law (2013), "UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective", pp. 1-2.

[18]UNCITRAL Model Law on Cross-Border Insolvency With Guide to Enactment, U.N. CITRALOR, 30th Sess., 1999.

[19]UNCITRAL, Status: UNCITRAL Model Law on Cross-Border Insolvency, 1997.

[20]Mohan S. (2012), "Cross-border Insolvency Problems: Is the UNCITRAL Model Law the Answer", 21 INT'L. INSOLV. REV. 199.

[21] *Ibid.*, p. 207.

[22] Supra Note 20, p. 208.

[23] Fletcher I. (1999), Insolvency in Private International Law, *Oxford University Press*, 361.

[24] Supra Note 18, p. 1.

[25] Supra Note 19.

[26]Mason R. (1999), "Implications of the UNCITRAL Model Law for Australian Cross-Border Insolvencies", 8 INT'L. INSOLV. REV. 83, p. 87.

[27]Fletcher I. (1991-1992), "Cross-border co-operation in cases of international insolvency: Some recent trends compared", 6/7 Tulane Civil Law Forum 171, p. 175.

[28]UNCITRAL Model Law on Cross-Border Insolvency With Guide to Enactment and Interpretation, U.N. CITRALOR, 46th Sess, 2014.

[29] Yamauchi K. (2004), "The UNCITRAL model cross-border insolvency law: the stay of proceedings and adequate protection", 13 INT'L. INSOLV. REV. 87, p. 7.

[30] U.N. Commission On International Trade Law (UNCITRAL) (2009), Practice Guide On Cross-Border Insolvency Cooperation, Vol. 6, p. 9.

[31] See section titled "Inter-Court Cooperation: Challenges and Opportunities".

[32] Adams E. and Finke J. (2009), "Coordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism", 15 COLUM. J. EUR. L. 43.

[33]*State Bank of India v. Jet Airways (India) Limited*, CP 2205 (IB)/MB/2019.

[34]*Ibid.*

[35]*Ibid.*

[36] Supra Note 28, Sales No. E.14.V.2 (2014), art. 2(b).

[37]*Ibid.*

[38]*Ibid.*

[39]*Ibid.*

[40] Videocon Industries Limited and Ors. [MA 2385-2019 in C.P.(IB)-02- MB-2018], February 12, 2020.

[41] The Insolvency and Bankruptcy Code, 2016.

[42] Section 234, IBC.

[43] Section 235, IBC.

[44] The Ministry of Finance, Economic Survey 2021-22.

[45]The Code of Civil Procedure, 1908.

[46] See Section titled "Inter-court Cooperation: Challenges and Opportunities".

[47]11 U.S.C. Chap. 11.

[48]11 U.S.C.

[49] *In re:Rolta Int'l, Inc.*, Case No. 20-82282-CRJ11, (Bankr. N.D. Ala. 2020).

[50]*Ibid.*

[51]11 U.S.C. §362.

[52]Supra Note 49.

[53]*Ibid.*, pp. 18-19, 23-27.

[54]Filing No. 2709138025062021 dated June 3, 2021, Case Status, NCLT.

[55]Ministry of Corporate Affairs, Press Release, Release ID. 1648579.

[56]*In re: Firestar Diamond, Inc.*, et al., Case No. 18-10509-SHL,(Bankr. S.D.N.Y. 2022).

[57]*Corporation Bank v. Firestar International Limited*, 2021 SCC OnLine NCLT 362, para 2.

[58]*Ibid.*, para 7.

[59]Supra Note 56, pp. 3-10.

[60] Ministry of Corporate Affairs, Report of Insolvency Law Committee on Cross-Border Insolvency, 2018.

[61]*Ibid.*

[62]*Ibid.*, p. 6.

[63]Press Release, Reliance Group India, Reliance Communications and Global Cloud Xchange Connect Emerging Markets Corridor, November 4, 2015.

[64]Public Announcement of CIRP, 2018.

[65]Public Announcement of CIRP, 2019.

[66]*Vodafone International Holdings BV v. Union of India* (2012) 6 SCC 613.

[67]*In re: GCX Limited*, et. al., Case No. 19-12031-CSS, (Bankr. Del. 2021).

[68]*Ibid.*

[69]11 U.S.C. Chap. 15.

[70] Supra Note 10.

[71] The Ministry of Corporate Affairs, Report on the rules and regulations for cross-border insolvency resolution, June 15, 2020.

[72] Supra Note 30, U.N. Sales No. E. 10.

[73]Draft Part Z, clause 18(1)(e).

[74]Draft Part Z, clause 18(1)(f).

[75]Supra Note 71, p. 62.

[76]Draft Part Z, clause 18(1).

[77]Draft Part Z, clause 14.

[78]Supra Note 71, p. 55.

[79]Zetta Jet Pte Ltd & Ors. (Asia Aviation Holdings Pte Ltd, Intervener), [2019] 1 S.G.H.C. 53.

[80]Draft Part Z, clause 12-18.

[81]Draft Part Z, clause 2(e).

[82]Draft Part Z, clause 2(f).

[83]Draft Part Z, clause 2(c).

[84]Supra Note 71, p. 20.

[85]Draft Part Z, clause 17-18.

[86]Draft Part Z, clause 17.

[87]Draft Part Z, clause 18.

[88]Supra Note 62.

[89]*Ibid.*

[90]*Ibid.*

[91]Sections 3(7) and 3(8), IBC.

[92]The Companies Act, 2013.

[93]The Limited Liability Partnership Act, 2008.

[94]Draft Part Z, clause 1(2).

[95]Section 2(b), IBC.

[96]Section 2(42), The Companies Act, 2013.

[97]Section 375, The Companies Act, 2013.

[98]Supra Note 66.

[99]Draft Part Z, clause 1(2).

[100]Supra Note 71, p. 9.

[101]Draft Part Z, clause 2(h).

[102]Supra Note 71, p. 40.

[103]The IBBI (Insolvency Professionals) Regulations, 2016.

[104]*Ibid*.

[105]Supra Note 71, pp. 41-42.

[106]Supra Note 71, p. 42.

[107]Supra Note 71, pp. 41-42.

[108]See section titled “Cross-Border insolvency and its inextricable link with courts”.

[109] *Solomons v. Ross* (1764) 1 HBI 131.

[110] Mason R (2012), “Cross-border Insolvency and Legal Transnationalisation”, 21 Int. Insolv. Rev. 105, 126.

[111] U.N. Comm’n On Int’l Trade Law (2013), UNCITRAL Model Law On Cross-Border Insolvency: The Judicial Perspective, p. 1.

[112] Crystal M. (2011), "The Golden Thread: Universalism And Assistance In International Insolvency", Jersey & Guernsey Law Review.

[113] *Kurt Nadelmann Solomons v. Ross and International Bankruptcy Law* 9 Mod LR 154 (1947).

[114] *Singularis Holdings Limited v. PricewaterhouseCoopers* [2014] UKPC 36.

[115] *Ibid.,* p. 25.

[116] Calamita N. (2006), *"Rethinking Comity: Towards a Coherent Treatment of International Parallel Proceedings"*, 27 U. Pa. J. Int'l L. 601.

[117] Barteld L. (2012), *"Cross-Border Bankruptcy and the Cooperative Solution"*, 9 BYU Int'l L. & Mgmt. R. 27

[118] In re African Farms Ltd [1906] TS 373.

[119] *In re Agrokord.d*. et al 591 BR 163.

[120] *In re Commercial Bank of South Australia* (1886) 33 Ch 174.

[121] *HIH Casualty & General Insurance Ltd.*, Re [2008] UKHL 21.

[122] *Rubin v. Eurofinance SA* [2012] UKSC 46.

[123] *Ibid.,* p. 91.

[124] Montgomery C. (2013), "Keep Calm and Don't Submit – the Supreme Court has its say on Recognition of Foreign Insolvency Proceedings", 26(2) Insolvency Intelligence 29.

[125] Supra Note 8, p.39.

[126] Chief Justice Spigelman AC, "Cross-Border Insolvency: Co-operation or Conflict?" (Address at the INSOL International Annual Regional Conference, Shanghai, 16 September 2008) 31.

[127] Companies Act (Chapter 50) Singapore, s 377 (3)(c).

[128] Re Opti-Medix Ltd (in liquidation) and another matter [2016] SGHC 108.

[129] *Beluga Chartering GmbH (in liquidation) and others v. Beluga Projects (Singapore) Pte Ltd (in liquidation) and another (deugro (Singapore) Pte Ltd, non-party)* [2014] SGCA 14.

[130] Sections 7, 9, 10 and 11, IBC.

[131] Section 31, IBC.

[132] *Innoventive Industries Ltd. v. ICICI Bank and Ors.,* AIR 2017 SC 4084.

[133] *Pratap Technocrats (P) Limited and Others v. Monitoring Committee of Reliance Infratel Limited and Another* [Civil Appeal No 676 of 2021].

[134] Section 30(2), IBC.

[135] *Arun Kumar Jagatmramka v. Jindal Steel and Power Ltd. & Ors.,* AIR 2021 SC 1563.

[136] *Ebix Singapore Private Limited and Ors. v. Committee of Creditors of Educomp Solutions Limited and Ors.* 2021 (4) RCR (Civil) 282.

[137] *Gujarat Urja Vikas Nigam Limited v. Mr. Amit Gupta &Ors.,* Civil Appeal No. 9241 OF 2019.

[138] *Ibid.*, p.87.

[139] *Ibid.*

[140] Draft Part Z, clause 2(a).

[141] Supra Note 70, p. 341.

[142] See Section titled "India and Cross-border Insolvency".

[143] Supra Note 111.

[144] Draft Part Z, clause 14.

[145] See Section titled "India and Cross-Border Insolvency: Complexities of cross-border Insolvency".

[146] *Ibid.*

[147] *Ibid*.

[148] Supra Note 33.

[149] Supra Note 125.

[150] *Credit Suisse Fides Trust v. Cuoghi* [1998] QB 818.

[151] Supra Note 36.

[152] Section 13, The Code of Civil Procedure, 1908.

[153] Supra Note 61.

[154] *Ibid.*

[155] *Usha Holdings LL.C. & Anr v. Francorp Advisors Pvt. Ltd.,* (Company Appeal (AT) (Insolvency) No. 44 of 2018).

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

[157] Supra Note 44.

[158] Section 44A, The Code of Civil Procedure, 1908.

[159] Das I. (2020), "The Need for Implementing a Cross-Border Insolvency Regime within the Insolvency and Bankruptcy Code", 2016, 45 Vikalpa2.

[160]Supra note 143.

[161]LoPucki L. (2022), "Global and Out of Control", Social Sciences Research Network (November 30).

[162]Judicial Insolvency Network.

[163] *Ibid.*

[164]U.S. Securities and Exchange Commission.

[165]Supra Note 154.

[166]IritMevorach, Modified Universalism as Customary International Law, Texas Law. Rev. 101, 101 (2048).

[167]*Ibid*.

[168] *DTC v. Majdoor Congress*, [1991 Supp (1) SCC 600; *State of Rajasthan v. Basant Nahata*, [(2005) 12 SCC 77; *BCCI v. Cricket Assn. of Bihar*, [(2015) 3 SCC 251.

[169]Draft Part Z, clause 4.

[170]*Ibid.*, clause 4(3).

[171]Chatur D. (2022), "Public Policy Exception to Proposed Cross-Border Insolvency Law – Two Problems & Proposed Amendments", IRCCL.

[172] Re Qimonda AG Bankr. Litig., 433 BR 547 (EDVa 2010); Re Qimonda AG, 462 BR 165 (Bankr. EDVa 2011) (Appeal).

[173]*Jaffé v. Samsung Elecs. Co.*, 737 F.3d 14 (4th Cir 2013).

[174] Garza A. M. (2015), "When is Cross-Border Insolvency Recognition Manifestly Contrary to Public Policy", 38 Fordham Intl. L. J. 1589, 1597.

[175]Supra Note 162.

[176]Teofilov T. (2022), "Brazil adopts JIN guidelines", Global Restructuring Review.

[177]Supra Note 162.

[178] Aurelio Gurrea-Martínez, "Building a Restructuring Hub: Lessons from Singapore", Social Sciences Research Network.

[179]Koon P. and LIM Wee Teck Darren, "Recent developments: Insolvency and restructuring in Singapore", Rajah and Tann.

[180]Eisner Amper.

[181]Supra Note 79.

[182]Thoreau H. (2008), Walden, *Yale University Press*.

21 THE HOMEBUYERS CONUNDRUM IN REAL ESTATE INSOLVENCY

- Mehreen Garg and Arjya B. Majumdar

EXECUTIVE SUMMARY

The purpose of the Insolvency and Bankruptcy Code, 2016 (IBC/Code), ostensibly, is to provide a speedy resolution of issues arising out of insolvency of corporate debtors (CD), in a timely manner and to balance the interests of stakeholders. The 2018 amendment which pertains to the rights of homebuyers reveal the intention of the legislature to be responsive of the needs of various stakeholders and to establish that insolvency issues in the real estate industry require a disparate approach. The authors argue that this approach, while laudable, is not yet complete. Homebuyers are not treated as secured creditors and do not have a security in the very properties that they have an interest in. An interest in property against payment of money later convertible into a debt would automatically create a lien, an encumbrance or a charge against the debtor.

Even if the property has not been clearly earmarked as part of the builder buyer agreement, or even if the property has not even been created, the homebuyer's primary claim would be to receive the property that it had paid for. This gives rise to a floating charge in favour of the homebuyer. In the real estate industry, homebuyers often spend their life savings to purchase homes and must be protected at least to the same extent as that of other secured creditors.

Keywords: Homebuyers, RERA, Real Estate, Secured Creditors, Security Interest

INTRODUCTION

Following widespread calls to completely revamp and take a fresh look at bankruptcy laws in India, the extant IBC replaced the Sick Industrial Companies (Special Provisions) Act, 1986 (SICA) and a number of relevant provisions in the Indian Companies Act, 2013 along with other related legislations.[1] Inspired by the UK Insolvency Act of 1986,[2] the IBC moves away from a 'debtor in possession' approach, which was previously the position in the SICA to a more 'creditor in control' approach.[3]

In its early years, the Supreme Court, various benches of the National Company Law Tribunal (NCLT), and the National Company Law Appellate Tribunal (NCLAT) issued a number of judgments analysing and interpreting various provisions of the IBC, many of which were quickly incorporated into the code.[4]

Modern insolvency law protects the interests of secured creditors well, but not employees, workmen, customers, tort victims, or environmental claimants.[5] However, it is also well understood that public policy is an ever-growing work in progress and will continue to develop and grow.[6] In the context of IBC, one category of stakeholders that needs attention is the allottee (or homebuyer) of a real estate project.

LITERATURE REVIEW

Before establishing the research questions and framework of this paper, it may be helpful to examine the existing literature on the topic.

Akshaya Kamalnath stresses the need for the implementation of a 'modified revlon duty' when a nearly bankrupt corporation solicits bids to ensure that no value is lost due to directors' unwillingness to relinquish control of the company. Directors under this model are obligated to either reorganize the firm (or make good faith attempts to restructure) outside of the IBC procedure or to submit the company to the IBC's insolvency resolution process.[7]

Ankeeta Gupta examines the Code's provisions critically, with a discussion of the successes and difficulties that have arisen as a result of the Code's implementation.[8] Alam, Pradhan and Raza examine whether the Court has just interpreted the language of the Code or if it has additionally built the interpretation of the Code's unclear and obscure sections. They note firstly that the Code has been revised several times since its implementation[9] - possibly no other Act has been amended so frequently in such a short period of time. Second, the Court issued its first decision on the Code in less than nine months, and in less than four years, it had discussed about 200 judgements. Thirdly, the Indian Parliament has changed the Code to include the Court's rulings, an uncommon occurrence in India that has occurred quite swiftly.[10]

Bajpai And Kapur discuss the Supreme Court judgment in *Union of India v. Rajasthan Real Estate Regulatory Authority & Ors.*[11] The article examines the discrepancy between the Real Estate (Regulation and Development) Act, 2016 (RERA) and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI). The authors opine that the Supreme Court's ruling broadens the scope of RERA's jurisdiction to include situations in which a complainant files a claim against a bank in its capacity as a secured creditor in the event that the bank invokes any of the remedies listed in section 13(4) of the SARFAESI.[12]

Mathur argues that homebuyers, as creditors without recourse have a decreased chance of recouping their investments.[13] Venkateshwaran,[14] Chora and Meenakshi Veetil analyze various judgments by the Supreme Court which raise the discussion about the rights of homebuyers as creditors of defaulting real estate developers under Indian law.[15] Feibelman provides an overview of the IBC and speculates on its potential effects once it is fully implemented, suggesting that that at least initially, the IBC will serve largely as a creditor's remedy and offer unsatisfactory insurance for individual and household creditors.[16] On a similar note, Khare analyzes the evolution of the IBC.[17] Zwieten discusses the history and features of the IBC.[18] Mishra and Pandey bring attention to the extensive and innovative efforts made by the legislative and judicial branches to safeguard the interests of homebuyers and real estate enterprises in financial distress.[19]

Kokorin examines 'conflict of interest' in group insolvency and intra-group financial arrangements. It examines methods to regulate and reduce conflict-of-interest concerns while guaranteeing cross-border cooperation and communication. It aims to reconcile the application of generic procedural effectiveness principles with the special demands of multinational (cross-border) enterprise group insolvencies.[20] Pandya discusses the features of the IBC in depth and provides a comparative analysis of the insolvency processes followed in different jurisdictions. He further points out the issues faced by the current framework and provides recommendations to ensure a smoother functioning of the IBC.[21] Dutta takes a law and economics approach to uncover the roots of value destruction and wealth transfer in the 2016 IBC.[22]

Pryor and Garg analyse that the administration of the corporate insolvency resolution process (CIRP) is deeply threatened by concerns of abuse of power by the committee of creditors (CoC). They raise questions over the legality of the resolution process due to the lack of information concerning the scope and quality of review of judgments by CoC.[23] Mohan and Raj discuss the discrimination persisting between real estate developers and other operational debtors. They also comparatively analyse the situation of homebuyers as creditors in the UK and USA.[24]

Shah and Diljit argue that there remains an irreconcilable relationship between the two stakeholders of real estate- the homebuyers and the real estate developers and propose a framework for their harmonious reconciliation.[25] Kattadiyil gives a brief overview of the status of homebuyers as financial creditors (FCs) and provides a comparative analysis of IBC, RERA and CPA.[26] Iheme raises the issue that over 90% of Indian enterprises are small and family-owned, which is at odds with the insolvency resolution method outlined in the Code. Further, he proposed to tackle the various issues faced by the IBC framework by adopting laws from the English legal system, U.S. Title 11, and Article 9 of the Uniform Commercial Code.[27]

RESEARCH QUESTIONS

The authors seek to trace the development of the IBC, with a focus on allotees as creditors and to explain the present position of allotees as limited or unsecured creditors. Through a doctrinal analysis of various judgments, the authors identify the challenges faced by the Adjudicating Authority (AA) and stakeholders in dealing with the insolvency of real estate companies. The authors further consider the position of real estate allotees vis-à-vis other creditors and stakeholders and examine the conflicts of interest in the positions of various stakeholders within the IBC framework and how they act in supplementary to remedies available to the allottee under the RERA. Through a deeper analysis of the law, the authors seek to address whether the gap between other secured FCs and the status of homebuyers as creditors can be bridged.

Recognizing the divergent needs and demands of various stakeholders under the IBC, we propose a harmonious construction of homebuyer's rights available under the RERA as well as the IBC. The authors seek to offer solutions that redress the issues that have arisen in real estate insolvency by amendments in the IBC, without the need for a separate framework for the insolvency resolution of real estate companies.

Tentative chapterisation

In first section, the authors set out the background of the paper, a brief review of existing secondary literature on the subject matter and the research questions that are sought to address. The authors describe the development of the problem statement in the second section which concerns homebuyers. This description is supported through relevant case law and the amendments to the IBC in 2018 and 2020. Analysing the jurisprudence developed by courts and various amendments to the IBC, this section confirms the current position of allotees as limited or unsecured FCs. Further, using these resources, the authors analyse the challenges faced by the AA and stakeholders in dealing with the insolvency of real estate enterprises.

In section three, the authors examine the rights of homebuyers under the RERA. The authors seek to create a harmonious position, balancing the rights of homebuyers under the RERA against the rights of all stakeholders under the IBC, and go on to argue that in the case of real estate companies, there exists a need to create adjustments in the IBC framework to accommodate the unique position of allotees. It is further argued that in such cases, allotees ought to be considered as secured FCs instead of the present position of limited or unsecured FCs. Section four summarizes, concludes and offers suggestions for further research.

REVAMPING THE INSOLVENCY AND BANKRUPTCY LAW IN INDIA

Insolvency law lies at a unique intersection of various dimensions of law and economics.[28] As a result, the provisions of the IBC form a complex web of features adopted from a number of statutes before the implementation of the Code, as well as from UNCITRAL and the insolvency laws in the UK and US amongst others, emphasizing more commonly on the UK law.[29] Prior to the IBC, there was no overarching legislation in India to address company insolvency. While the Companies Act, 1956 governed the dissolution and liquidation of businesses, whereas the SICA would govern their revival.[30]

SICA

The SICA was implemented to detect sick or unviable companies and also potentially sick industrial companies.[31] The SICA was enacted following the suggestions of the T. Tiwari Committee set up by the Reserve Bank of India (RBI) in 1981[32] which were, in turn, influenced by Chapter 11 of the US- a formal process focused on the restructuring of a debtor's financial obligations.[33] While the SICA was a commendable effort on behalf of the RBI to rehabilitate sick companies, there were a number of shortcomings in the legislation which did not allow it to efficiently target all insolvency issues.[34]

The report of the Committee on Industrial Sickness and Corporate Restructuring suggested that SICA's aim was to help industrial companies, which often excluded micro, small and medium enterprises (MSMEs) in the country.[35] The report also argued that SICA created an imbalance between debtors and creditors by heavily relying on provisions in the favour of debtors.[36] Under SICA, applications could be filed after confirming the balance sheet of the companies. This led to fraudulent management of CDs forging their books of accounts to potentially escape liability towards their corporate creditors.[37] As a result and fraught with delays, the insolvency process under SICA failed.

The Eradi Committee report

In October, 1999, the Government set up the Eradi Committee which was tasked to review the then-existing laws on insolvency and restructuring of companies and suggest reforms in the insolvency process within the legislation.[38] The Committee observed that high courts in India held jurisdiction over matters of insolvency and winding up of companies. Therefore, it was suggested that a National Tribunal be established by amending Article 323B of the Constitution, updating the Companies Act, 1956 and by the repeal of SICA.[39] The Committee noted that the Indian legislation on companies closely resembles the UK law on winding up, which is now codified as a distinct statute from the Companies Act and known as the U.K. Insolvency Act, 1986.

Bankruptcy Law Reform Committee

In his Budget speech for the year 2015–16, the then Finance Minister Mr. Arun Jaitley stated that a comprehensive bankruptcy code in line with international best practices and providing the requisite judicial capability, will be implemented.[40] As a result, the Government set up the Bankruptcy Law Reform Committee (BLRC) in August, 2014, which submitted its report to the Finance Ministry on November 4, 2015.[41] The Committee was set up with the aim of reducing the duration of the insolvency process, reducing losses in the recovery process, and increasing debt financing across all instruments. The Committee took note of the little leverage that creditors have in the event of debtor default. The average amount of debt they were able to collect was just 20%, which meant that only the largest enterprises would receive financing.[42] Furthermore, the Committee noted that the creditors ought to be able to make commercial choices as to the future of the insolvent company. The evolution of insolvency rules in India thus became a collaborative effort of the country's legislative, executive, and judicial branches.

Volume 2 of the BLRC's report proposed the Insolvency and Bankruptcy Bill which became a road map for dealing with personal and corporate insolvency. At the time, only secured FCs could apply against the default of a debtor to initiate the insolvency process.[43] The BLRC recommended that, depending upon the context, either the debtor or the creditors ought to be able to apply for the commencement of the insolvency procedure. Additionally, the BLRC also recommended that operational creditors (OCs) such as workers whose pay checks were overdue ought to be able to commence CIRP against the debtor company.[44] Further, the Committee recommended that a certified insolvency practitioner oversee the whole CIRP. For the duration of the CIRP, the expert should have charge of the debtor's assets and manage them in a way that keeps them safe while discussions with regard to the financial future of the company continue. Additionally, to address the 'need for speed' in the insolvency process, the Committee recommended that creditors and debtors must negotiate under strict time limits to reach a swift bankruptcy settlement.[45] As a result, the Committee suggested that the CIRP ought to be completed within 180 days. The BLRC also suggested that this deadline be extended upto 90 days for exogenous situations, provided that 75% of the creditors agreed.[46]

UNCITRAL

The push for establishing uniform principles of insolvency law globally can be recognised as an aftermath of the Great Depression, which forced an abundance of banks into insolvency.[47] Further, with the development of globalization and the free flow of commercial trade worldwide, there was a dire need to consolidate a legislation based upon international standards. The UNCITRAL adopted the Legislative Guide on Insolvency Law in 2004 to provide far-reaching objectives aimed at assisting in insolvency law reform in countries across the world.[48] The IBC, keeping the key features of the Legislative Guide on Insolvency Law, inculcated provisions to implement the promotion of economic stability and growth; a separate judicial forum to avoid the plethora of cases plaguing the Indian courts, and most significantly focus on balancing between the rights of the creditors and the rehabilitation of the debtor.[49]

This section presented the development of the extant insolvency framework in India. The next section moves on to describes the problem statement which concerns homebuyers or allottees. This description is supported through case law and the amendments to the IBC in 2018 and 2020. Analysing the jurisprudence developed by courts and various amendments to the IBC, the next section discusses the current position of allotees as limited or unsecured FCs creditors. Further, using these resources, the authors analyse the challenges faced by the AA and stakeholders in dealing with the insolvency of real estate enterprises.

THE RISE OF THE HOMEBUYER

In 2017, the NCLT and the NCLAT had one of their first opportunities to examine the position of allottees as creditors within the IBC framework in a number of cases. In *Nikhil Mehta v. AMR Infrastructure*, the NCLT held that homebuyers are not FCs as there is no consideration for the time value of money and that these are simple sale transactions.[50] However, the NCLAT took an opposite view holding that the amounts invested by the homebuyers were not mere sale transactions, but would indeed come under the ambit of financial debts under section 5(8) of the IBC.[51] The NCLAT held that allottees are indeed, FCs.

In *Anil Mahindro & Anr v. Earth Iconic Infrastructure (P) Ltd*, reliance was placed on *Nikhil Mehta v. AMR Infrastructure* to the same end and effect.[52] The sum of these decisions was that an allottee was neither an OC nor a FC unless an allottee was assured returns, in which case, it would be a FC. This caused much confusion about the status of home buyers under the Code.[53] Thus, an allottee was held to not have the right to initiate an insolvency process unless an allottee was assured returns in terms of allotment.[54] It could only file claim under the category of 'other creditors'. The IBBI amended the regulations in the year 2017 to introduce a special form (Form CA) in which claim could be filed by an allottee.[55] In 2018, the Insolvency Law Committee (ILC) noted that disbursements of funds by potential homebuyers were typically made against the delivery of a future asset, namely the residence. Upon failure of the project, money is repaid, based on the time value of money.[56] This further cemented the position of the homebuyer as an FC.

This status further gave homebuyers the right to approach the NCLT and NCLAT for the resolution of their disputes and to initiate proceedings against bankrupt debtors. Consequently, this also meant that when recovering dues from insolvent real estate firms, homebuyers would also get a seat at the CoC.[57] A seat at the CoC meant that the homebuyers do have a voice while deciding the outcome of real estate CDs under insolvency.[58] This new status also gives homebuyers access to financial statements and information of the debtor which are not readily available to the general public or OCs.[59]

The 2018 amendment to the IBC

Following the recommendations of the ILC in 2018,[60] the rise of the allottee as a creditor was further codified with the Insolvency and Bankruptcy (Amendment) Ordinance, 2018[61] and later, in the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 (2018 Amendment). Prior to this amendment, allottees had no status of either a FC[62] or of an OC[63] within the IBC – this status was granted through case law, but not codified under the IBC. The 2018 amendment also provides that the finances of real estate allottees directed towards the failed real estate project would have the same commercial effect as that of a debt.[64] The statements made by the Supreme Court in *Jaypee Orchard Resident Welfare Society v. Union of India*[65] that they will endeavour to do all in its power to safeguard the interests of the homebuyers is notably encouraging. In *Chitra Sharma v. Union of India*, the Supreme Court protected the interests of home buyers in projects floated by Jaypee Infratech Limited and directed the CoC to be constituted afresh in accordance with the provisions of the Insolvency and Bankruptcy (Amendment) Ordinance, 2018, more particularly the amended definition of the expression 'FCs'.[66] However, in *Ajay Walia v. Sunworld Residency Private Limited*, courts took the view that a homebuyer who had subrogated its rights in favour of a bank could not take the additional advantage of a FC.[67]

The constitutional validity of the classification of FCs and OCs was upheld in the now seminal case of *Swiss Ribbons v. Union of India.*[68] The Supreme Court in this case held that the repayment of financial debts infused capital into the economy as banks and financial institutions were able, with money that had been paid back, to further lend such money to other entrepreneurs for their businesses. This rationale created an intelligible differentia between financial debts and operational debts, which were unsecured. The constitutional validity of the inclusion of allottees as FCs was discussed and challenged in *Pioneer Land Infra v. Union of India*[69] on the grounds of it being violative of Article 14 and Article 19(1)(g) read with Article 19(6) of the Constitution of India. The Supreme Court rejected the challenges and upheld the 2018 Amendment Act's constitutionality. The Supreme Court observed, based on a reading and interpretation of section 5(8)(f) of the IBC, that homebuyers/allottees were included in the main provision, section 5(8)(f), from the beginning of the Code, with the explanation being added in 2018 merely to clarify doubts about the status of homebuyers. The Supreme Court further held that interests of allottees in the insolvency of a real estate company must be protected.

This was also upheld in the recent judgment of *Yadubir Singh Sajwan v. Ms. Som Resorts*[70] where the NCLT was of the view that homebuyers are those who are genuinely interested in taking possession of the housing units, and the principal amount paid by them to the real estate developer is a financial debt. Hence, the NCLT concluded that homebuyers are indeed, FCs.

In *Bikram Chaterji v. Union of India,*[71] the Supreme Court noted that '*if the real estate business has to survive in India, it has to be answerable to the public and has necessarily to uphold the trust reposed in builders/promoters*'.[72] The court went on to establish the status of homebuyers in housing projects vis-à-vis lenders and government authorities. The apex court was of the view that in a real estate project fraught with financial issues, the status of homebuyers was paramount. The Court decided this case with the rationale that for a homebuyer to purchase a house, a major proportion of their life saving are invested with their real estate firm defaulting in their projects generally leads homebuyers to lose this large amount of their life savings which often gets stuck for years.

Around the same time, in *Flat Buyers Association v. Umang Realtech Pvt. Ltd*[73] the NCLAT introduced a novel concept of a reverse CIRP which allowed the real estate CD to continue its construction activities in the face of an application under section 7 of the IBC. This was done 'in the interest of the allottees and survival of the real estate companies and to ensure completion of projects which provides employment to large number of unorganized workmen'. The NCLAT in *Umang Realtech* also provided for the segregation of projects being developed by the same CD while holding that a CIRP against one project should not affect the others. It was found that individual allottees were filing insolvency petitions based on individual grievances and disputes rather than for the resolution of the CD. The challenge in using the usual CIRP route is that although allottees have been awarded the status of FCs, being unsecured FCs, they have limited voting rights and do not possess the expertise to assess the long-term sustainability of the CD. This leads to two unfortunate consequences for allottees. Since allottees would usually be in favour of delivery of their property over return of monies invested, this would not be possible if the CD goes in liquidation, nor if the CoC reaches a conclusion.[74] Even if the CD goes into liquidation, allottees' rights to distributable funds are still severely impacted as unsecured creditors.

The 2020 amendment to the IBC

The Insolvency and Bankruptcy Code (Amendment) Act, 2020 (2020 Amendment Act) was incorporated to balance the scales. The 2020 Amendment Act provided that a CIRP against the real estate CD can be initiated only jointly, by not less than 100 of such allottees under the same real estate project or not less than 10% of the total number of such allottees under the same real estate project, whichever happens to be less.[75] Further, as per the amendment, matters already filed by individual homebuyers but not yet admitted by the AA prior to the commencement of the 2020 Amendment Act will be dismissed if they are not modified to meet the above-mentioned minimum threshold requirement within 30 days of the commencement of the 2020 Amendment Act.

In the case of *Manish Kumar v. Union of India,*[76] the Supreme Court upheld the constitutional validity of the 2020 Amendment Act. However, in the case of *Puneet Kaur v. K V Developers Private Limited,*[77] the NCLAT ruled that even claims of homebuyers who did not file claims should be included in the information memorandum if they were reflected in the CD's record. The NCLAT determined that ignoring such claims would result in inequitable and unfair resolution. The Appellate Tribunal also mentioned the complexity homebuyers had to face in filing their claims. It was discovered that the public announcement inviting claims is usually made in the area where the CD has its registered office and corporate office, and there is a good chance that all of the homebuyers, who are usually hundreds in number, are unaware of the CIRP and do not file their claims within the time limit. As a result, the NCLAT observed that failure to submit claims within the prescribed time frame is a common characteristic in the insolvency process of almost all real estate projects. The Appellate Tribunal went on to rule that once the allotment letters have been issued to the homebuyers and payments have been received, the real estate company is obligated to provide possession of the houses, as well as other associated liabilities. Hence, homebuyers have every right to contest their claim.

As a result, the present position on the status of allotees within the IBC framework is that of an unsecured FC capable of commencing a CIRP against a real estate CD as long as that action is collective. However, as some authors note, this now places homebuyers, insofar as initiation of insolvency applications is concerned, behind even ordinary OCs, who can initiate an insolvency application for any default above ₹ 10 million.[78]

However, even prior to the enactment of the IBC and its amendments as well as various case law protecting them, homebuyers' rights were safeguarded under the RERA. If a harmonious interpretation of homebuyers' rights as consumers under the RERA as well as stakeholders under the IBC is to be derived, the provisions under RERA must be studied which has been done in the next section.

HOMEBUYERS RIGHTS UNDER THE RERA

Background and need for the RERA

Taking advantage of the rising demand for housing in India, private real estate developers had ostensibly taken over the real estate sector with no concern for the consumers.[79] A need for regulating the burgeoning real estate sector had come into sharp focus in the matter of *Belaire Owner's Association v. DLF Limited and Ors*.[80] The Competition Commission of India held that DLF, a major real estate development company, was abusing its dominant position owing to several unfair and onerous conditions in its builder buyer agreement, allowing DLF to make unilateral changes in construction plans and schedules and absolute discretion to change clauses without the consent of allottees.[81] The Commission taking into account all the instances of abuse imposed a penalty on DLF at the rate of 7% of the average turnover for the last three preceding financial years, amounting to approximately ₹ 6.3 billion. This decree was upheld by the Competition Commission Appellate Tribunal[82] as well as the Supreme Court of India.[83] One of the direct results of *Belaire* was the promulgation of the RERA. While the RERA was widely met with approval,[84] there was considerable resistance from the real estate industry itself and quite understandably so.[85]

Salient features of RERA

The RERA establishes a Real Estate Regulatory Authority in each state.[86] Real Estate Regulatory Authorities are government agencies charged with the responsibility of regulating real estate development activities and to maintain transparency in the sector. It is further responsible for keeping a record of development activities by conducting inquiries and directing the roles of promoters, allottees and real estate agents. The Real Estate Regulatory Authority, along with the Central Advisory Council is also expected to advise the Government on policy matters governing the real estate sector.[87] Real Estate Regulatory Authorities may issue directions for the implementation or impose penalties and fines for the non-compliance of the provisions of the RERA.[88] An appeal against an order of a Real Estate Regulatory Authority lies to the Real Estate Regulatory Tribunal.[89]

The companies engaged in real estate development projects, also known as 'promoters',[90] are required to register themselves before the Real Estate Regulatory Authority having jurisdiction over the location where the project is to be constructed.[91] Details of the project, including delays in the completion of other projects promoted by the applicant[92] and the time period within which the project is to be completed[93] must be provided. Upon registration, details of the project, including the site and layout plan, and schedule for completion of the real estate project must be provided to the Real Estate Regulatory Authority for further dissemination to the public.[94]

Real estate promoters take on the primary responsibility of completion of the real estate project and are subject to a number of obligations under the RERA including reducing information asymmetry,[95] entering into an agreement for sale with proposed allottees,[96] adhering to the sanctioned specifications.[97] The promoter is further charged with the duty to repair and rectify any structural defects in the construction within a period of two years from the date on which the allottee was granted possession.[98]

The RERA was created to ensure greater accountability towards consumers, and significantly reduce frauds, arrest delays and high transaction costs associated with real estate development.[99] It attempts to balance the interests of consumers and promoters by imposing certain responsibilities on both. It seeks to establish symmetry of information between the promoter and purchaser, transparency of contractual conditions, set minimum standards of accountability and a fast-track dispute resolution mechanism.[100]

Rights of allottees under the RERA

The RERA provides for a number of rights of allottees, which may be grouped generally under information rights,[101] rights to title,[102] insurance,[103] right to prevent transfer to a third party,[104] pecuniary rights,[105] etc. However, any legal proceedings that may be commenced before the NCLT under the IBC, must necessarily involve a debt. That is, an amount that is required to be paid by the promoter as the CD to the allottee as the FC. Therefore the conditions under which such a debt may be created, must be examined.

Dues that are payable by real estate promoters to allottees may fall into two categories, viz. return of sums advanced, along with interest, and compensation. Allottees, having advanced any sums towards the allotment, sale or transfer of a plot, apartment, or building,[106] may choose to withdraw from the project under two circumstances. Firstly, if the allottee suffers any losses or damage due to false or incorrect statements made in an advertisement or prospectus promoting a real estate project.[107] Secondly, if the promoter has not been able to deliver the apartment, plot or building within the timeframe declared at the time of registration.[108] Under section 18 of RERA, allottees of delayed projects may elect to either withdraw from the project, which leads to the return of the sums advanced, along with interest, or to continue with the project, in which case allottees are entitled to compensation for delayed transfer of possession.

Allottees are also entitled to compensation in case of structural defects and faults in the project,[109] any loss caused to him due to defective title of the land on which the project is being developed[110] or the failure on part of the promoter to discharge its obligations under the RERA.

Therefore, the authors note that there are several instances where a debt may accrue on part of the promoter as the CD in favour of the allottee. Non-payment of such debt would amount to a default[111] under the IBC and has been noted earlier, this would create a cause of action for homebuyers to approach the NCLT, post the 2020 amendment, albeit as unsecured creditors.

However, the authors believe that a cogent argument may be made to show that the status of homebuyers may still be elevated to secured FCs. That, while homebuyers have a seat at the CoC table, there remains a gap between other secured FCs and homebuyers. The next section seeks to bridge that gap.

HOMEBUYERS AS SECURED CREDITORS

According to sub-section 3(30) of the IBC, a secured creditor is a creditor in whose favour a security interest is created. A definition for 'security interest' may be found in section 3(31) of the Code. Mortgage, charge, hypothecation, assignment and encumbrance, as well as any other agreement or arrangement ensuring payment or performance of any obligation of any person, generate a security interest in favour of, or provide for, a secured creditor.

In any CIRP, stakeholders are bound to have conflicting priorities. In *Swiss Ribbons*, the Supreme Court upheld the interests of all stakeholders including workers, creditors and shareholders. In light of this judgment, arguments have been raised suggesting that the IBC takes a more inclusivist approach to insolvency resolution as compared to previous attempts.[112] According to the liquidation cascade outlined in section 53 of the Code, all secured creditors shall be paid in proportion to their approved claims. Each secured creditor is free to pursue the enforcement of their security interest in accordance with the applicable law and opt out of the liquidation process, or to waive their security interest and participate in the liquidation proceedings, in which the CD's assets are sold collectively.[113] In the case of real estate CDs, homebuyers are likely to prioritize speedy delivery of their constructed apartments while the other FCs would prioritize maximization of debt recovery.[114]

The 2020 amendment in the IBC brings an interesting bit of inspiration from the Companies Act, 2013. Under the said Act, a minimum of 100 members or members holding no less than 10% of the voting rights in the company may institute an action for minority oppression and/ or mismanagement[115] or for compensation.[116] The authors note a similar mechanism adopted under the 2020 amendment which provides that a CIRP against the real estate CD can be initiated only jointly, by not less than 100 of such allottees under the same real estate project or not less than 10% of the total number of such allottees under the same real estate project, whichever happens to be less.

In order to derive an argument for homebuyers to be treated as secured creditors, it must first be understood the nature of secured debt under the Companies Act, 2013.

Loan finance is a key source of capital for companies.[117] Financial Institutions like banks, while lending money to companies take securities over the assets of the company to ensure minimum exposure to the risk of non-repayment of loan.[118] Liens created against properties of the company for the purposes of securing loans, referred to in the Companies Act, 2013 as charges, must be registered with the Registrar or Companies (ROC).[119]

The homebuyer – real estate developer relationship

While the contractual and statutory relationship between the homebuyer and the real estate developer has been described earlier in this paper and elsewhere, it may be prudent to capture the essence of the relationship here. The homebuyer and the real estate developer enter into what is commonly known as the builder buyer agreement[120] – an agreement to sale a property to be created by the real estate developer against the timely payment of consideration by or on behalf of the homebuyer. This contractual relationship is subject to further statutory considerations as described in the previous chapter. As a result, the homebuyer provides consideration or a promise for consideration against the timely delivery of immoveable property. Thus, while the purpose of the builder buyer agreement is to deliver immoveable property to the homebuyer, the authors see how that purpose may be turned into a debt on part of the real estate developer by action of the RERA. The authors believe this creates a floating charge on the yet-to-be delivered property.

The floating charge

The Companies Act, 2013 does not create a distinction between a fixed and a floating charge. However, the difference laid down in *Illingworth v. Houldsworth*[121] has been upheld in Indian courts time and again. The authors understand that a floating charge is a convenient and flexible method of securing a claim while letting a debtor sell his assets where required and also upholding the creditor's interest.[122]

Section 85 of the Act requires every company to keep in its registered office, a register of all floating charges affecting any property or assets of the company or any of its undertakings. As per the nature of the charge, the chargor has the authority to manage the assets as he seems fit without worrying about the assets being subjected to a charge. In other words, the charge can be seen to 'hover' over the assets until the charge crystallizes due to a certain event.[123] A floating charge becomes fixed when (a) the company ceases to carry on the business (b) commencement of winding up of the company (c) the principal money has become payable to the debenture holder.[124]

Further section 332[125] states that upon the winding up of the company any floating charge which has been created within twelve months preceding the commencement of the winding up shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except for the amount of any cash paid to the company at the time of, or subsequent to the creation of, and in consideration for, the charge, together with interest on that amount at the rate of five percent per annum.[126]

A floating charge is produced when a company pledges its assets or its undertaking as security for the payment of debts that it incurs after entering into financial transactions. A charge like this one might encompass attributes that are either defined or left undetermined in the corresponding legal instrument that creates the charge. It's possible that this is only a generic description. The High Court of Allahabad in the case of *Krishna Deva Bhargava v. Official Liquidator U.P Oil Industries*[127] applies section 17(1)(b) of the Registration Act, 1908[128] and the Indian Companies Act (Act VII of 1913).[129]

The High Court of Allahabad in this case specifies that one odd aspect of this transaction is, however, that until the occurrence of a future event, it is not feasible to predicate the specific asset on which the charge would operate. This is one of the peculiar features of this transaction. This potential occurrence in the future might include either the winding down of the firm itself or the appointment of a receiver by the creditors of a corporation in order to collect on the obligations owed to them. Up until such a time as this occurrence occurs in the future, the charge is of a character that is ambulatory or roving. It continues to exist in this hovering position until the event that is being anticipated in the future actually takes place. The charge, on the other hand, will become stable and will be attached to a particular asset after the future event in question has occurred. The right that was established as a result of it is undeniably a right that exists in the present.[130]

Accretion of the floating charge

However, the security in regard to which the right is formed does not become crystallized until the time that the future occurrence really takes place.[131] It is therefore possible to say that the right that was generated as a result of this is a dormant right up until the moment when such a subsequent event takes place.[132] This dormant right assumes a dynamic form, and becomes capable of enforcement against certain specified property or properties which answer the description of the property given in the debenture the moment such a future event takes place.[133] This description of the property is included in the debenture.[134]

Although the Court while deciding the case of *Krishna Dev*[135] refrains from giving a decision on the question of floating charges on future property, it does conclude that as the charge only becomes affixed to the property upon the occurrence of some future event, a floating charge can be thought of as a contingent right.[136]

The Supreme Court of New Zealand in the case of *BFSL and Bridgecorp v. Steigrad, Houghton*[137] observed that security over future property was not recognized under common law unless the grantor took additional steps after acquiring the property to show his or her desire that it should transfer under the security.[138] Nonetheless, a charge over future property was acknowledged by equity. Therefore, as soon as the debtor acquires the collateral, the debtor acquires an equitable interest in the property.[139] Depending on the conditions of the agreement, such a charge might be floating, fixed, or a hybrid of the two.[140] Further, the Court stated that a floating charge is a charge over future property that fits the charge instrument's description and lasts only until the debtor's authority to control his or her assets is terminated, either because of bankruptcy, receivership, liquidation, or some other event.[141] At that point, the charge would become a hard lien on the specific assets described in the charge instrument in which the debtor corporation had or subsequently acquired an interest.[142]

On the other hand, the Court of Appeals, London, in the case of *SAW (SW) 2010 Ltd v. Wilson,*[143] at the time that it was created, the validity of an instrument as a floating charge did not depend on whether or not the company had any assets that were not charged at the time, nor did it depend on whether or not the company had the ability to acquire assets in the future that would be free from any fixed charge that would result from the crystallization of an earlier floating charge.[144]

Basis of the secured debt

In previous sections, it is discussed that how one of the critical identifying factors of a floating charge is that it becomes enforceable against a specific property only upon the happening of an event. It is true that the nature of the transaction between the homebuyer and the real estate developer is that of sale of property. However, provisions in the RERA make it clear that upon events of default on part of the real-estate developer, this transaction of sale gives rise to a debt, which is then enforceable not just under the RERA,[145] but also the IBC.[146]

However, the basis of this debt is that the homebuyer retains a legitimate expectation to either have their investment returned or having their home built. As a result, much like a secured FC, the homebuyer also has the right to claim property as part of the original sale transaction. As Khare suggests, while FCs would accord some urgency to the repayment of their debts, homebuyers would prefer the delivery of their property.[147]

Recognising the motivations and preference of homebuyers to receive property over repayment of debt, courts have examined a relatively novel concept of a reverse CIRP. In *Flat Buyers Association Winter Hills v. Umang Realtech Pvt Ltd*,[148] the NCLAT was of the view that instead of following the usual route of inviting a resolution plan for the CD, the project in question would be handed over to an alternate real estate developer[149] who would carry on the project instead of the CD. In effect, the other projects being developed by the CD would not be affected by the delays in one. The concept of reverse CIRP, while absent in the IBC itself, shows that the judiciary is not averse to legal experimentation,[150] particularly in the case of a real estate CD. Reverse CIRPs have been met with mixed reactions, with proponents lauding it as 'what is needed to achieve the harmony between stakeholders'[151] and opponents suggesting that the NCLAT exceeded their jurisdiction, amongst other issues under the IBC.[152] Irrespective of whether reverse CIRPs will be used in the future as well,[153] one may argue that the reverse CIRP might be misused by homebuyers as an arm twisting tactic against delayed possession of apartments.

At this stage, it may be prudent to revisit our understanding of how security interests are created under property law. A mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.[154] As noted by the Law Commission of India, this section creates three essential characteristics of a mortgage. Firstly, that there must be a transfer of interest. Second, that interest must be in specific immoveable property; and lastly, the transfer must secure the payment of a loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.[155]

Applying the above principles to the homebuyer, undoubtedly, as explained earlier, an interest in specific immovable property in favour of the homebuyer when the builder buyer agreement is entered into. It is also clear that such an interest in the homebuyer is in the identified specific immovable property. Thirdly, as explained earlier, under the scheme of RERA, the homebuyer is entitled to secure the performance of the builder buyer agreement. Such that it gives rise to a pecuniary liability. In other words, the homebuyer has a contractual right to receive a specific unit in the real estate project. Upon delay in handing over possession, a statutory debt is created under the RERA and this non-performance by the real estate developer results in a pecuniary liability under RERA. This non-performance of the real estate developer gives rise to a pecuniary liability. This argument is further substantiated by the fact that the banks which extends home loans, recognise the allotment letter as evidence of homebuyers' interest in a unit. The allotment letter is given to the initial buyer of the home by either the builder or the housing authority. This letter contains all of the pertinent information about the property, including a physical description of the home and information regarding the payment. While purchasing a home, it is imperative to make sure that the seller provides you with a copy of the allocation letter. This is because the allotment letter is one of the crucial documents that the bank requires in order to complete your application for a home loan, and it is included when you submit your application for a home loan.[156] An allotment letter, from the lender's perspective, is a legal document that proves the buyer's intent to acquire the property and guarantees the bank will be repaid for its loan. Before authorising a loan, the bank will normally perform its own due diligence to confirm the legitimacy of the allotment letter and the buyer's creditworthiness. An allotment letter may not pique a homebuyer's interest straight away, but it is a vital legal document that establishes the buyer's ownership rights and acts as a basis for future transactions involving the property. The homebuyer may also be obligated to make payments on the property before taking possession, such as during the construction period or for other incidental expenditures like parking, etc.[157]

It is also pertinent to mention that as stated by the Hon'ble Supreme Court in the case of Rainbow Papers, the definition of 'secured creditor'[158] and 'security interest'[159] in IBC are broad and wide enough to cover all types of security interests '*including right, title or interest or a claim to property, created in favor of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes…any other agreement or arrangement…or performance of any obligation of any person*'. Therefore, read together, the provisions of RERA, The Transfer of Property Act, 1882, and IBC, and the ratio of the *Rainbow judgment*, a homebuyer would be a secured creditor holding a security interest.

In *Umang Realtech*, the NCLAT established that '*the 'unsecured creditors' have a right over the assets of the Corporate Debtor i.e. flats/ apartment, assets of the Company*'.[160] As a result, an interest in property is created in favour of the homebuyer as soon as the builder buyer agreement is executed. An interest in property against payment of money later convertible into a debt would automatically create a lien, an encumbrance or a charge against the debtor. Even if the property has not been clearly earmarked as part of the builder buyer agreement, or even if the property has not even been created, the homebuyer's primary claim would be to receive the property that it had paid for. This gives rise to a floating charge in favour of the homebuyer.

Another approach to this argument would entail the conversion of the homebuyer's agreement, which ostensibly is a document memorialising the sale of property. Upon a default on part of the real estate developer, this sale agreement converts to a claim of debt. This argument is supported by the fact that homebuyers have the right to claim their money back as a debt under the RERA and the IBC. The basis of that debt is the existence of the sale agreement. It may be argued that while the intention of the parties was to enter into a contract of sale, by operation of law, this contract of sale converts to a claim of debt with a legitimate interest and expectation to receive property.

Consequently, an argument may be made that the homebuyer does have a secured debt, with the underlying property in which the homebuyer has an interest, which bring the homebuyer at par with other FCs.

An unsecured creditor's claim for repayment is immensely dependent on his personal contractual rights.[161] A contract's aggrieved party often has just one option for redress: a demand for damages.[162] Action on the debt will be accessible when the claim is for a liquidated sum currently payable, and specific performance and injunctions may also be sought. Unsecured creditors have no rights to the debtor's property while a lawsuit is still pending, and even after a decision has been obtained, the debtor's assets cannot be seized or sold to satisfy the debt without a court order authorizing such enforcement.[163]

Post the Insolvency and Bankruptcy Code (Amendment) Act, 2018, homebuyers, despite being granted similar rights as secured FCs and with the amount owed to them being recognized as financial debt, are as of yet not considered secured FCs.[164] The Supreme Court in the *Pioneer* case[165] clarified homebuyers to be unsecured creditors: '*54… True, allottees are unsecured creditors, but they have a vital interest in amounts that are advanced for completion of the project, maybe to the extent of 100% of the project being funded by them alone'.*[166]

A floating charge debenture holder is in a distinct situation than the others. Once the charge has solidified into a fixed charge, the parties who hold such a charge have the legal right to make an application to the court for an order of sale of the property that is subject to the charge. The court will then decide whether or not to grant the order. The potential power to enforce security without first acquiring judgment for the sums owed and an order enforcing such judgment differentiates a charge from a claim that is based solely on a contract, and it is indicative of a proprietary claim.[167] This is true even though the floating charge remains dormant until it crystallizes.[168]

Section 11(4)(h) of RERA[169] provides that, initially, a mortgage cannot be put on a property for which the agreement has already been signed by a defaulting developer. The proviso states that in case a situation arises where mortgage has been charged, it will not be allowed to tamper with the rights and interests of the respective homebuyers.

In sum, a harmonious reading of provisions of RERA, The Transfer of Property Act, 1882 and section 3(31) of the IBC[170] makes it clear that the homebuyers would become secured FCs by operation of law in the event of default by the developer (CD in the vent IBC proceedings are commenced). However, this interpretation has not yet been judicially identified and hence, there remains ambiguity around it. As per the resolution process, in order to claim dues and exercise the right to a seat in the committee of creditors, it is necessary to be a FC.[171] As unsecured FCs, there could be ambiguity related to the homebuyer's interests in the assets of the company and consequent claims over distributable proceedings. If the resolution applicant is giving a certain value to the assets of the company while taking over the company as a going concern, the first claim over the assets would fall to the secured creditors, not homebuyers as unsecured creditors.[172] Unless the homebuyer manages to fall into the majority of 66% or get a blocking vote of 33% or more, the chances of them getting a priority in distribution of assets over secured FCs are next to nothing.[173]

However, it also needs to be recognised that a secured creditor in order to perfect a security interest has to undertake certain provisions of the law and follow certain compliances. The company must file a charge with the ROC as per section 77 of the Companies Act, 2013. The FC (in this case homebuyer) will also have to file a public notice with the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) under the SARFAESI. This date and time of the notice will determine the priority of the charge.

The above (operation of law) argument is supported by the ratio laid down by the Hon'ble Supreme Court in the case of *Tax Officer v. Rainbow Papers Limited.*[174] In *Rainbow*, the Hon'ble Supreme Court has held that if in the statute in which the liability arises in favor of a statutory creditor like in the case of Gujarat VAT or GST department, the particular statute has a provision which provides that in the event of a default in the payment of liability in the act by the person, then the statutory authority will have a lien on the property of that person to the extent of the amount in default. Therefore, in *Rainbow Paper*, it was held that by operation of law, they become a secured creditor, there need not be a security deed or agreement.

If a lien is created by law, then it is a security interest. In RERA, this security interest gets created by operation of law. There the ratio of the judgment is that there can be a lien by operation of law without getting into any contract. Even if a bank loans to a company and that company creates security interest by way of mortgage, the security needs to be perfected.

In the case of *Rainbow Paper*, the property over which a lien is to be created is not identified. When it comes to homebuyers, the lien created can be identified to a specific property. Invariably, in the case of homebuyers, any other FC may not have a charge as when the bank gives loans to the companies, they give permission to sell the units and they release their mortgage on those units so that those units can be sold by the developer.

The situation would however be different where the homebuyer has in turn mortgaged its security interest in favor of a bank to secure the home loan availed by them to buy the unit. In such case, whether the homebuyer can claim to have security interest or not would be debatable as the security interest has been charged to another entity. Therefore, such a homebuyer may arguably not be a secured FC, nor of course, would be the bank from which the loan is obtained and the unit is mortgaged to, because no financial debt exists viz. the CD. In the *Jaypee* case, there are approximately 20,000 units. Apparently, these are not encumbered with any bank. However, the homebuyers may have taken a loan from a bank. This may mean that while there may not be a general lien on these units by any of the other FCs of the CD, the homebuyer may have ceded the mortgage in the favor of the bank from which the home loan was taken. This problem may be recognised in situations where the unit holder has taken a loan and created a charge. In this situation the unit holder or the homebuyer may not be considered a secured FC.[175]

This analysis brings us to address why banks approve loans on allotment letters when it doesn't create any interest in the homebuyer.

The allotment letter is given to the initial buyer of the home by either the builder or the housing authority. This letter contains all of the pertinent information about the property, including a physical description of the home and information regarding the payment. While purchasing a home, it is imperative to make sure that the seller provides you with a copy of the allocation letter. This is because the allotment letter is one of the crucial documents that the bank requires in order to complete your application for a home loan, and it is included when you submit your application for a home loan.[176]

An allotment letter, from the lender's perspective, is a legal document that proves the buyer's intent to acquire the property and guarantees the bank will be repaid for its loan. Before authorising a loan, the bank will normally perform its own due diligence to confirm the legitimacy of the allotment letter and the buyer's creditworthiness. An allotment letter may not pique a homebuyer's interest straight away, but it is a vital legal document that establishes the buyer's ownership rights and acts as a basis for future transactions involving the property. The homebuyer may also be obligated to make payments on the property before taking possession, such as during the construction period or for other incidental expenditures like parking, etc.[177]

CONCLUSION

One of the key objectives of insolvency proceedings is the principle of *pari passu* which recommends similarly placed creditors in an insolvency proceeding to be treated equally.[178] However, in an insolvency proceeding, all movable property of the CD is sold to cover the claims. In such cases the remaining funds of the company may not be enough to cover the claims of the unsecured creditors of the company.[179]

The intention of the law while introducing the 2020 amendment to the IBC was to bring the homebuyers at par with other FCs in order for the homebuyers to get a say in approving the resolution.[180] However, even after the 2020 amendment, homebuyers still do not have a seat at the CoC table equal to that of FCs as they remain unsecured creditors. Given that the property created for the very apartments that are built for the usage and purpose of homebuyers, it remains a legal absurdity to say that homebuyers have no security in those very properties.

The purpose of the IBC, ostensibly, is to provide a speedy resolution of issues arising out of insolvency of CDs in a timely manner and to balance the interests of stakeholders.[181] As Alam, Pradhan and Raza suggest, the Code has been revised several times since its implementation - more than any other legislation in such a short period of time.[182] Two of these amendments, in 2018 and 2020 pertain to the rights of homebuyers. Clearly, the intention of the legislature has been to be responsive of the needs of various stakeholders and to establish that insolvency issues in the real estate industry require a disparate approach.

In this paper, the authors have argued that this approach, while laudable, is not yet complete. Homebuyers as yet, do not have a security in the very properties that they have an interest in. The approach taken by the IBC and in general practice, is for creditors to take a haircut, move on and allow the CD to carry on its business, either under previous or new management.[183] However, homebuyers cannot be expected to take on similar risks and asked to take a haircut on their homes.[184]

As a result, the authors suggest that in order to further protect the position of homebuyers in insolvent real estate companies, that they be considered as equal participants in the CIRP, as secured creditors. This *avatar* of insolvency law in India is still in its infancy and it remains to be seen whether different industries such as the real estate industry would continue to draw a differentiated treatment. Therefore, legislative intervention may be required to capture this legal position in the IBC.

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

[2] *M/S. Innoventive Industries Ltd v. ICICI Bank* (2018) 1 SCC 407; *see also* Zweiten K. (2019), "Insolvency and Bankruptcy Code 2016: Impact on Markets and the Economy", Keynote Address : Insolvency and Bankruptcy Board of India and Vidhi Centre for Legal Policy In partnership with The Faculty of Law and the Commercial Law Centre, Harris Manchester College at the University of Oxford.

[3] Tandon D. and Tandon N., "Drifts in Banking Business and Deepening Losses Amidst the Insolvency and Bankruptcy Code, 2016"; Rajagopal B. R. (ed) Business Governance and Society, Palgrave Macmillan, Cham. *see also* Kamalnath A. (2019), "Corporate Insolvency Resolution Law in India-A Proposal to Overcome the Initiation Problem" , 88(1) University of Kansas-Missouri City Law Review 631.

[4] Alam G. et. al. (2019), "The Insolvency and Bankruptcy Code, 2016 Interpreted-Constructed by the Supreme Court of India",1 NLIU Journal of Business Laws 19.

[5] Gant J.L.L. (2022), "Optimising fairness in insolvency and restructuring: A spotlight on vulnerable stakeholders", Int Insolv Rev, 31, pp. 3-7.

[6] Remarks 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.

[7] Kamalnath A. (2019), "Corporate Insolvency Resolution Law in India – A Proposal to Overcome the Initiation Problem", University of Missouri-Kansas City Law Review.

[8] Gupta A. (2019), "Insolvency and Bankruptcy Code, 2016: A Paradigm Shift within Insolvency Laws in India", vol. 36, no. 2, The Copenhagen Journal of Asian Studies, pp. 75-99.

[9] The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 [7 of 2017]; The Insolvency and Bankruptcy Code (Amendment) Act, 2017 [Act 8 of 2018]; The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 [6 of 2018]; The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 [Act 26 of 2018]; The Insolvency and Bankruptcy

Code (Amendment) Act, 2019 [Act 26 of 2019]; The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 [16 of 2019]; The Insolvency and Bankruptcy Code (Amendment) Act, 2020 [1 of 2020]; The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 [9 of 2020]. These listed amendments are limited until 2020, till the time of writing of this article.

[10] Supra Note 4.

[11] *Union Bank of India, Jaipur v. Rajasthan Real Estate Regulatory Authority & Ors*., D.B. Special Leave Petition (Civil) No. 1861-1871/2021.

[12] Bajpai G. and Kapur N. (2022), "The primacy of homebuyers over financial institutions: the RERA and SARFAESI conundrum".

[13] Mathur C. (2017), "Form B or C: Are Home Buyers 'Operational Creditors' under Insolvency and Bankruptcy Code, 2016?".

[14] Venkateshwaran H. (2020), "Financial Creditor, Operational Creditor and An Overview on Home-Buyers under Indian Bankruptcy Code", Supremo amicus journal, Vol. 15.

[15] Chora V. and Veetil J. (2018), "IBC 2018 Amendment, a Viable Solution to the Home-Owners Problem?", 7 Supremo Amicus 335.

[16] Feibelman A. (2019), "Legal Shock Or False Start: The Uncertain Future of India's New Consumer Insolvency and Bankruptcy Regime", 93 Am Bankr LJ 429.

[17] Khare U. (2021), "Insolvency in Real Estate: A Difficult Balancing Act", JGILS Working Paper No. 3 / 2021.

[18] Zwieten K. (2020), "Insolvency and Bankruptcy Code 2016: Impact on Markets and the Economy".

[19] Mishra A. and Pandey S. (2020), "It Takes a Village to Raise a Child!' - The Development of Corporate Insolvency Law in India for Real Estate Companies", 2 NLUD J Legal Stud 23.

[20] Kokorin I. (2020), "Conflicts of interest, intra-group financing and procedural coordination of group insolvencies", International Insolvency Review, Vol. 29 Issue 1.

[21] Pandya P. (2015), "Corporate Insolvency and Corporate Rescue in India - An Economic Analysis".

[22] Dutta P. (2018), "Value Destruction and Wealth Transfer Under the Insolvency and Bankruptcy Code, 2016", National Institute of Public Finance and Policy (NIPFP), Working Paper No. 247.

[23] Pryor S., and Garg R. (2020), "Differential Treatment Among Creditors Under India's Insolvency and Bankruptcy Code", 94 Amer. Bankr. L.J. 123.

[24] Mohan M. and Raj V. (2020), "Apartment Buyers as Financial Creditors: Pushing the Conceptual Limits of the Indian Insolvency Regime", 33 Colum J Asian L 219.

[25] Shah R. and Diljit A. (2020), "Real Estate Developers and Homebuyers: Finding a Harmony under the IBC", 2020 NLS Bus L Rev 79.

[26] Kattadiyil B. (2020), "Moving Forward With Reverse CIRPs: Dissecting Flat Buyers Association Vs Umang Realtech", International Journal Of Multidisciplinary Educational Research*,* Vol. 9, Issue 5(8).

[27] Iheme W. (2020), "Remedying the Defects in India's Credit and Insolvency Frameworks With Adapted Solutions From the Anglo-American Legal Scholarships", 2020 (11)(2) Union Uni. L. Sch. Rev (PRAVNI ZAPISI), pp. 580-619.

[28] Foreword by Justice A.K Sikri in Sumant Batra, Corporate Insolvency: Law and Practice (EBC, 2017).

[29] High Level Committee, Law Relating To Insolvency And Winding Up Of Companies, 2000, para 6.1 (Eradi Comittee)

[30] Batra S. (2002), "Proposals for Reforms - The Indian Position", The Second Forum for Asian Insolvency Reform.

[31] The Sick Industrial Companies (Special Provisions) Act, 1985 was enacted in 1985 and was officially notified in 1987.

[32] The T. Tiwari Committee was set up by the RBI on May 14, 1981 and chaired by Shri T. Tiwari, Chairman, Industrial Reconstruction Corporation of India, Calcutta.

[33] Batra S. (2017), Corporate Insolvency: Law and Practice, EBC.

[34] Supra Note 30.

[35] The Committee on Industrial Sickness and Corporate Restructuring was set up by the Union Finance Minister Dr. Manmohan Singh on May 27, 1993, and was chaired by Dr. Omkar Goswami, Indian Statistical Institute, Delhi. The Committee submitted its report on July 13, 1993.

[36] Report of The Committee on Industrial Sickness and Corporate Restructuring, 1993.

[37] Batra S., "Asian Recovery: Progress and Pitfalls, the Position of India", The World Bank Guild.

[38] *Ibid.*

[39] *Ibid.*, para 2.8.

[40] Press Information Bureau, Government of India on the Budget Speech for the year 2015–16 by Finance Minister Mr. Arun Jaitley.

[41] Report of the Bankruptcy Law Reform Committee, Vol.1, 2015.

[42] *Ibid*.

[43] *Ibid*.

[44] *Ibid.*

[45] *Ibid.*

[46] *Ibid.*, para 5.4.

[47] Supra Note 33.

[48] Uncitral Legislative Guide on Insolvency Law Commission on International Trade Law, United Nations.

[49] Supra Note 28.

[50] IB-02(PB)/ 2017.

[51] [2017] 137 CLA 163 (NCLT).

[52] Company Appeal (AT) (Insolvency) No. 74 of 2017.

[53] Datta P. (2018), "Value Destruction and Wealth Transfer under the Insolvency and Bankruptcy Code, 2016", NIPFP Working Paper Series, No. 247.

[54] Company Appeal (AT) (Insolvency) No. 8 of 2017.

[55] As per Regulation 8A of Insolvency and Bankruptcy Code, 2016; Home Buyers are "Class of Creditors as Financial Creditors. Any person claiming to be a creditor in a class is to submit claim with proof to the interim resolution professional under FORM CA.

[56] Report of the Insolvency Law Committee, March, 2018.

[57] Section 21(2) of the IBC provides for the committee of creditors to comprise of all financial creditors of the debtor company.

[58] Section 30(4) of the IBC enables the committee of creditors to approve a proposed insolvency resolution plan with a three-fourths majority.

[59] Answerable to the committee of creditors under section 27 of the IBC, the insolvency resolution professional is required to provide all manner of information regarding the corporate debtor to the committee (Section 25 (2)), prepare an information memorandum (Section 29) and seek the approval of the committee on certain actions not in the ordinary course of business (Section 28).

[60] Supra Note 56.

[61] "President Approves Promulgation of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018", Press Information Bureau, Government of India, Ministry of Corporate Affairs, June 6, 2018.

[62] Section 5(7) of the IBC.

[63] Section 5(21) of the IBC.

[64] Explanation to Section 3 of the 2018 Amendment.

[65] Writ Petition (Civil) No. 854 of 2017.

[66] (2018) 18 SCC 575.

[67] CP (IB) 11/ALD/2018. Decision date- 30.07.2018.

[68] (2019) 4 SCC 17.

[69] (2019) 8 SCC 416.

[70] *Yadubir Singh Sajwan & Ors. v. Som Resorts Private Limited*, Company Petition No. (IB)-67(ND)/2022.

[71] 2019 SCC OnLine SC 901.

[72] (2018) 17 SCC 691.

[73] Company Appeal (AT) (Insolvency) No. 926 of 2019.

[74] Supra Note 26.

[75] Insolvency and Bankruptcy (Amendment) Act, 2020.

[76] 2021 SCC OnLine SC 30.

[77] Company Appeal (AT) (Insolvency) No. 390 of 2022.

[78] Supra Note 17.

[79] 30th Report of the Standing Committee on Urban Development, Ministry of Housing and Urban Poverty Alleviation, Government of India, February 2014, p. 8.

[80] 2011 CompLR 0239 (CCI), p. 52.

[81] Shoaib (2011), "The Penalty on DLF by CCI will effect the real estate sector", Good Returns.

[82] *DLF Limited v. Competition Commission of India*, Competition Appellate Tribunal, Appeal No. 20 of 2011 2014 CompLR 1 (CompAT).

[83] *DLF Limited v. Competition Commission of India*, Interim Application (for stay) No. 1 of 2014 in Civil Appeal No. 6328 of 2014, order dated 27 August 2014.

[84] "Real Estate Regulation Bill to draw fair industry practices, accountability", *Business Standard*, September 19, 2013.

[85] Patel S. (2013), "Real Estate Bill: Naïve to think that it will solve all problems", New Delhi, *The Economic Times*, November 15. *See also* "Developers seek changes in Bill", *The Hindu Business Line,* August 2013.

[86] Section 20, RERA.

[87] Section 42, RERA.

[88] Sections 33-40, RERA.

[89] Section 43, RERA.

[90] Promoters take on the primary responsibility for real estate development and include real estate development companies, development authorities, State level co-operative housing finance societies, primary co-operative housing societies under section 2 (zk).

[91] Section 3, RERA.

[92] Section 4(2)(b), RERA.

[93] Section 4(2)(l)(C), RERA.

[94] Each Real Estate Regulatory Authority maintains a website wherein registered real estate project developers may create individual web pages for their projects under section 5, RERA.

[95] Section 12 of the RERA requires that the promoter compensate allottees in case of loss or damage caused by incorrect information in advertisements and the prospectus of the real estate project.

[96] Section 13, RERA allows promoters to receive upto ten percent of the cost of the apartment, plot or building without having to enter into an agreement for sale.

[97] Section 14, RERA.

[98] Section 14(3), RERA.

[99] Statement of Objects and Reasons, RERA.

[100] Supra Note 79, p. 9.

[101] Section 12, RERA.

[102] Section 17, RERA.

[103] Section 16, RERA.

[104] Section 15, RERA.

[105] Section 18, RERA.

[106] Section 2(d), RERA.

[107] Section 12, RERA.

[108] Section 18, RERA.

[109] Section 14(3), RERA.

[110] Section 18(2), RERA.

[111] Section 2(12), IBC.

[112] Kamalnath A. and Kaul A. (2022), "Adding Mediation to India's Corporate Resolution Process", International Insolvency Review31, p. 163–182.

[113] Technology Development Board vs Mr. Anil Goel & Ors. [I.A No. 514 of 2019 in CP(IB) No. 04 of 2017.

[114] Supra Note 17.

[115] Section 242 of the Indian Companies Act allows for directive or injunctive relief to be granted by the NCLT.

[116] Section 245 of the Indian Companies Act allows for compensation to be granted by the NCLT. See Majumdar A. B. and Bhawnani S. (2016), "Class Action Suits- Genesis, Analysis and Comparison", Rgnul book series on corp. l. & corp. aff., pp. 7-8.

[117] Ferran E. (1988), "Floating Charges, The Nature of the Security", The Cambridge Law Journal, Vol. 47, No. 2, p. 213.

[118] *Ibid.*

[119] Section 77, The Companies Act, 2013.

[120] *M/s. Imperia Structures Ltd. v. Anil Patni***,** Civil Appeal No. 3581-3590 of 2020.

[121] [1904] AC 355.

[122] Kasak A. (2015), "The Law as a Source and Guarantor of Rights", Juridica International. Law Review.

[123] *Illingworth v. Houldsworth* [1904] A.C. 355 at 358 per Lord Macnaughten in Ferran E. (1988), "Floating Charges, The Nature of the Security", The Cambridge Law Journal, Vol. 47, No. 2, p. 214.

[124] Ministry of Corporate Affairs, "Registration Of Charges" (ICSI).

[125] Corresponds to section 534 of the Companies Act, 1956.

[126] S.332, Companies Act, 2013, *"Effect of floating charge.— Where a company is being wound up, a floating charge on the undertaking or property of the company created within the twelve months immediately preceding the commencement of the winding up, shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid,*

except for the amount of any cash paid to the company at the time of, or subsequent to the creation of, and in consideration for, the charge, together with interest on that amount at the rate of five per cent. per annum or such other rate as may be notified by the Central Government in this behalf."

[127] AIR 1962 All 101.

[128] Section 17(b) in The Registration Act, 1908.

"(b) other non-testamentary instruments which purport or operate to create, declare, assign, limit or extinguish, whether in present or in future, any right, title or interest, whether vested or contingent, of the value of one hundred rupees and upwards, to or in immovable property;"

[129] With the enactment of the Companies Act 1956, the Companies Act 1913 was repealed.

[130] AIR 1962 All 101.

[131] *Ibid.*

[132] *Ibid.*

[133] *Ibid.*

[134] *Ibid*.

[135] *Ibid.*

[136] *Ibid.*

[137] [2014] 1 NZLR 304.

[138] *Lunn v. Thornton* ([1845] 135 ER 587 at 590. See also Blanchard P. and Gedye M. (1994), "The Law of Company Receiverships in Australia and New Zealand", 2nd edition, Butterworths, Wellington, 1994.

[139] *Holroyd v. Marshall* [1862] 11 ER 999. Michael Gedye, Ronald CC Cuming and Roderick J Wood Personal Property Securities in New Zealand (Brookers, Wellington, 2002).

[140] Supra Note 138.

[141] Generally, an individual cannot give a floating charge: see RJ Scragg "Floating Charge" in Andrew Borrowdale (ed) Butterworths Commercial Law in New Zealand (Butterworths of New Zealand Ltd, Wellington, 1996) 607 at 607 and Louise Gullifer (ed) Goode on Legal Problems of Credit and Security (4th ed, Sweet & Maxwell, London, 2008).

[142] *Ibid.*

[143] [2017] EWCA Civ 1001.

[144] UK Insolvency Act 1986 (c 45), Sch B1, para 14 (as inserted by Enterprise Act 2002 (c 58), s 248).

[145] Sections 12 and 18 of the RERA.

[146] Post the 2020 amendment.

[147] Supra Note 17.

[148] Company Appeal (AT) (Insolvency) No. 926 of 2019.

[149] In this case, Uppal Housing Pvt Ltd, acting as a Promoter/ Intervenor, "*agreed to remain outside the Corporate Insolvency Resolution Process but intended to play role of a Lender (Financial Creditor) to ensure that the Corporate Insolvency Resolution Process reaches success and the allottees take possession of their flats/apartments during the Corporate Insolvency Resolution Process without any third party intervention"*

[150] *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta & Ors.* (2019 SCC Online SC 1478) read with *Swiss Ribbons Pvt Ltd v Union of India* (2019) 4 SCC 17.

[151] Supra Note 26.

[152] Kumar S. and Sehgal A., "Reverse CIRP: An Alien Concept to the IBC Regime".

[153] *Ram Kishor Arora Suspended Director of M/s. Supertech Ltd v. Union Bank of India Company Appeal* (AT) (Insolvency) No. 406 of 2022.

[154] Section 58(a), The Transfer of Property Act, 1882.

[155] Law Commission of India, Seventieth Report on The Transfer of Property Act, 1882, August 1977, p. 389.

[156] "Importance of Letter of Allotment in a Home Loan" (Kotak Mahindra Bank - Home Loan Stories May 10, 2022).

[157] *Ibid.*

[158] Section 2(30) of the Insolvency and Bankruptcy Act, 2016- *""secured creditor" means a creditor in favour of whom security interest is created".*

[159] Section 2(30) of the Insolvency and Bankruptcy Act, 2016- *""security interest" means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person: Provided that security interest shall not include a performance guarantee".*

[160] Company Appeal (AT) (Insolvency) No. 926 of 2019.

[161] Supra Note 117, p. 215.

[162] *Ibid.*, *Hadley v. Baxendale* (1854) 9 Exch. 341.

[163] *Ibid.*, p. 216.

[164] Supra Note 56.

[165] (2019) 8 SCC 416.

[166] *Ibid.*

[167] *23 Tennant v. Trenchard* (1869) L.R. 4 Ch. App. 537 at 542 per Lord Hatherley L.C. in Ferran E. (1988), "Floating Charges, The Nature of the Security", Vol. 47, No. 2, The Cambridge Law Journal.

[168] Ministry of Corporate Affairs, "Registration Of Charges" (ICSI).

[169] Section 11(4)(h) of RERA … *"(h) after he executes an agreement for sale for any apartment, plot or building, as the case may be, not mortgage or create a charge on such apartment, plot or building, as the case may be, and if any such mortgage or charge is made or created then notwithstanding anything contained in any other law for the time being in force, it shall not affect the right and interest of the allottee who has taken or agreed to take such apartment, plot or building, as the case may be"*

[170] Section 3(31) of the Insolvency and Bankruptcy Code, 2016, "*(31) "security interest" means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person…*"

[171] *Standard Chartered Bank, London v. Khubchandani Hospitals Private Limited*, Company Appeal (AT) (Insolvency) No. 911 of 2021

[172] Pattanayak B. (2018), "Bankruptcy Code: Are Homebuyers Secured Financial Creditors?" *The Financial Express*, 12 July.

[173] Supra Note 56.

[174] *State Tax Officer (1) v. Rainbow Papers Limited*, Civil Appeal No. 2568.

[175] *Mr. Anuj Jain Interim RP Jaypee Infratech Ltd. v. Suraksha Realty Ltd*.

[176] "Importance of Letter of Allotment in a Home Loan" (Kotak Mahindra Bank - Home Loan Stories, May 10, 2022.

[177] *Ibid.*

[178] World Bank. Principles and Guidelines for Effective Insolvency and Creditor Rights Systems. 2001, p. 76.

[179] Mohanty D, "Security Interests over Moveable Assets - Charges, Mortgages, Indemnities India" (Security Interests Over Moveable Assets - Charges, Mortgages, Indemnities – India November 6, 2017).

[180] *Ibid.*

[181] Preamble to the IBC.

[182] The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 [7 of 2017]; The Insolvency and Bankruptcy Code (Amendment) Act, 2017 [Act 8 of 2018]; The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 [6 of 2018]; The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 [Act 26 of 2018]; The Insolvency and Bankruptcy Code (Amendment) Act, 2019 [Act 26 of 2019]; The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 [16 of 2019]; The Insolvency and Bankruptcy Code (Amendment) Act, 2020 [1 of 2020]; The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 [9 of 2020]. These listed amendments are limited until 2020, till the time of writing of this article. See in Ghayur Alam, Abhinav Pradhan and Aqa Raza, 'The Insolvency and Bankruptcy Code, 2016 Interpreted-Constructed by the Supreme Court of India', (December 2019) 19-126 NLIU Journal of Business Laws, Volume 1.

[183] *Flat Buyers Association v. Umang Realtech Pvt. Ltd,* Company Appeal (AT) (Insolvency) No. 926 of 2019.

[184] *Ibid.*

22 IMPACT OF COVID-19 ON CORPORATE DISTRESS AND BANKRUPTCY OF RETAILING COMPANIES LISTED ON THE BOMBAY STOCK EXCHANGE

- Mohammadali Khadimhussain Momin, Dr. Dhimen Jagdishbhai Jani and Dr. Nimesh Pramodkumar Bhojak

EXECUTIVE SUMMARY

The COVID-19 pandemic makes it challenging for companies to operate profitably and efficiently. This study aims to measure the financial distress of the companies under the retailing sector of India registered on Bombay Stock Exchange (BSE) in post COVID-19 pandemic. The quantitative research method was adopted to measure corporate distress and bankruptcy in retailing companies. The population in this study amounted to 17 listed retailing companies, which shows the generalisation result for the BSE retailing industry. Financial ratios, recognised as one of the most significant factors affecting bankruptcy prediction, are used to develop prediction models. Secondary data was collected using Prowess IQ from 2018 to 2022 to answer the research questions and hypotheses of the study. Altman, Springate, and Zmijewski models give the most accurate results for predicting financial distress, while Grover G-score models have insignificant accuracy for measuring financial distress for retailing companies. Springate S-score has the highest level of accuracy, Altman Z-score has the second level of accuracy, and Grover G-score and Piotroski F-score have the lowest level of accuracy. All the scores have shown a significant impact in predicting financial distress and bankruptcy among the retailing companies, while the Ohlsons O-score and the Zmijewski X-score have shown an insignificant result in predicting the financial distress and bankruptcy of the companies. The study has two limitations, first it only covered retailing companies listed on the BSE in the retailing industry from 2018 to 2022. Second, the study employed an accounting-based model for predicting the financial distress of the companies. The study contributes to the academic community in terms of coaching the appropriate model for predicting financial distress. The study will benefit society by providing the results of companies at risk of going bankrupt, allowing investors to make better stock investment decisions. The study has focused on measuring the financial distress of the retailing companies with the application of the accounting models and providing the accuracy of the models for the calculation.

Keywords: Financial Distress, Accounting Models, Bankruptcy, Insolvency, Retailing

INTRODUCTION

Since the global financial crisis of 2009, financial distress has been an emerging concept. Financial distress has emerged not only in the corporate world but also in the academic world over the last decade. The COVID-19 pandemic once again elucidated the financial distress concept in both worlds. Financial distress has involved a weaker financial position, insolvency, and bankruptcy of the companies. The COVID-19 pandemic makes it challenging for companies to operate profitably and efficiently. As a result, the company's financial condition deteriorated during the crisis. The financial distress predictive model is vital for companies to take decisions during a crisis (Zhao et al., 2022). Financial distress and corporate bankruptcy are vital issues for businesses and the nation's economy during a crisis. Low and middle income countries, such as India, were hard hit by the financial distress of companies. Retail companies have suffered a lot during the pandemic crisis due to the lockdown.

Hence, this study measures the financial distress and bankruptcy of retail companies in India. The financial distress accounting model was used to measure the financial distress of retail companies' post-pandemic. This study assesses financial distress with various performance indicators such as net profit to total assets, operational revenue to total assets, earnings per share and cash flow per share, profitability, liquidity, turnover, operating structure, firm size, and market capitalization, etc. as the financial indicators for measuring the financial distress. Various accounting models, such as the Altman Z-score (Altman, 1968), Beneish M-score (Beneish, 1999), Springate S-score (Springate, 1978b), Ohlsons O-score (Ohlson, 1980), Zmijewski X-score (Zmijewski, 1984), Grover G-score (Grover, 2003), and Piotroski F-score (Piotroski, 2000), were used in this study to assess financial distress. This study also used the Hazard Model, which was developed by Shumway (2001) (Shumway, 2001) by taking the financial variables of the Altman Z-score (Altman, 1968), and Zmijewski X-score (Zmijewski, 1984) .

This study adds to the literature on corporate financial distress and bankruptcy and contributes to the prediction accounting model, which adopts various accounting techniques. The chairman of the companies, the nation's policymakers, and the portfolio managers predict financial distress and corporate liability for the company, sectors, economies, and investors' well-being. The flow of the article is based on the basic concept of financial distress. The literature review discusses financial distress factors or causes, performance indicators to assess a company's financial distress, and the prediction of financial distress using various models. The method mentions the selection of retail companies and performance indicators of financial distress, etc. The result then describes the various financial distress accounting prediction models; the discussion mentions the appropriate accounting model to predict financial distress; and lastly describes the conclusion and implication of the study.

REVIEW OF LITERATURE

Financial distress

Financial distress is a situation in which the decreasing liquidity or weakening of a company's financial position is measured. According to (Salim & Ismudjoko, 2021) the definition of financial distress is an increase in liabilities and a decrease in assets. Financial distress means the company's financial situation is in an unhealthy condition. A company's financial distress usually refers to a situation in which its operating cash flow cannot exceed its negative net assets (Geng et al., 2015). Financial distress is the final stage of a liquidity crisis and is potentially included in the bankruptcy stage (Drescher, 2014; Tron, 2021). The definition of financial distress put forth by different authors, who belong to various countries, has varied accounting procedures. Financial distress involves four similar terms: failure, bankruptcy, insolvency, and default.

Failure occurs when the rate of return on investment is significantly lower than the returns generated from comparable investments or when the revenue is insufficient to cover the cost of the business (Appiah et al., 2015). Insolvency refers to the company's inability to settle its current obligations, which are related to its liquidity position (Hannigan, 2018). Insolvency is the stage between financial distress and bankruptcy. The bankruptcy indicates that the company is in financial distress and requires a legal declaration from jurisdictions (Tian et al., 2015). Company default is defined as a situation where a firm fails to meet periodic repayments (Tian et al., 2015).

Factors/causes of financial distress in companies/corporate

According to previous researchers, there are numerous causes of financial distress, the most common of which are unexpected illness in business (Wyrwich et al., 2016), Government policies (Mahtani & Garg, 2018), natural disasters (Crespí-Cladera et al., 2021), unfavourable economic conditions

(Shahwan, 2015), and management failure (Fredrick, 2019). Poor profit indicates that the company is in a bad financial situation (Ghazali et al., 2015). The situation for raising the external capital is that the internal fund of the business cannot achieve breakeven (Ellis, 2014). According to (Bhunia & Sarkar, 2011; Putri, 2021), when debtors take too long to pay their debts and the cash flow is severely stretched, it indicates a situation of financial distress in the business. The capital structure of the companies also causes financial distress for the companies (Muigai & Muriithi, 2017). Some of the reasons given by (Alan & Lapré, 2018; Hotchkiss et al., 2021; Udin et al., 2017) for the financial distress condition of the businesses were poor working capital management, inadequate financial controls, poor business planning, a lack of communication, and the poorest customer experience.

The announcement of quarantine and lockdown conditions imposed in the country during the pandemic of COVID-19 has impacted businesses that had enjoyed a high and steady income for years but suddenly saw their revenue drop to zero. According (Crespí-Cladera et al., 2021), the hospitality industry has experienced financial distress. Manufacturing, service, and trade sectors have shown a financially unhealthy situation after COVID-19 (Aydin et al., 2022). (Makni, 2022) stated that the pandemic harmed enterprises' performance by reducing their total investment and overall income.

Performance indicators to measure the financial distress of the companies

Performance indicators for measuring the financial distress of the business differed from author to author and study to study. (Geng et al., 2015) have taken net profit to total assets, operational revenue to total assets, earnings per share, and cash flow per share as the financial indicators for measuring financial distress. Profitability, liquidity, turnover, operating structure, firm size, and market capitalization are the indicators suggested by (Sensini, 2016) for measuring the financial distress of the companies. (Amendola et al., 2015) have added the solvency ratio and studied the financial distress of the companies. (Restianti & Agustina, 2018) have studied financial indicators such as the current ratio, retained earnings, earnings before interest and tax, return on equity, debt to assets ratio, and asset turnover ratio andstated that earnings before interest and tax and return on equity have impacted the financial distress of firms.

Prediction of financial distress through various models

Accounting models developed by taking financial data and applying statistical analysis, machine learning, and artificial intelligence are used to measure a company's financial distress.

Accounting Models	Machine Learning utilizing Data Mining techniques
Altman Z-score (Altman, 1968) Beneish M-score (Beneish, 1999) Springate S-score (Springate, 1978b) Ohlsons O-score (Ohlson, 1980) Zmijewski X-score (Zmijewski, 1984) Grover G-score (Grover, 2003) Piotroski F-score (Piotroski, 2000) Hazard Model (Shumway, 2001)	Taskdriven approach (Van Engelen & Hoos, 2020) Data driven approach (Sarker, 2021) Semisupervised machine-learning method (Oladipo et al. , 2022; Yusuf & Akande, 2021) Reinforcement machine-learning method (Charpentier et al. , 2021) Support vector machines (Cleofas-Sánchez et al. , 2016) Artificial Neural Network

Note: Formula for calculating the various accounting models is given in Appendix 1.

The study has employed accounting based models from the literature. Machine learning techniques can provide better performance in classifying companies as failing or not failing compared to accounting models. However, accounting models for predicting business failure are still used worldwide and are comparable to machine learning techniques in terms of accuracy and predictive performance (Oz & Yelkenci, 2017) have stated that the accounting model provides high-level prediction accuracy in predicting the financial distress of the companies. Altman Z-score model works reasonably well for most countries (Alareeni & Branson, 2013; Kiaupaite-Grushniene, 2016; Mohammed, 2016; Özyeºil, 2020). The majority of the research has used, and continue to use the accounting models such as Altman Z-score (Altman, 1968), Beneish M-score (Beneish, 1999), Springate S-score (Springate, 1978b), Ohlsons O-score (Ohlson, 1980), Zmijewski X-score (Zmijewski, 1984), Grover G-score (Grover, 2003), and Piotroski F-score (Piotroski, 2000). Hazard Model is developed by (Shumway, 2001) by taking the financial variables of Altman Z-score (Altman, 1968), and Zmijewski X-score (Zmijewski, 1984) so the model is not considered in the study. Both Altman Z-score and Ohlson O-score significantly predict defaulter firms operating in Thailand (Rahman et al., 2021) compared the performance of the Springate and Zmijewski models for firms on the Tehran Stock Exchange, and the Zmijewski model is the most accurate predictor of bankruptcy. The literature reports mixed results concerning the predictive ability of the traditional distress prediction models when applied to different economies. The selected accountingbased model is used by the authors for measuring the financial distress and possibility of bankruptcy of the companies in the banking industry in Brazil and Europe (Chiaramonte & Casu, 2017; Wanke et al., 2015), companies from various industries in Indonesia (Restianti & Agustina, 2018), public companies listed on Jordan stock exchange (Al-Khatib & Al-Horani, 2015).

(Supitriyani et al., 2021) investigated the financial distress of transportation companies before and after the COVID-19 pandemic, concluding that the Altman Z-score provided an accurate result. Because of the COVID-19 disaster, Spanish hospitality firms suffered financial trouble in 2020 (Crespí-Cladera et al., 2021). The hotel, restaurant, and tourism industries have faced financial distress during and after COVID-19 in Indonesia. (Rahmah & Novianty, 2021).

H01: The financial statements published by the retailing companies listed on the BSE showed signs of corporate distress due to the COVID-19 pandemic before the failure.

H02: The financial statements published by the retailing companies listed on the BSE were manipulated due to the COVID-19 pandemic before the failure.

H03: The financial statements published by the retailing companies listed on the BSE showed signs of bankruptcy due to the COVID-19 pandemic before the failure.

RESEARCH METHODOLOGY

The COVID-19 pandemic outbreak has forced many businesses to close, leading to an unprecedented disruption of commerce in most industry sectors (Alsharef et al., 2021; Dube et al., 2021; Jones & Comfort, 2020). Retailers have faced many challenges related to health and safety, the supply chain, the workforce, cash flow, consumer demand, sales, and marketing (Panzone et al., 2021; Roggeveen & Sethuraman, 2020; Yang et al., 2021). Retailers need to understand how to factor COVID-19 into their operations during existential crises and to meet their financial needs. The quantitative research method was adopted to measure corporate distress and bankruptcy in retailing companies. The population in this study amounted to 17 listed retailing companies, which shows the generalisation result for the BSE retailing industry. No previous infectious disease episode led to daily stock-market swings that even remotely resembled the response in the past month to COVID-19 developments (Alam et al., 2020).

The investors have lost their wealth by not making the proper investment decisions in the companies and the stocks of the companies (Nofsinger, 2017). Businesses have lost money on their investment in financial distress. A financial crisis will force the company into bankruptcy. Financial distress accounting and bankruptcy prediction models used various statistical and machine learning techniques (Balcaen & Ooghe, 2006; Barboza et al., 2017; Kumar & Ravi, 2007; Pena et al., 2011). Many studies have attempted to propose input variables on prediction performance using novel machine-learning techniques to improve the prediction performances of the models. Financial ratios, recognised as one of the most significant factors affecting bankruptcy prediction, are used to develop prediction models. Altman Z-score, Beneish M-score, Springate S-score, Ohlson's O-score, Zmijewski X-score, Grover G-score, and Piotroski F-score are all possible. Secondary data was collected using ProwessIQ from 2018 to 2022 to answer the research questions and hypotheses of the study. The Altman Z-score, Beneish M-score, Springate S-score, Ohlson's O-score, Zmijewski X-score, Grover G-score, and Piotroski F-score were the analytical tools used in this study.

Excel and SPSS statistical data processing software was used to assist in the analysis of the study. The data for the study have been analysed on the assumption and linearly distributed (Bischoff et al., 1991; Hull & White, 1998; Osborne & Waters, 2002).

RESULTS

This section contains the hypotheses tested and the outcome of the study. MDA scores were Altman Z-score, Beneish M-score, Springate S-score, Ohlson's O-score, Zmijewski X-score, Grover G-score, and Piotroski F-score, which were made up of independent and dependent variables. The basic assumption is that data are linearly distributed and auto correlated to test the research hypotheses through multiple discriminant analyses.

Table 1: Tests of Normality

Model	Shapiro-Wilk		
	Statistic	df	Sig.
Z-score	.861	17	.089
M-score	.685	17	.092
S-score	.910	17	.101
O-score	.675	17	.790
X-score	.969	17	.802
G-score	.929	17	.211
F-score	.890	17	.066

Table 1 shows that the Shapiro-Wilk test was run on the data to see if the normality assumption was met. It was tested at the 5% significance level. The study failed to reject the null hypothesis because the sig values of the Z-score, M-score, S-score, O-score, X-score, G-score, and F-score, respectively, were above the p-value of 0.05. the normality assumption is satisfied for all data. The Durbin-Watson test is used to determine whether there is autocorrelation in the residue of time series regression revealed in Table 2. A value is around 2. The null hypothesis is rejected due to autocorrelation in the data.

Table 2: Durbin-Watson's Test of Autocorrelation

Model	R	R. Square	Adj. R. Square	Std. E	Durbin-Watson
Z-score	1	1	1	0.00	2.195
M-score	1	1	1	0.00	2.234
S-score	1	1	1	0.00	2.421
O-score	1	1	1	0.00	2.452
X-score	1	1	1	0.00	1.873
G-score	1	1	1	0.00	2.578
F-score	1	1	1	0.00	2.039

Table 3: Altman Z-score for the selected retailing companies

Company Name	Z-score 2018	Z-score 2019	Z-score 2020	Z-score 2021	Z-score 2022	Z-score
Arvind Fashions Ltd.	2.25	2.01	0.66	0.32	0.83	1.21
Aditya Birla Fashion & Retail Ltd.	2.08	2.33	1.29	1.01	1.57	1.66
Avenue Supermarts Ltd.	10.04	9.41	7.77	8.07	9.67	8.99
Future Enterprises Ltd.	0.75	0.73	0.23	-0.13	-2.14	-0.11
Future Market Networks Ltd.	0.38	0.18	0.16	-0.32	0.14	0.11
Future Retail Ltd.	4.16	3.39	1.11	-0.52	0.29	1.68
Go Fashion (India) Ltd.	4.84	6.29	4.49	4.30	4.23	4.83
Heads U P Ventures Ltd.	2.95	2.18	1.43	0.32	0.24	1.42
J L A Infraville Shoppers Ltd.	0.80	1.40	1.57	1.25	0.37	1.08
Shoppers Stop Ltd.	3.71	2.70	1.25	0.57	1.10	1.87
Spencer's Retail Ltd.	1.91	3.36	1.83	1.31	1.31	1.94
Taaza International Ltd.	1.72	0.34	0.75	0.78	1.61	1.04
Trent Ltd.	3.22	3.34	2.25	2.23	2.94	2.80
V 2 Retail Ltd.	3.92	3.01	1.51	1.10	1.29	2.17
V-Mart Retail Ltd.	5.99	6.46	2.52	2.36	2.46	3.96
Vedant Fashions Ltd.	6.24	7.74	8.70	7.66	5.56	7.18
White Organic Retail Ltd.	8.97	8.06	1.81	1.98	8.55	5.87

The Altman Z-score was used to determine the bankruptcy status of the retailing companies registered on the BSE; the result is shown in Table 3. Analyzing the financial statement using the Altman Z-score model provides an understanding and evaluation of the business operations carried out by the retailing companies and how well the business has done.

Table 4: Beneish M-score for the selected retailing companies

Company Name	M-score 2018	M-score 2019	M-score 2020	M-score 2021	M-score 2022	M-score
Arvind Fashions Ltd.	-4.28	-3.62	-4.03	-3.92	-2.15	-3.60
Aditya Birla Fashion & Retail Ltd.	16.24	-4.72	-5.21	-5.10	-4.26	-0.61
Avenue Supermarts Ltd.	-2.58	-3.05	-3.00	-2.91	-2.89	-2.89
Future Enterprises Ltd.	-3.37	-3.49	-4.53	-3.33	-6.69	-4.28
Future Market Networks Ltd.	-5.11	-5.09	-5.29	-5.76	-4.33	-5.12
Future Retail Ltd.	-3.64	-3.85	-4.96	-6.75	-2.80	-4.40
Go Fashion (India) Ltd.	-0.03	-0.64	-2.38	-3.14	-2.18	-1.67
Heads U P Ventures Ltd.	-3.71	-3.71	-4.17	-6.94	-2.46	-4.20
J L A Infraville Shoppers Ltd.	-1.98	0.83	-1.96	-1.68	-1.66	-1.29
Shoppers Stop Ltd.	-4.81	-4.84	-5.09	-5.66	-5.21	-5.12
Spencer's Retail Ltd.	1.47	-2.14	-4.66	-4.98	-5.17	-3.10
Taaza International Ltd.	-3.29	-1.99	4.30	12.20	42.93	10.83
Trent Ltd.	-3.87	-3.42	-3.01	-3.96	-2.77	-3.41
V 2 Retail Ltd.	-1.89	-2.43	-3.48	-3.96	-3.63	-3.08
V-Mart Retail Ltd.	-21.78	-22.67	-35.56	-29.71	-4.79	-22.90
Vedant Fashions Ltd.	-0.97	-0.84	-1.44	-2.15	-1.45	-1.37
White Organic Retail Ltd.	-5.09	-2.28	-2.57	-1.54	-0.37	-2.37

Table 4 shows the result of the Beneish M-score analysis using the secondary data of the retailing companies to determine whether financial statements were manipulated. In this light, the Beneish M-score was used to deduct the financial fraud of the reinsurance companies. The variables are constructed from the company's financial statements to create an M-score. The M-score describes how much the earnings have been manipulated.

Table 5: Springate S-score for the selected retailing companies

Company Name	S-score 2018	S-score 2019	S-score 2020	S-score 2021	S-score 2022	S-score
Arvind Fashions Ltd.	0.62	0.43	0.14	-0.10	0.16	0.25
Aditya Birla Fashion & Retail Ltd.	0.52	0.53	0.31	-0.02	0.24	0.31
Avenue Supermarts Ltd.	2.90	2.71	2.72	2.09	2.41	2.57
Future Enterprises Ltd.	0.43	0.41	0.06	-0.14	-0.81	-0.01
Future Market Networks Ltd.	-0.04	-0.07	0.06	-0.37	0.06	-0.07
Future Retail Ltd.	1.36	1.24	0.42	-0.59	0.13	0.51
Go Fashion (India) Ltd.	2.70	2.80	1.32	0.62	0.96	1.68
Heads U P Ventures Ltd.	1.25	0.89	-0.01	0.01	-0.27	0.38
J L A Infraville Shoppers Ltd.	0.73	0.79	0.83	1.07	0.26	0.73
Shoppers Stop Ltd.	1.09	0.90	0.45	-0.04	0.17	0.52
Spencer's Retail Ltd.	0.55	1.29	0.60	0.29	0.32	0.61
Taaza International Ltd.	0.82	-0.80	0.05	0.22	0.42	0.14
Trent Ltd.	0.77	0.92	0.72	0.30	0.56	0.65
V 2 Retail Ltd.	1.66	1.13	0.78	0.46	0.51	0.91
V-Mart Retail Ltd.	2.24	2.08	0.98	0.69	0.62	1.32
Vedant Fashions Ltd.	2.22	2.30	1.66	0.86	1.26	1.66
White Organic Retail Ltd.	0.83	1.53	0.80	0.97	3.16	1.46

The Springate S-score is the model selected from four of nineteen common financial ratios to determine the likelihood of firms failing. This model also uses stepwise discriminant analysis to result in scores for the retailing companies, and the result is shown in Table 5.

Table 6: Ohlsons O-score for the selected retailing companies

Company Name	O-score 2018	O-score 2019	O-score 2020	O-score 2021	O-score 2022	O-score
Arvind Fashions Ltd.	15.75	-280.26	-328.56	22.96	302.77	-53.47
Aditya Birla Fashion & Retail Ltd.	-277.49	-612.63	-1672.96	757.09	3389.47	316.70
Avenue Supermarts Ltd.	-2519.02	-4091.88	-4884.31	-7038.02	-6076.28	-4921.90
Future Enterprises Ltd.	-229.13	63.10	-124.82	1504.91	5475.12	1337.84
Future Market Networks Ltd.	119.00	-8.39	-50.66	-56.22	153.37	31.42
Future Retail Ltd.	-1902.12	-59.03	-3805.26	-173.64	16570.40	2126.07
Go Fashion (India) Ltd.	-45.69	-111.53	-191.91	-283.89	16.33	-123.34
Heads U P Ventures Ltd.	-72.89	-56.15	0.93	163.91	12.81	9.72
J L A Infraville Shoppers Ltd.	-93.97	-76.91	-1.88	-0.80	-1.74	-35.06
Shoppers Stop Ltd.	101.64	-60.58	-408.55	736.84	1437.73	361.42
Spencer's Retail Ltd.	39.65	45.07	-40.75	298.56	668.90	202.28
Taaza International Ltd.	3.13	-3.29	13.99	1.93	-0.85	2.98
Trent Ltd.	-558.53	-609.67	-664.66	-807.44	265.71	-474.92
V 2 Retail Ltd.	-205.89	-162.70	-106.50	-53.29	57.81	-94.12
V-Mart Retail Ltd.	-231.26	-407.11	-320.70	-262.69	31.70	-238.01
Vedant Fashions Ltd.	-555.85	-782.91	-952.62	-1278.17	-682.75	-850.46
White Organic Retail Ltd.	-0.73	-15.10	-3.82	-3.15	-6.55	-5.87

To predict the bankruptcy of the retailing companies from their financial statements, the Ohlson O-score is used, and the result is shown in Table 6. The Ohlson O-score is a better predictor of bankruptcy than similar accounting models (Najib & Cahyaningdyah, 2020; Verlekar & Kamat, 2019). However, investors may find it suitable to adopt Altman and Ohlson in predicting a company's bankruptcy.

Table 7: Zmijewski X-score for the selected retailing companies

Company Name	X-score 2018	X-score 2019	X-score 2020	X-score 2021	X-score 2022	X-score
Arvind Fashions Ltd.	-18.960	-17.710	-1.216	9.105	-4.681	-6.692
Aditya Birla Fashion & Retail Ltd.	-8.911	-21.656	7.465	29.782	3.120	1.960
Avenue Supermarts Ltd.	-66.228	-63.372	-54.127	-42.134	-50.964	-55.365
Future Enterprises Ltd.	-0.115	-1.303	9.298	46.307	183.469	47.531
Future Market Networks Ltd.	-1.475	-8.138	-7.297	22.481	11.262	3.367
Future Retail Ltd.	-24.560	-1.249	-31.071	0.359	77.132	4.122
Go Fashion (India) Ltd.	-0.364	-3.270	0.277	1.339	-23.201	-5.044
Heads U P Ventures Ltd.	-31.432	0.483	241.079	25.935	65.958	60.405
J L A Infraville Shoppers Ltd.	-9.432	-4.749	-5.762	-6.474	-6.895	-6.662
Shoppers Stop Ltd.	-4.549	-15.131	16.777	36.297	11.556	8.990
Spencer's Retail Ltd.	2.204	-5.825	17.909	39.719	25.815	15.964
Taaza International Ltd.	-2.050	107.682	39.495	18.186	4.113	33.485
Trent Ltd.	-25.227	-24.719	-13.899	3.124	-14.729	-15.090
V 2 Retail Ltd.	-38.525	-22.076	-7.290	5.697	6.990	-11.041
V-Mart Retail Ltd.	-65.794	-46.172	-18.680	0.422	-3.184	-26.682
Vedant Fashions Ltd.	16.541	22.470	-59.814	-69.001	-80.575	-34.076
White Organic Retail Ltd.	-26.247	-15.364	-2.685	-4.263	-66.619	-23.035

The Zmijewski X-score is a bankruptcy model used to predict the bankruptcy of retailing companies in two years (Table 7). The Zmijewski X-score is an empirical test for predicting financial distress that requires a sample of companies under financial pressure and companies that are not. X-score is negative, then the company is said to be healthy (Fauzi & Saluy, 2021).

Table 8: Grover G-score for the selected retailing companies

Company Name	G-score 2018	G-score 2019	G-score 2020	G-score 2021	G-score 2022	G-score
Arvind Fashions Ltd.	0.293	0.209	0.004	-0.015	0.161	0.130
Aditya Birla Fashion & Retail Ltd.	0.003	0.005	-0.096	-0.159	-0.008	-0.051
Avenue Supermarts Ltd.	1.182	0.973	0.781	0.795	0.778	0.902
Future Enterprises Ltd.	0.421	0.388	-0.053	-0.029	-1.135	-0.082
Future Market Networks Ltd.	-0.160	-0.305	-0.121	-0.477	-0.022	-0.217
Future Retail Ltd.	0.544	0.455	-0.013	-0.792	0.381	0.115
Go Fashion (India) Ltd.	1.683	1.750	1.104	0.701	0.936	1.235
Heads U P Ventures Ltd.	0.574	0.313	-0.260	0.354	0.310	0.258
J L A Infraville Shoppers Ltd.	0.828	0.899	1.048	1.254	0.297	0.865
Shoppers Stop Ltd.	-0.053	0.079	0.008	-0.271	-0.132	-0.074
Spencer's Retail Ltd.	0.171	0.455	-0.096	-0.277	-0.273	-0.004
Taaza International Ltd.	0.477	0.052	0.828	1.152	1.202	0.742
Trent Ltd.	0.285	0.468	0.625	0.285	0.470	0.427
V 2 Retail Ltd.	1.187	0.676	0.552	0.345	0.349	0.622
V-Mart Retail Ltd.	1.300	1.196	0.608	0.729	0.522	0.871
Vedant Fashions Ltd.	1.679	1.773	1.465	0.942	1.165	1.405
White Organic Retail Ltd.	0.088	0.499	0.684	0.895	1.812	0.796

The Grover G-score was used to forecast the bankruptcy of retailing companies (Table 8). The Grover G-score Model predicts financial distress by designing and reassessing the Altman Z-score method.

Table 9: Piotroski F-score for the Selected Retailing Companies

Company Name	F-score 2018	F-score 2019	F-score 2020	F-score 2021	F-score 2022	F-score
Arvind Fashions Ltd.	1	0	0	0	0	1
Aditya Birla Fashion & Retail Ltd.	0	0	0	0	0	0
Avenue Supermarts Ltd.	1	0	1	0	0	2
Future Enterprises Ltd.	1	0	0	0	1	2
Future Market Networks Ltd.	0	0	0	0	0	0
Future Retail Ltd.	1	0	0	0	0	1
Go Fashion (India) Ltd.	1	0	0	0	0	1
Heads U P Ventures Ltd.	1	0	0	0	1	2
J L A Infraville Shoppers Ltd.	3	1	0	1	0	5
Shoppers Stop Ltd.	0	0	0	0	0	0
Spencer's Retail Ltd.	1	1	0	0	0	2
Taaza International Ltd.	1	1	1	1	0	4
Trent Ltd.	0	0	1	0	0	1
V 2 Retail Ltd.	1	0	0	0	0	1
V-Mart Retail Ltd.	1	0	0	1	0	2
Vedant Fashions Ltd.	1	1	0	0	0	2
White Organic Retail Ltd.	0	1	0	1	1	3

The Piotroski F-score is the ranking between zero and nine which involves nine factors of the financial strength of retailing companies (Table 9). If a company has a score of eight or nine, it is considered to be a good value. The score between zero and two points is not a good value.

RESEARCH ANALYSIS

Table 10: Compression Result of the Models

Sl.	Prediction Model	Comparison Result			Total	Level of accuracy	Level of Error
		Financial Distress	Gray Area	Non-Distress			
1	Altman Z-score	8	4	5	17	47.06	23.53
2	Beneish M-score	4	1	12	17	23.53	5.88
3	Springate S-score	11	0	6	17	64.71	35.29
4	Ohlsons O-score	8	0	9	17	47.06	52.94
5	Zmijewski X-score	8	0	9	17	47.06	52.94
6	Grover G-score	3	2	12	17	17.65	11.76
7	Piotroski F-score	3	2	12	17	17.65	11.76

Note: Level of accuracy and Level of Error are calculated using the formula given in Appendix I.

Altman Z-score

The calculation of the Altman Z-score Model is shown in Table 3. The model has three criteria for describing the company's financial condition: healthy condition, grey condition, and distress condition. The company is in a healthy situation if the z-score result is more than 2.6 (Z>2.6), while the distressed company has a z-score below 1.1 (Z1.1) ; if the company has a score between 1.1 and 2.6 (1.1Z2.6), then the company is in a grey area condition (Altman, 1968). Based on the calculation, the distressed companies are marked in red, the grey companies are marked in grey, and the healthy companies are marked in green. From 2018 to 2022, eight companies in the retailing industry were classified as 'healthy', with Avenue Supermarts Ltd. receiving the highest score, four companies in the 'grey area', and eight companies in 'distress'. The companies in the red region are in financial distress and could go bankrupt in the upcoming years. (Li et al., 2020; Tinoco & Wilson, 2013) have used the original Altman Z-score model in their study, and Z-score presents appropriate classification accuracy in the case of financially distressed firms and the accuracy of Altman's model was worse. The result of the study supports the study of (Pradhan, 2014; Swalih et al., 2021; Swalih & Vinod, 2017; Tyagi, 2014); who stated that the Altman Z-score model gives the Indian individual and institutional investor a path for investment decisions in the stocks of various industries based on their financial distress.

Beneish M-score

The calculation for the Beneish M-score is shown in Table 4. It determines if a corporation has manipulated its results, financial ratios and eight other factors are used. An M-score is generated by building the variables from the information in the company's financial statements. It indicates how much the earnings have been manipulated. These eight factors are computed, and their results have the company's M-score. If the company's M-score is less than -1.78, likely, it won't manipulate the market. M-score is between -1.78 and -2.22, which indicates the possibility of manipulation. If M-score is more than -2.22, the firm is most likely a manipulator. (Beneish, 1999; Khatun et al., 2022; Sujeewa & Kawshalya, 2020). Based on the calculation, the manipulator companies are marked in red, the likely manipulator companies are marked in yellow, and the healthy companies are marked in green. In 2018–2022, four companies were most likely to be manipulators, one company was vulnerable to manipulation, and 12 companies were safe from financial manipulation in business earnings. (Halilbegovic et al., 2020; Triani, 2019) have stated that the Beneish M-score is a suitable model for measuring the earnings manipulation of companies.

Springate S-score

The calculation for the Springate S-score is shown in Table 5. This model used four out of 19 widely used financial measures to estimate the chance of business failure. Additionally, stepwise discriminant analysis is used in this model to get ratings for each unique organization. Companies are classified as 'failed' if their Springboard score is less than 0.862 (Hungan & Sawitri, 2018; Soelton, 2019; Springate, 1978a). Based on the calculation, companies in distress zones are marked in red, while healthy ones are in green. From 2018 to 2022, 11 companies were in financial distress, while six were healthy. (Arini, 2021; Kusumaningrum, 2021; Putra et al., 2022; YEÞÝLDAÞ, 2021) have applied the Springate Sscore in their studies and stated that the S-score helps investors make investment decisions. (Prasetiyani & Sofyan, 2020) have studied the impact of COVID-19 on retail companies in Indonesia, and the S-score has made good predictions for the companies.

Ohlsons O-score

The calculation for Ohlsons' O-score is shown in Table 6. Two of the nine factors included in the O-breakdown Dummy variables are default risk scores for a company. These nine variables are used to calculate a firm's size, leverage, working capital, liquidity, profitability, change in net income, and debt financing. A composite O-score involves nine factors. A business has a significant likelihood of defaulting if the results are more than 0.5 (Ohlson, 1980). From 2018 to 2022, eight companies would score greater than 0.5, indicating a higher risk of default, while nine will be in the 'healthy zone', denoted by green. The Altman Z-score has been compared with other comparable accounting models. The Ohlson score is a stronger predictor of bankruptcy than these models; still, investors may find value in utilising both Altman and Ohlson to help anticipate a firm's insolvency (Lawrence et al., 2015; Najib & Cahyaningdyah, 2020; Pramudita, 2021).

Zmijewski X-score

The calculation for the Zmijewski X-score is shown in Table 7. The score is a methodology for predicting bankruptcy that can forecast a company's demise in two years. Zmijewski's score was estimated using probity analysis. In this situation, scores under 0.5 indicate a higher likelihood of default (Zmijewski, 1984). From 2018 to 2022, eight companies are in the financial distress zone (red), and nine are in the healthy (green). (Silvan, 2020) has stated in the study that by observing the results of both analyses, bankruptcy prediction models Zmijewski and Altman suggest that factors that significantly affect the company are working capital, retained earnings, net income, and the total liabilities of the companies.

Grover G-score

The calculation for Grover's G-score is shown in Table 8. The Grover G-score categorises companies as bankrupt if the score is equal to or less than -0.02, not bankrupt if the score is equal to or more than 0.01, and companies with a G-score between the upper and lower limits are in the grey area (Grover, 2003). From 2018 to 2022, three companies were in the financial distress zone (red), and 12 were in the financial health zone (green). Model Grover is a predictor of bankruptcy most suitable for companies dealing with the distribution of goods (Hantono, 2019).

Piotroski F-score

The calculation for the Piotroski F-score is shown in Table 9. It is a discrete score between zero and nine that reflects nine criteria used to determine the strength of a firm's financial position. The Piotroski F-Score was estimated as the best-value stock, with nine being the best and zero being the worst. The Piotroski F-Score is a favourite metric used to judge the value of stocks. From 2018 to 2022, three companies were in the worst zone, indicated by red; 12 companies were in the weaker, indicated by orange; and two companies were in the stable, indicated by yellow. (Durán-Vázquez et al., 2014; Hyde, 2018) have applied the F-score in their studies and stated that the score is suitable for evaluating corporate finance and stock valuation.

Table 11: Multicollinearity Test

Prediction Model	Test Value = 1.73961					
	t	df	Sig.	Mean Difference	Collinearity Statistics	
					Tolerance	VIF
Altman Z-score	4.555	16	0.000	2.81	1.50	4.1
Beneish M-score	2.297	16	0.035	3.45	0.30	6.63
Springate S-score	4.628	16	0.000	0.80	0.43	1.2
Ohlsons O-score	-0.416	16	0.683	-141.69	3.11	9.7
Zmijewski X-score	-0.066	16	0.948	-0.46	5.30	4.4
Grover G-score	3.841	16	0.001	0.47	0.21	0.7
Piotroski F-score	5.177	16	0.000	1.71	1.01	2.4

Note: Dependent variable: Bankrupt – Nonbankrupt

Hosmer and Lemeshow Test			
Step	Chi-square	df	Sig.
1	.000	5	1.000

Multicollinearity testing is done by calculating the Variance Inflation Factor (VIF). If the Tolerance Level value is > 0.10 and the VIF value is 10, it could be concluded that there are no symptoms of multicollinearity. (Sari et al., 2022). Hosmer and Lemeshow's test results indicate a value of 1.000 greater than 0.05, which means there is no difference between the predictions of the logistic regression model and the observational data. Table 11 shows that there is no independent correlation in this study. In the T-test value for the Altman Z-score variable, it was discovered that the significance of 0.000 was less than 0.05 and the t value of 4.555 was higher than the t table value, implying that the H1 hypothesis was accepted; in the T-test value for the Beneish M-score variable, it was discovered that the significance of 0.035 was less than 0.05 and the t value of 2.297 was higher than the t table value. The T-test value for the Zmijewski X-score variable revealed that the significance of 0.948 was higher than 0.05 and the t value of -0.066 was less than the t table value, implying that the H1 hypothesis was rejected; the T-test value for the Grover G-score variable revealed that the significance of 0.001 was less than 0.05 and the t value of 3.841 was higher than the t table value. Altman Z-score, Beneish M-score, Springate S-score, Grover G-score, and Piotroski F-score models can be used to predict the financial distress conditions of retail companies listed on the BSE from 2018 to 2022. The result supports the study of (Mavengere, 2015), which validates the use of Altman Z-score in predicting bankruptcy and Beneish M-score in detecting earnings manipulation compared with secondary data relating to the companies. (Bhavani & Amponsah, 2017) stated that the Beneish M-score model was not detecting any fraud, while the Altman Z-score provided some indication that the company's financial statements were flawed.

The result of the study states that both the Altman Z-score Model and the Beneish M-score were appropriate for measuring the financial distress of retail companies. The result of the study supports the findings of (Prasetiyani & Sofyan, 2020), who stated that Altman Z-score and Springate S-score both gave accurate results relating to the bankruptcy of retailing companies registered on the Indonesian Stock Exchange. The study by (Primasari, 2018) stated that the Altman, Springate, and Zmijewski models give the most accurate results for predicting financial distress, while Grover G-score models have insignificant accuracy for measuring financial distress for retailing companies registered on the Indonesian Stock Exchange. Altman, Grover, Springate, and Zmijewski models are applied to find distress score results for the automobile companies registered on the BSE, which will confirm if there is any change in the financial performance of the companies. The result has shown that all the models were significant for the bankruptcy of the automobile companies. A comparison of the Altman and Ohlson models reveals that the Altman model performs better in all three situations studied. Investors use the Ohlson O-score to predict the bankruptcy of companies, and it has shown a non-significant effect in predicting the bankruptcy of retailing companies (Karamzadeh, 2013). (Ghodrati & Moghaddam, 2012) have stated that the Zmijewski and Springate models used to predict financial distress are sufficiently able to predict the continuation of activities of those successful companies admitted to the stock exchange of Tehran. (Hyde, 2018) has stated that F-score strategies are sensitive to the chosen universe of stocks and approach to portfolio construction, which supports the result of the study.

CONCLUSION, LIMITATIONS AND IMPLICATIONS

Based on the results and the discussion above, Altman's Z-score predicted that eight of the 17 retailing companies were in financial distress; four were in the 'grey zone', where financial distress was possible. Beneish M-score has predicted that four companies have manipulated their earnings, and one company has control of revenue. The Springate S-score model predicts eleven companies in financial distress. According to the Ohlson O-score model, eight companies have a risk of bankruptcy. The Zmijewski X-score model predicts eight companies in financial distress. Grover G-score predicted three companies had financial distress, and two companies were in the 'grey zone', which means the possibility of financial distress. The Piotroski F-score model has predicted three companies were in the worst zone, 12 companies were in the week zone, and two companies were in the stable zone. Arvind Fashions Ltd., Aditya Birla Fashion & Retail Ltd., Future Enterprises Ltd., Future Market Networks Ltd., Future Retail Ltd., Heads U. P. Ventures Ltd., J. L. A. Infraville Shoppers Ltd., and Taaza International Ltd. were the possible bases of financial distress based on predicting accounting model.

Springate S-score has the highest level of accuracy, Altman Z-score has the second level ofaccuracy, and Grover G-score and Piotroski F-score have the lowest level of accuracy. Beneish's M-score has the lower accuracy but the lowest error level. All the scores have shown a significant impact in predicting financial distress and bankruptcy among the retailing companies, while the Ohlsons O-score and the Zmijewski X-score have shown an insignificant result in predicting the financial distress and bankruptcy of the companies. The study has two limitations: first, it only covered retailing companies listed on the BSE in the retailing industry from 2018 to 2022. Second, the study employed an accountingbased model for predicting the financial distress of the companies. Further research can be done by involving an accountingbased model and machine learning techniques that utilise data mining techniques to get more accurate analysis using artificial intelligence and machine learning. The study contributes to the academic community in terms of coaching the appropriate model for predicting financial distress. The study will benefit society by providing the results of companies at risk of going bankrupt, allowing investors to make better stock investment decisions.

BIBLIOGRAPHY

(1) Al-Khatib & Al-Horani (2015), “Predicting Financial Distress of Public Companies Listed in Amman Stock Exchange”, European Scientific Journal, 8 (15), pp.437–449.

(2) Alam M. et. al. (2020), “Stock market response during COVID-19 lockdown period in India: An event study”, The Journal of Asian Finance, Economics and Business, 7 (7), pp.131–137.

(3) Alan Y. & Lapré M. A. (2018), “Investigating operational predictors of future financial distress in the US airline industry”, Production and Operations Management, 27 (4), pp.734–755.

(4) Alareeni B. & Branson J. (2013), “Predicting listed companies’ failure in Jordan using Altman models: A case study”, International Journal of Business and Management, 8 (1), p.113.

(5) Alsharef A. et. al. (2021), “Early impacts of the COVID-19 pandemic on the United States construction industry”, International Journal of Environmental Research and Public Health, 18 (4), p.1559.

(6) Altman E. I. (1968), “Financial ratios, discriminant analysis and the prediction of corporate bankruptcy”, The Journal of Finance, 23 (4), pp.589–609.

(7) Amendola A. et. al. (2015), “An analysis of the determinants of financial distress in Italy: A competing risks approach”, International Review of Economics and Finance, 37, pp.33–41.

(8) Appiah K. O., et. al. (2015), “Predicting corporate failure: a systematic literature review of methodological issues”, International Journal of Law and Management.

(9) Arini I. N. (2021), “Analisis Akurasi Model-Model Prediksi Financial Distress”, Jurnal Ilmu Manajemen, 9 (3), pp.1196–1204.

(10) Aydin N. et. al. (2022), “Prediction of financial distress of companies with artificial neural networks and decision trees models”, Machine Learning with Applications, 10, 100432.

(11) Balcaen S., & Ooghe H. (2006), “35 years of studies on business failure: An overview of the classic statistical methodologies and their related problems,” The British Accounting Review, 38 (1), 63–93.

(12) Barboza F., Kimura H., & Altman E. (2017), “Machine learning models and bankruptcy prediction, Expert Systems with Applications, 83, 405–417.

(13) Beneish M. D. (1999), “The detection of earnings manipulation”, Financial Analysts Journal, 55 (5), pp.24–36.

(14) Bhavani G. & Amponsah C. T. (2017), “M-Score and Z-Score for Detection of Accounting Fraud”, Accountancy Business and the Public Interest, July, 2017.

(15) Bhunia A. & Sarkar R. (2011), “A study of financial distress based on MDA”, Journal of Management Research, 3 (2), pp.1–11.

(16) Bischoff W. et. al. (1991), “Normal distribution assumption and least squares estimation function in the model of polynomial regression”, Journal of Multivariate Analysis, 36 (1), pp.1–17.

(17) Charpentier A., Elie R., & Remlinger C. (2021), “Reinforcement learning in economics and finance”, Computational Economics, 1–38.

(18) Chiaramonte L. & Casu B. (2017), “Capital and liquidity ratios and financial distress. Evidence from the European banking industry”, The British Accounting Review, 49 (2), pp.138–161.

(19) Cleofas-Sánchez L. et. al. (2016), “Financial distress prediction using the hybrid associative memory with translation”, Applied Soft Computing, 44, 144–152.

(20) Crespí-Cladera R., Martín-Oliver A., & Pascual-Fuster B. (2021), “Financial distress in the hospitality industry during the COVID-19 disaster”, Tourism Management, 85, 104301.

(21) Drescher F. (2014), “Financial Distress and Insolvency Timing”, In Insolvency Timing and Managerial Decision-Making (pp.23–52), Springer.

(22) Dube K. et. al. (2021), “COVID-19 pandemic and prospects for recovery of the global aviation industry”, Journal of Air Transport Management, 92, 102022.

(23) Durán-Vázquez R. et. al. (2014), "Effectiveness of corporate finance valuation methods: Piotroski score in an Ohlson model: The case of Mexico", Journal of Economics Finance and Administrative Science, 19 (37), pp.104–107.

(24) Ellis C. (2014), "Break-even maturity as a guide to financial distress", Contemporary Economics, 8 (4), 387–396.

(25) Fauzi S. E. & Saluy A. B. (2021), "Comparative analysis of financial sustainability using the altman Z-score, Springate, Zmijewski and Grover models for companies listed at Indonesia stock exchange sub-sector telecommunication period 2014–2019", Journal of Economics and Business, 4 (1).

(26) Fredrick I. (2019), "Firm specific determinants of financial distress: Empirical evidence from Nigeria", Journal of Accounting and Taxation, 11 (3), pp.49–56.

(27) Geng R. et. al. (2015), "Prediction of financial distress: An empirical study of listed Chinese companies using data mining", European Journal of Operational Research, 241 (1), pp.236–247.

(28) Ghazali A. W., Shafie N. A., & Sanusi Z. M. (2015), "Earnings management: An analysis of opportunistic behaviour, monitoring mechanism and financial distress", Procedia Economics and Finance, 28, 190–201.

(29) Ghodrati H. & Moghaddam A. M. (2012), "A Study of the Accuracy of Bankruptcy Prediction Models: Altman, Shirata, Ohlson, Zmijewsky, CA Score, Fulmer, Springate, Farajzadeh Genetic, and McKee Genetic Models for the Companies of the Stock Exchange of Tehran", American Journal of Scientific Research, 59, pp.55–67.

(30) Grover J. S. (2003), "Validation of a cash flow model: A non-bankruptcy approach", Nova Southeastern University.

(31) Halilbegovic S. et. al. (2020), "Application of Beneish M-score model on small and medium enterprises in Federation of Bosnia and Herzegovina", Eastern Journal of European Studies, 11 (1).

(32) Hannigan B. (2018), Company law, Oxford University Press, USA.

(33) Hantono H. (2019), "Predicting financial distress using Altman score, Grover score, springate score, zmijewski score (Case study on Consumer Goods Company)", Accountability, 8 (1), 1–16.

(34) Hotchkiss E. S. et. al. (2021), "Private equity and the resolution of financial distress", The Review of Corporate Finance Studies, 10 (4), pp.694–747.

(35) Hull J. & White A. (1998), "Value at risk when daily changes in market variables are not normally distributed", Journal of Derivatives, 5, pp.9–19.

(36) Hungan A. G. D. & Sawitri N. N. (2018), "Analysis of Financial Distress with Springate and Method of Grover in Coal In BEI 2012-2016", International Business and Accounting Research Journal, 2 (2), pp.52–60.

(37) Hyde C. E. (2018), "The Piotroski F score: evidence from Australia. Accounting & Finance", 58 (2), 423–444.

(38) Jones P. & Comfort D. (2020), "The COVID-19 crisis and sustainability in the hospitality industry", International Journal of Contemporary Hospitality Management.

(39) Karamzadeh M. S. (2013), "Application and comparison of altman and ohlson models to predict bankruptcy of companies", Research Journal of Applied Sciences, Engineering and Technology, 5 (6), pp.2007–2011.

(40) Khatun A., Ghosh R., & Kabir S. (2022), "Earnings manipulation behavior in the banking industry of Bangladesh: The strategical implication of Beneish M-score model. Arab Gulf Journal of Scientific Research, ahead-of-print.

(41) Kiaupaite-Grushniene V. (2016), "Altman Z-score model for bankruptcy forecasting of the listed Lithuanian agricultural companies", 5th International Conference on Accounting, Auditing, and Taxation (ICAAT 2016), pp.222–234.

(42) Kumar P. R. & Ravi V. (2007), "Bankruptcy prediction in banks and firms via statistical and intelligent techniques–A review", European Journal of Operational Research, 180 (1), pp.1–28.

(43) Kusumaningrum T. M. (2021), "PERBANDINGAN TINGKAT AKURASI MODEL-MODEL PREDIKSI FINANCIAL DISTRESS PADA PERUSAHAAN YANG TERMASUK KANTAR'S 2020 TOP 30 GLOBAL RETAILS (EUR), Jurnal Ilmiah MEA (Manajemen, Ekonomi, & Akuntansi), 5 (3), 1309–1327.

(44) Lawrence J. R. et. al. (2015), "The use of Ohlson's O-Score for bankruptcy prediction in Thailand", Journal of Applied Business Research (JABR), 31 (6), pp.2069–2078.

(45) Li Y. et. al. (2020), "Financial distress, internal control, and earnings management: Evidence from China", Journal of Contemporary Accounting & Economics, 16 (3), p.100210.

(46) Mahtani U. S. & Garg C. P. (2018), "An analysis of key factors of financial distress in airline companies in India using fuzzy AHP framework", Transportation Research Part A: Policy and Practice, 117, pp.87–102.

(47) Makni M. S. (2022), "Analyzing the impact of COVID-19 on the performance of listed firms in Saudi market", Technological Forecasting and Social Change, p.122171.

(48) Mavengere K. (2015), "Predicting corporate bankruptcy and earnings manipulation using the Altman Z-score and Beneish M score. The case ofZ manufacturing firm in Zimbabwe", International Journal of Management Sciences and Business Research, 240 (10), pp.8–14.

(49) Mohammed S. (2016), "Bankruptcy prediction by using the Altman Z-score model in Oman: A case study of Raysut cement company SAOG and its subsidiaries", Australasian Accounting, Business and Finance Journal, 10 (4), pp.70–80.

(50) Muigai R. G. & Muriithi J. G. (2017), "The moderating effect of firm size on the relationship between capital structure and financial distress of non-financial companies listed in Kenya", Journal of Finance and Accounting, 5 (4), pp.151–158.

(51) Najib A. S. & Cahyaningdyah D. (2020), "Analysis of the Bankruptcy of Companies with Altman Model and Ohlson Model", Management Analysis Journal, 9 (3), pp.243–251.

(52) Nofsinger J. R. (2017), "The psychology of investing", Routledge.

(53) Ohlson J. A. (1980), "Financial ratios and the probabilistic prediction of bankruptcy", Journal of Accounting Research, pp.109–131.

(54) Oladipo I. D. et. al. (2022), "Machine Learning and Deep Learning Algorithms for Smart Cities: A Start-of-the-Art Review", IoT and IoE Driven Smart Cities, pp.143–162.

(55) Osborne J. W., & Waters E. (2002), "Four assumptions of multiple regression that researchers should always test", Practical Assessment, Research, and Evaluation, 8 (1), 2.

(56) Oz I. O., & Yelkenci T. (2017), "A theoretical approach to financial distress prediction modeling. Managerial Finance", 43 (2), 212–230.

(57) Özyeºil M. (2020), "A Relationship between Altman's Z Scores and Stock Price Performance: A Review on Listed Companies in Bist-30 Index", International Journal of Economics and Management Studies (SSRG-IJEMS) –7 (2).

(58) Panzone L. A., Larcom S., & She, P. -W. (2021), "Estimating the impact of the first COVID-19 lockdown on UK food retailers and the restaurant sector", Global Food Security, 28, 100495.

(59) Pena T., Martínez S., & Abudu B. (2011), "Bankruptcy prediction: A comparison of some statistical and machine learning techniques", In Computational Methods in Economic Dynamics (pp.109–131), Springer.

(60) Piotroski J. D. (2000), "Value investing: The use of historical financial statement information to separate winners from losers", Journal of Accounting Research, pp.1–41.

(61) Pradhan R. (2014), "Z Score Estimation for Indian Banking Sector", International Journal of Trade, Economics and Finance, 5 (6), pp.516–520.

(62) Pramudita A. (2021), "The Application of Altman Revised Z-Score Four Variables and Ohlson O-Score as A Bankruptcy Prediction Tool in Small and Medium Enterprise Segments in Indonesia", 5th Global Conference on Business, Management and Entrepreneurship (GCBME 2020), 132–135.

(63) Prasetiyani E. & Sofyan M. (2020), "Bankruptcy analysis using Altman Z-score model and Springate model in retail trading company listed in Indonesia Stock Exchange", Ilomata International Journal of Tax and Accounting, 1 (3), pp.139–144.

(64) Primasari N. S. (2018), "Analisis Altman Z-Score, Grover score, Springate, Dan zmijewski Sebagai Signaling Financial Distress (Studi Empiris Industri Barang-Barang Konsumsi di Indonesia)", Accounting and Management Journal, 1 (1), 23–43.

(65) Putra K. S. H., Wahyuni E. T., & Fitrijanti T. (2022), "Financial Distress, Size, Age, and Corporate Social Responsibility Disclosure: Empirical Study From Indonesia Before and During the COVID-19 Pandemic", Jurnal Dinamika Akuntansi Dan Bisnis Vol, 9 (1), 73–88.

(66) Putri P. (2021), "The Effect of Operating Cash Flows, Sales Growth, and Operating Capacity in Predicting Financial Distress", International Journal of Innovative Science and Research Technology, 6 (1), pp.638–646.

(67) Rahmah I. & Novianty I. (2021), "Comparative Analysis of Financial Distress Before and During the Covid-19 Pandemic: Empirical Evidence in Indonesia", International Journal of Business, Economics and Law, 24 (5), pp.216–222.

(68) Rahman M. et. al. (2021), "Predicting firms' financial distress: An empirical analysis using the F-score model", Journal of Risk and Financial Management, 14 (5), p.199.

(69) Restianti T. & Agustina L. (2018), "The Effect of Financial Ratios on Financial Distress Conditions in Sub Industrial Sector Company", Accounting Analysis Journal, 7 (1), pp.25–33.

(70) Roggeveen A. L. & Sethuraman R. (2020), "How the COVID-19 pandemic may change the world of retailing", Journal of Retailing, 96 (2), p.169.

(71) Salim M. N. & Ismudjoko D. (2021), "An analysis of financial distress accuracy models in indonesia coal mining industry: an Altman, Springate, Zmijewski, Ohlson and Grover approaches", Journal of Economics, Finance and Accounting Studies, 3 (2), pp.1–12.

(72) Sari D. P., Nabella, S. D., & Fadlilah, A. H. (2022), "The Effect of Profitability, Liquidity, Leverage, and Activity Ratios on Dividend Policy in Manufacturing Companies in the Food and Beverage Industry Sector Listed on the Indonesia Stock Exchange in the 2016-2020 Period", Jurnal Mantik, 6 (2), 1365–1375.

(73) Sarker I. H. (2021), "Machine learning: Algorithms, real-world applications and research directions", SN Computer Science, 2 (3), 1–21.

(74) Sensini L. (2016), "An Empirical Analysis of Financially Distressed Italian Companies", International Business Research, 9 (10), 75.

(75) Shahwan T. M. (2015), "The effects of corporate governance on financial performance and financial distress: evidence from Egypt", Corporate Governance.

(76) Shumway T. (2001), "Forecasting bankruptcy more accurately: A simple hazard model", Journal of Business, 74 (1), pp.101–124.

(77) Silvan A. (2020), "Financial Statement Ratio Analysis to Predict Bankruptcy nn Company Registered in BEI - Jakarta (Altman Z-Score Method and Zmijewski) ", Hasanuddin Economics and Business Review, 3 (3), 122.

(78) Soelton M. (2019), "Analysis of accuracy level of Altman Z-Score model and Springate model in measuring the potential of financial distress in plantations industries", International Journal of Economics and Financial Research, 5 (2), pp.16–25.

(79) Springate G. L. V. (1978a), "Predicting the possibility of failure in a Canadian firm: A discriminant analysis", Simon Fraser University.

(80) Springate G. L. V. (1978b), "Predicting the possibility of failure in a Canadian firm", Unpublished MBA Research Project, Simon Fraser University, 1.

(81) Sujeewa G. M. M. & Kawshalya M. D. P. (2020), "Detecting red flags of corporate financial statement frauds using Beneish m score model in Sri Lanka", International Journal of Accounting and Business Finance, 6 (2).

(82) Supitriyani S. et. al. (2021), "Analysis of financial distress in measuring bankruptcy before and after the Covid-19 pandemic", Journal of Governance Risk Management Compliance and Sustainability, 1 (2), pp.53–60.

(83) Swalih M. M., Adarsh K. B., & Sulphey M. M. (2021), "A study on the financial soundness of indian automobile industries using altman z-score", Accounting, 7 (2), 295–298.

(84) Swalih M. M. & Vinod M. S. (2017), "Application of Altman Z Score on BSE-Greenex Companies", Journal of Applied Management and Investments, 6 (3), pp.205–215.

(85) Tian S. et. al. (2015), "Variable selection and corporate bankruptcy forecasts", Journal of Banking & Finance, 52, pp.89–100.

(86) Tinoco M. H. & Wilson N. (2013), "Financial distress and bankruptcy prediction among listed companies using accounting, market and macroeconomic variables", International Review of Financial Analysis, 30, pp.394–419.

(87) Triani N. (2019), "Fraudulent Financial Reporting Detection Using Beneish M-Score Model in Public Companies in 2012-2016", Asia Pacific Fraud Journal, 4 (1), pp.27–42.

(88) Tron A. (2021), "Corporate Distress and Financial Equilibrium: Genesis and Prognosis. In Corporate Financial Distress", Emerald Publishing Limited.

(89) Tyagi V. (2014), "A Study To Measures The Financial Health Of Selected Firms With Special Reference To Indian Logistic Industry/ : An Application of Altman's Z Score", Industrial Engineering Letters, 4 (4), 43–53.

(90) Udin S. et. al. (2017), "The effects of ownership structure on likelihood of financial distress: an empirical evidence", Corporate Governance: The International Journal of Business in Society.

(91) Van Engelen J. E. & Hoos H. H. (2020), "A survey on semi-supervised learning", Machine Learning, 109 (2), 373–440.

(92) Verlekar R. P. & Kamat M. S. (2019), "Recalibration and application of Springate, Zmijewski and Grover bankruptcy models in Indian banking sector", International Journal of Business Analytics and Intelligence, 7 (2), 19.

(93) Wanke P. et. al. (2015), "Financial distress drivers in Brazilian banks: A dynamic slacks approach", European Journal of Operational Research, 240 (1), pp.258–268.

(94) Wyrwich M., Stuetzer M., & Sternberg R. (2016), "Entrepreneurial role models, fear of failure, and institutional approval of entrepreneurship: A tale of two regions", Small Business Economics, 46 (3), 467–492.

(95) Yang K. et al. (2021), "Effects of retailers' service quality and legitimacy on behavioral intention: The role of emotions during COVID-19", The Service Industries Journal, 41 (1–2), pp.84–106.

(96) YEÞÝLDAÞ E. (2021), "Detecting differences between financial distress method results and stock choosing performance on manufacturing companies listed on bist between 2017-2019", Sosyal Bilimlerde Nicel Araþtýrmalar Dergisi, 1 (1).

(97) Yusuf A. & Akande O. (2021), "Hyper-parameter optimization and evaluation on selected machine learning algorithm using hepatitis dataset", FUDMA Journal of Sciences, 5 (2), pp.447–455.

(98) Zhao S. et. al. (2022), "Financial distress prediction by combining sentiment tone features. Economic Modelling", 106, 105709.

(99) Zmijewski M. E. (1984), "Methodological issues related to the estimation of financial distress prediction models", Journal of Accounting Research, pp.59–82.

Appendix 1: Formulas used for the Calculation in the Research Paper

Altman Z-score:

$$Z = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E$$

Where:
Z is the Altman's Z-score
A is the Working Capital/Total Assets ratio
B is the Retained Earnings/Total Assets ratio
C is the Earnings Before Interest and Tax/Total Assets ratio
D is the Market Value of Equity/Total Liabilities ratio
E is the Total Sales/Total Assets ratio

Beneish M-score:

$$M = -4.84 + 0.92*DSRI + 0.528*GMI + 0.404*AQI + 0.892*SGI + 0.115*DEPI - 0.172*SGAI + 4.679*TATA - 0.327*LEVI$$

Where:
M is the Beneish M-score
DSRI: Day Sales in Receivable Index
GMI: Gross Margin Index
AQI: Assets Quality Index
DEPI: Depreciation Index
SGAI: Sales, General and Administrative Expenses Index
LVGI: Leverage Index
TATAI: Total Accruals to Total Assets Index

Springate S-score:

$$Z = 1.03A + 3.07B + 0.66C + 0.4D$$

A: Working Capital / Total Assets

B: EBIT / Total Assets

C: EBT / Current Liabilities

D: Sales / Total Assets

Ohlsons O-score:

$$T = -1.32 - 0.407 \log (TA_t/GNP) + 6.03 \frac{TL_t}{TA_t} - 1.43 \frac{WC_t}{TA_t} + 0.0757 \frac{CL_t}{CA_t}$$

$$- 1.72X - 2.37 \frac{NI_t}{TA_t} - 1.83 \frac{FFO_t}{TL_t} + 0.285Y - 0.521 \frac{NI_t - NI_{t-1}}{|NI_t| + |NI_{t-1}|}$$

Where:

TA = Total Assets

GNP = Gross National Product Price Index Level (in USD, 1968 = 100)

TL = Total Liabilities

WC = Working Capital

CL = Current Liabilities

CA = Current Assets

X = 1 if TL > TA, 0 otherwise

NI = Net Income
FFO = Funds from Operations
Y = 1 if a net loss for the last two years, 0 otherwise

Zmijewski X-score:

$$X = -4.3 - 4.5X1 + 5.7X2 - 0.004X3$$

Where:
X = Overall Index
X1 = Return on Asset (ROA)
X2 = Leverage (Debt Ratio)
X3 = Liquidity (Current Ratio)

Grover G-score:

$$G = 1.650X1 + 3.404X2 - 0.016\,X3 + 0.057$$

Where:
X1 is Working Capital /Total Assets
X2 is Net Profit Before Interest and Tax/ Total Assets
X3 is Return on Assets (ROA)

Piotroski F-score:

The score is calculated based on 9 criteria divided into 3 groups.

Profitability

Return on Assets (ROA) (1 point if it is positive in the current year, 0 otherwise);

Operating Cash Flow (1 point if it is positive in the current year, 0 otherwise);

Change in Return of Assets (ROA) (1 point if ROA is higher in the current year compared to the previous one, 0 otherwise);

Accruals (1 point if Operating Cash Flow/Total Assets is higher than ROA in the current year, 0 otherwise);

Leverage, Liquidity and Source of Funds

Change in Leverage (long-term) ratio (1 point if the ratio is lower this year compared to the previous one, 0 otherwise);

Change in Current ratio (1 point if it is higher in the current year compared to the previous one, 0 otherwise);

Change in the number of shares (1 point if no new shares were issued during the last year);

Operating Efficiency

Change in Gross Margin (1 point if it is higher in the current year compared to the previous one, 0 otherwise);

Change in Asset Turnover ratio (1 point if it is higher in the current year compared to the previous one, 0 otherwise);

Accuracy Level & Error Level:

Level of Accuracy = Total True Prediction / Total Sample * 100%
Level of Error = Total Error / Total Sample * 100%

23 EMPIRICAL ANALYSIS OF EARLY SIGNALS FOR FINANCIAL DISTRESS USING ACCOUNTING, MARKET AND REPORTING ANOMALY VARIABLES

- Muhammed Suhail PS and Arun Kumar Gopalaswamy

EXECUTIVE SUMMARY

This study aims to empirically examine the signals of financial distress among listed non financial firms in India, using variables from accounting, market, and reporting anomalies. This study has comprehensively covered the various phases of financial distress using three alternative definitions: financial health-based, legal outcome-based, and a combination of these two. Based on the panel data collected from 2008-2021, it is observed that return on assets (ROA), assets turnover ratio (ATR), debt to equity ratio (DE), market capitalization, and market value of equity to book value of debt (MVEBVD) are credible signals of impending distress. Findings suggest that the effectiveness of reporting anomaly as a signal depends on the firm's position in the distress continuum. Further, evidence reported that combining accounting, market, and reporting anomaly variables can significantly enhance the model's accuracy. The findings of this study provide insights to regulators and managers for recognising the early signals of financial distress, thereby reducing the substantial distress cost to stakeholders.

Keywords: Financial Distress, Bankruptcy, Insolvency, Default, Financial Signals, Reporting Anomalies

INTRODUCTION

The Insolvency and Bankruptcy Board of India (IBBI),[1] instituted in 2016, has brought in stringent regulations resulting in more than 6,000 companies filing for corporate insolvency and resolution process (CIRP),[2] which caused about 46% to liquidate, followed by 14% adopting resolution plans (IBBI, 2022). Financial distress indicates a firm's inability to meet its financial commitments and comprises failure, default, insolvency, and bankruptcy (Altman *et al.,* 2019). Failure occurs when the firm fails to service the debt and exhausts all avenues for repayment. Whereas default can be both technical and legal. The former arises when debts are not serviced on time, and the latter occurs when debt covenants are violated. Insolvency happens when the firm files for insolvency proceedings and bankruptcy is when a firm undergoes statutory procedures, which may end up with a legal declaration that the firm is bankrupt (Habib *et al.,* 2020). Financial distress does not imply that a firm will ultimately fail; however, the persistent decline in financial performance may lead to bankruptcy.

The consequences of financial distress to various stakeholders can be severe. For instance, in addition to loss accruing for the shareholders and creditors, there will be disruptions in the supply chain, a decline in employee remuneration, and damage to the firm's reputation (Ali *et al.,* 2018; Argenti, 1976). In lieu of this, bankruptcy prediction models were developed to provide early signals for distress and to foresee bankruptcy. Since the seminal works of Fitzpatrick (1932) and Beaver (1966), accounting ratios pertaining to profitability, solvency, liquidity, efficiency, and cash flow have been extensively used. For instance, Beaver (1966) used financial ratios to classify bankrupt and non-bankrupt firms in a univariate setup, and Altman (1968) subsequently extended Beaver's study by adopting multiple discriminant analysis (MDA). In studies by Ohlson (1980) and Zmijewski (1984), logit and probit methodologies were used to predict bankruptcy.

In addition to accounting measures, Shumway (2001) considered market-driven variables and found that few of the accounting ratios used in prior studies of Altman (1968) and Zmijewski (1984) are poor bankruptcy predictors. However, the model's accuracy was enhanced upon combining market and accounting variables in line with Chava and Jarrow (2008). Further, studies also considered signals related to book-tax differences (Noga and Schnader, 2013), corporate governance (Daily and Dalton, 1994), cash flow (Bhandari and Iyer, 2013), and macroeconomy (Jacobson *et al.,* 2013) to predict financial distress.

A handful of studies have considered financial reporting quality as a signal of distress. The results of those studies indicated that distressed firms have strong incentives to engage in earnings manipulation strategies to camouflage their deteriorating condition. (Franz *et al., 2014;* Habib *et al.,* 2013). In the current study, such strategies are termed as reporting anomalies indicating the changes in reporting patterns prior to distress. Studies have used various proxies for reporting anomalies, such as restatement of financial statements, discretionary accruals, earnings management index, real and accrual earnings management, reporting delays, and earnings quality as credible signals of distress (Ashraf *et al.*, 2020; Beaver *et al.*, 2012; Li *et al.*, 2021; Serrano-Cinca *et al.*, 2019).

Despite numerous attempts by researchers, there is no consensus on the selection of signals or reported findings as they are sensitive to time period, industry, and country characteristics. Largely, studies fail to consider the incentives for distressed firms to manipulate earnings (Franz *et al.,* 2014). Further, there is a lack of consensus on the effectiveness of accounting and market-based variables in explaining financial distress (Beaver *et al.,* 2005). However, a few studies have reported an improvement in predictive ability subsequent to the integration of accounting and market-driven variables (Campbell *et al*., 2008; Balasubramanian *et al.,* 2019). Therefore, the objective of this study is 'to identify financial distress signals and their impact using a hybrid model by combining variables from accounting, market, and reporting anomalies'.

A study on Indian firms is currently relevant due to the rapid increase in CIRP filing. Further, the extant literature in India primarily deals with the distress faced by banks, small-scale sectors, and specific industries restricted to existing bankruptcy prediction models like Altman's (1968) Z score. The applicability and accuracy of such models in Indian firms across industries are debatable, as these models were proposed in developed nations with a predominant focus on the manufacturing sector (Singh and Mishra, 2016). Further, studies primarily relied on varied definitions of financial distress based on different threshold values of accounting, market variables, and credit rating (Agrawal and Maheshwari, 2019; Shrivastava *et al.,* 2018), with very few relying on IBBI data (Arora and Saurabh, 2022; Balasubramanian *et al.,* 2019). The reason for not using the legal definition was that distressed firms under IBBI were in their early stages of legal proceedings (Sehgal *et al.,* 2021). However, 75% of the liquidations under IBC was also a part of the Board for Industrial and Financial Reconstruction (BIFR- predecessor of IBBI), indicating that these firms were not in their early stages.[3] In the current study, distressed firms are classified into three categories, i.e., firms undergoing severe distress but not filed for insolvency yet, firms filed for insolvency under IBC, and a combination of these two. Despite extensive literature search, there has been no study that has used a broader definition of financial distress with comprehensive coverage of variables using IBBI data.

The overall findings of the study indicate that ROA, ATR, and DE are credible signals among accounting variables. On the contrary, cash flow information is observed to be less significant in explaining distress. Among the market-related variables, market capitalization and MVEBVD have substantial explanatory power. Besides the five variables specified, there is inconsistency in the coefficients across other variables based on the degree of financial distress. Though the developed Earning Management (EM) index enhances the model's explanatory power, the results are inconsistent. The findings suggest that the choice of earnings management primarily depends on the firm's position on the distress continuum.

The rest of the paper is categorized as follows. It first discusses the literature, research questions, and hypothesis, followed by details of the data and methodology. The empirical findings and discussions are thereafter presented followed by the conclusion and implication of the study.

LITERATURE REVIEW, RESEARCH QUESTIONS, AND HYPOTHESIS

Financial signals of distress

The bankruptcy prediction models gained widespread attention during the 1930s with the seminal work of Fitzpatrick (1932). Since then, studies have extensively used traditional accounting ratios pertaining to profitability, solvency, liquidity, efficiency, and cash flow. For instance, Fitzpatrick (1932) used 13 financial ratios to compare failed and healthy firms, concluding that most ratios favour successful firms. In their model, net worth to debt and net profit to net worth ratios were highly significant. Until then, the analysis was primarily based on comparing average values of several ratios. Subsequently, Beaver (1966) used univariate discriminant analysis with 30 financial ratios to classify bankrupt and non-bankrupt firms and observed that the net income to total assets, net income to sales, net income to net worth, cash flow to total debt, and cash flow to total assets are significant predictors.

Altman (1968) improved Beaver's study by using MDA in which five financial ratios were considered, i.e., working capital to total assets (WCTA), retained earnings to total assets (RETA), earnings before interest and taxes to total assets, MVEBVD, and sales to total assets. Based on this, the Altman Z score was developed and reported 95% accuracy in predicting bankruptcy up to one year before failure. However, due to the restrictive assumption of MDA, Ohlson (1980) developed a conditional logit model and concluded that firm size, total liabilities to total assets (leverage), net income to total assets (profitability), and WCTA (liquidity) are significant predictors. In contrast, using probit analysis, Zmijewski (1984) found total liabilities to total assets as the crucial variable in predicting bankruptcy.

Several researchers criticised the studies that primarily used accounting-based variables. For instance, Mensah (1984) emphasized the need to revise the accounting-based models by indicating that they do not reflect firms' future performance. Similarly, Hillegeist *et al*. (2004) found that the ability of accounting information is likely to be limited in predicting bankruptcy. In light of these criticisms, numerous studies have attempted to develop prediction models based on market-driven variables by assuming that the market reflects the firm's future performance.

Merton (1974) developed the first market-based default model by extending Black and Scholes's (1973) option pricing theory to model default risk. Subsequently, Shumway (2001) used a discrete-time hazard model and found that all variables used in Altman's (1968) model, except earnings before interest & tax to total assets and MVEBVD, were insignificant. Similarly, the only significant indicator in Zmijewski's (1984) model is net income to total assets. The study also reported that market capitalization, past excess return, and idiosyncratic risk are significant predictors. Further, Chava and Jarrow (2008) support Shumway (2001) by concluding that accounting signals provide minor predictive power than market signals.

The extant literature in India primarily relied on existing bankruptcy prediction models restricted to specific industries. For instance, Khan *et al*. (2022) used Altman's (1968) Z score to understand the probability of bankruptcy in the telecom sector. Similarly, Sawant *et al*. (2021) used Piotroski's (2000) F score along with Altman's (1968) Z score to assess the severity of distress in the retail industry. In contrast, Mahtani and Garg (2018) focused on the aviation sector. On similar lines, Agrawal and Maheshwari (2019) focused on the extent of influence of industry-level factors in default risk. Another strand of literature deals with macroeconomic determinants of financial distress (Agrawal and Maheshwari, 2014; Hafeez and Kar, 2021; Sehgal *et al.,* 2021). However, these studies failed to use IBBI data, and Sehgal *et al.* (2021) further restricted the data period prior to 2016 to avoid the impact of IBC since it could have resulted in bias due to the surge in bankruptcy filings.

An empirical analysis of financial distress in India is minimal, with a handful of studies attempting to understand the signals of distress. Arora and Saurabh (2022) considered the firms that filed for insolvency under IBC and found that market capitalization to debt, RETA, ROA, and cash return on total assets are significant predictors. Similarly, Sehgal *et al.* (2021) examined the firm-level determinants of distress without considering IBBI data, as the distressed firms under IBC were in their early stages of legal proceedings. The study reported that the return on capital employed, operating cash flow to debt, ATR, DE, and fixed assets to total assets are significant predictors. Balasubramanian *et al*. (2019) defined distressed firms as those declared sick under BIFR, in line with Singh and Mishra (2016). The study used a combination of financial and non-financial variables and found that the long-term DER, ROA and RETA are significant predictors.

Reporting anomalies as a signal of financial distress

Studies using accounting variables to explain or predict distress assume that financial statements provide reliable information to assess a company's financial health accurately. However, distressed firms have strong enticements to adopt earnings manipulation strategies to make firms look healthier than they are (Franz *et al., 2014;* Habib *et al.,* 2013). For instance, Beaver *et al.* (2012) investigated the impact of changes in financial reporting attributes on the predictive accuracy of accounting ratios by assuming these ratios are a subset of all information reflected in the market price. Their study used the restatement of financial statements and discretionary accruals as the proxies for discretion in financial reporting to conclude that both proxies significantly deteriorate the model's predictive power by making financial ratios less informative. Similarly, Ashraf *et al.* (2020) reported that a firm with poor earnings quality has high discretionary accruals and a higher likelihood of financial distress. Predictive accuracy was substantially improved when such proxies were included in the model. In contrast, Agrawal and Chatterjee (2015) and Li and Faff (2019) found an insignificant coefficient for discretionary accruals.

In addition to discretionary accruals, Li *et al*. (2021) examined real earnings management, '*the deliberate alteration of earnings by adjusting the timing of investment activities and making financial decisions for personal gain*' (Healy and Wahlen, 1999). They reported a negative relationship between real earnings management and distress, suggesting that distressed firms are less capable of conducting real earnings management. Based on financial ratios from creative and forensic accounting literature, Serrano-Cinca *et al*. (2019) constructed an EM index to detect accounting anomalies. The proposed index reported the highest predictive power than traditional financial ratios to capture the degree of conservatism in financial reporting. Further, Bhandari and Iyer (2013) considered earnings quality as a signal, and the findings reported a negative relationship with distress. Jacobson *et al*. (2013) used the delay in financial reporting to explain the default, as several distressed firms experienced a delay in financial reporting prior to bankruptcy. In India, studies examining reporting anomalies as a signal of distress are scarce with the majority of studies have focused on reporting anomalies as a consequence of financial distress (Nagar and Sen, 2016;Agrawal and Chatterjee, 2015).

Research questions and hypothesis

As indicated, variables related to accounting, market, and reporting anomalies can provide credible signals about the downward spiral of financial distress. Despite numerous attempts by researchers, the empirical evidence is mixed and inconclusive. For instance, Campbell *et al*. (2008) and

Balasubramanian *et al.* (2019) used accounting and market-driven variables and concluded that the ability to predict bankruptcy in both long and short-term horizons is more accurate than previous market-based models. However, Beaver *et al.* (2005) reported that market-driven variables complement accounting variables and lead to only a minor reduction in predictive power. Further, Ashraf *et al*. (2020) included the proxies for reporting anomalies alongside market-based and accounting variables, and reported improved prediction accuracy compared to models that rely solely on financial variables. Instead of focusing on the more accurate signal among these groups, the ideal approach would be to focus on their combination (Kealhofer 2003, 2003). Therefore, this study aims to identify financial distress signals and their impact using a hybrid model by combining variables from accounting, market, and reporting anomalies. Accordingly, the first hypothesis of the study is as follows:

Hypothesis 1: The proposed hybrid model with accounting, market, and reporting anomaly variables can yield higher accuracy in predicting financial distress.

The current study also facilitates understanding the effect of reporting anomalies on distress. One strand of literature documented that earnings management can be an effective signal since its adoption rapidly increases when a firm undergoes financial distress. Besides this, other incentives to engage in earnings management are: to avoid delisting, to meet the earnings expectations (opportunistic behaviour hypothesis), to reduce earnings volatility (income smoothing hypothesis), to maximize the compensation (bonus plan hypothesis), and to avoid debt covenant violations (debt covenant hypothesis) (Graham *et al.*, 2005; Healy, 1985; Park *et al.*, 2021; Xu *et al*., 2021). Contrary to this, studies reported that if the firm is on the verge of bankruptcy, it tends to secure more cash flow to stabilize the firm than engage in earnings management as managers become aware of the legal consequences, exhaust their capacity for further manipulation, and mandatory disclosure of high-quality financial information (Campa 2019). Based on this reasoning, the second hypothesis is derived as follows:

Hypothesis 2: There is a positive association between reporting anomalies and financial distress.

DATA AND METHODOLOGY

Definition of financial distress

Studies have used varied definitions of financial distress based on financial health, legal outcome, and a combination of both. The financial health-based definition classifies distressed firms based on a threshold value of various financial ratios (Christopoulos *et al.,* 2019; Pindado *et al.,*2008; Shrivastava *et al.,* 2018). The inherent limitation of such classification is that it completely ignores the actual data of distressed firms from the IBBI. Legal outcome-based definitions consider a firm as distressed when a firm files for insolvency, receives a liquidation or resolution order, is delisted, and has a poor credit rating (Ashraf *et al.,* 2020; Li *et al.,* 2021; Noga and Schnader, 2013; Ong *et al.,* 2011; Singh and Mishra, 2016; Tsai and Chang, 2010; Zhang, 2015).

The current study has used three broad definitions of financial distress to comprehensively cover the various phases of distress. A firm is said to have experienced distress based on its financial health when earnings before interest, tax, depreciation, and amortization (EBITDA) are less than financial expenses for two consecutive years (Keasey *et al.,* 2015), net worth to total debt is less than one and has a negative net worth growth for two successive years (Gupta *et al.,* 2018). The first part of the definition indicates the inability of the firm to service debt from core operations, and the second part captures the deterioration in the financial structure. Further, a firm is also recorded as distressed in the year subsequent to these events. Under the legal outcome-based definition, a firm is recorded as distressed when it files for insolvency through CIRP under IBBI.[4] In the third definition, a firm is considered distressed when the firm meets both the criteria of financial health and legal outcome-based definition.

Sample description

The sample of the study includes NSE-listed firms and listed firms that have filed for insolvency under CIRP. The study period from 2008 to 2021 covers a long time frame as the deteriorating condition of firms can be traced ten years prior to legal bankruptcy (Hambrick and D'Aveni, 1988). Financial and utility firms are excluded from the study since the inclusion of such diverse entities can affect the generalizability of the findings because of their unique operational and financial characteristics. Financial data of all companies have been extracted from the CMIE prowess IQ database. The data of listed firms under IBBI were retrieved from the IBBI research division. In this study, data post the listing date has been considered, and firm-year observations were removed when the values were missing to calculate the relevant variables. For the legal outcome-based definition, financial data till the date of CIRP filing was considered due to the unavailability of data post the event.

Table 1 shows the sample selection process and the number of firms under each definition. Appendix I presents the classification of firm-year observations as non-distressed (0) and distressed (1) across all three definitions (Panel A, B, and C). The percentage of financial distress is calculated by dividing the number of distressed firms in a particular year by the total number of firms in the relevant year. The last row provides the total number of observations of distress, approximately 3.3%, 15.4%, and 1% under Panel A, B and C, respectively, consistent with the seminal works of Ohlson (1980) and Zmijewski (1984). The number of firms that meet both criteria (Panel C) is significantly less.

Table 1: Sample selection criteria

Financial health-based definition:	**No. of firms**
NSE Listed firms	2114
Less: Financial firms	259
Final Sample	**1853**
Legal outcome-based definition:	
Insolvency filing under IBC	5752
Less: Unlisted firms	5292
Listed firms	460
Less: Data unavailable in prowess	82
Listed firms that have data	378
Less: Financial firms	44
Listed non-financial firms	334
Add: Other NSE listed non-financial firms[5]	1727
Final Sample	**2061**
Combination of financial health and legal outcome	
Listed non-financial firms	1853
Add: Listed IBC non-financial firms	334
Total	2187
Less: Duplicate firms	126
Final Sample	**2061**

Variable selection

Accounting and market-driven variables

Based on the literature, variables were identified within the purview of financial theories. The variables comprise accounting measures representing profitability, financing and leverage, liquidity, efficiency, cash flow, and market-driven variables (Appendix II). These variables vastly capture the firm's deteriorating situation and provide credible signals about the impending distress.

Profitability measures reflect firms' ability to generate earnings (Joseph and Lipka, 2006). Ohlson (1980) documented that profit deteriorates if a firm moves from a non-distressed state to a distressed one. ROA is an extensively used proxy to measure the profit-generating capacity of the firm's assets. Studies predominantly reported a negative association with distress since a higher return reduces the risk of non-servicing debt (Almamy *et al.,* 2016). Secondly, RETA is among the key variables in Altman's (1968) model to measure the cumulative profitability of the firms and the capacity for self-financing. Studies consistently documented a negative relationship between RETA and distress (Pindado *et al.,* 2008). Thirdly, the operating profit margin (OPM) reflects the ability of the firm to generate profit from the core operations. OPM is considered as a significant predictor of distress, and an increase in OPM reduces the possibility of distress (Korol, 2013). Lastly, return on equity (ROE) indicates the ability of the firm to make equity investments profitable (Moch *et al.,* 2019). Based on the above reasoning, a negative association is expected with financial distress for all the profitability variables.

The financing and leverage group reflects the capital structure decisions of the distressed firm. The debt-to-assets ratio (DA) is a widely used proxy to understand the degree of leverage used by the firm to finance assets. Studies document that it has the highest discriminatory power and positive association with financial distress, implying the excessive use of leverage by distressed firms (Beaver *et al.,* 2012). Further, the DE captures the degree to which a company finances its operations with debt, and studies reported that companies with a higher DE are more likely to experience financial distress (Moch et *al.,* 2019). Given this, leverage will be positively associated with the likelihood of financial distress.

The liquidity variables measure the company's ability to meet short-term obligations with assets that can be easily converted to cash (Rashid and Abbas, 2011). A firm with lower liquid assets is more sensitive to bankruptcy (Beaver, 1966). The WCTA captures the shrinkage in net liquid assets to total assets. Evidence reported that WCTA has high discriminative power and documented a negative relationship with financial distress (Li and Faff, 2019; Shrivastava *et al.,* 2018). Further, the current ratio (CR) measures the ability of the firm to meet its short-term obligations. Tsai and Chang (2010) found a negative coefficient indicating that a low CR leads to financial distress, consistent with Korol (2013) and Moch *et al.* (2019).

Efficiency variables capture the ability to manage receivables, inventory, and other assets. The ATR is a significant proxy to evaluate the profit-generating ability of a company's assets (Altman, 1968). Based on the literature, it can be inferred that there is a consistent inverse relationship with financial distress, indicating a decline in the true productivity of distressed assets (Ong *et al.,* 2011; Tsai and Chang, 2010). Given this, liquidity and efficiency variables are expected to have a negative relationship with financial distress.

Bankruptcy prediction models predominantly used annual accounting information based on accrual accounting, which may not give a fair view of the financial position (Balcaen and Ooghe, 2006). Consequently, researchers have started incorporating cash flow signals into bankruptcy models. Cash return on assets (CRTA) measures the cash flow generative ability of total assets and found a negative relation with distress. Therefore, the probability of financial distress is low if the firm's cash flow position is stable (Bhandari and Iyer, 2013; Obradoviæ *et al.,* 2018). Further, the operating cash-to-debt ratio (OCD) represents the cash inflow to outstanding debt obligations, and the studies found a negative relationship with distress (Li *et al*., 2021; Ong *et al.,* 2011). For instance, Almamy *et al*. (2016) used OCD in Altman's (1968) model, which was found to be highly significant in predicting distress among firms in the UK. Finally, the operating cash flow margin (OCM) measures the ability of the firm to convert sales into cash. Bhandari and Iyer (2013) and Jimeno and García (2017) show a negative relationship between OCM and failure. Therefore, a negative relationship between cash flow variables and financial distress is expected.

In addition to accounting variables, several market-driven variables are also considered. Traders typically discount the market equity of distressed firms near bankruptcy (Shumway 2001). Therefore, the natural log of market capitalization (MCAP) of each firm-year is computed. Besides this, book to market ratio (BTM) was included since it reflects the future earnings expectation of firms (Jan and Ou, 2012). Firms with negative BTM are usually perceived as financially distressed and improbable to last long. The MVEBVD is another key variable in Altman's (1968) model. It explains how much market value can decline before the liabilities exceed the assets and the company goes bankrupt. Studies commonly found a negative association with financial distress (Almamy *et al.,* 2016; Wang and Campbell, 2010). A high value for MVEBVD indicates that the investors feel optimistic about the firm's financial soundness. Therefore, a negative relationship with distress is expected for all market-driven variables.

Reporting anomaly variables

Prior studies have incorporated variables such as restatement of financial statements, discretionary accruals, reporting delays, earnings quality, real and accrual earnings management as credible signals of distress to enhance prediction accuracy. Unlike prior works, the current study employed variables from creative and forensic accounting literature, as documented by Serrano-Cinca *et al*. (2019) and Beneish (1999), to capture the effect of reporting anomalies (Appendix III). These variables are selected based on three essential features of an earnings manipulator (Li *et al.,* 2021). First, to capture the prospects of the company. Second, to understand the underlying deteriorating condition. Third, to detect the adoption of aggressive accounting practices and discretionary accounting choices.

The sales growth index (SGI) has been developed to capture the company's prospects by measuring the growth and abnormal change in sales. An increase in sales does not necessarily imply that the firm will engage in manipulation. However, growth firms have more incentives for manipulation to beat or meet analysts' forecasts and industry benchmarks. Moreover, in the case of distressed firms, sales growth will be meagre. Therefore in line with Eckel (1981), the coefficient of variation of sales was calculated.

The underlying deterioration of the firm is captured with four variables. The gross margin index (GMI) reflects the shrinkage in profit, which may create an enticement for earnings manipulation. Apart from this, the coefficient of variation of profit indicates profit stability, and a high coefficient leads to default. The Assets quality index (AQI) measures the proportion of total assets for which future benefits are uncertain, and it also captures the changes in the realization risk of assets (Siegel and Hoban, 1991). AQI of more than one indicates high assets realization risk, more likely to capitalize and incur huge deferred costs.

The selling, general, and administrative expenses index (SGAI) captures the administrative and marketing efficiency, and SGAI disproportionate to sales may indicate the presence of earnings manipulation (Lev and Thiagarajan, 1993). The positive accounting theory of Watts and Zimmerman (1978) argues that distressed firms have strong incentive to manipulate earnings to avoid debt covenant violations. Thus, the Leverage index (LEVI) captures the degree of leverage by considering the current year's leverage ratio divided by the previous year.

The adoption of aggressive accounting practices and discretionary accounting choices of managers to distort the financial statements are captured using five variables. The depreciation index (DEPI) reflects the distortions in depreciation, as companies' lower depreciation to appear profitable and increase the depreciation to evade taxes. A DEPI of more than one indicates that the depreciation rate has slowed, leading to inflating of income. Days sales in receivable index (DSRI) estimate the level of balance between sales and receivables for two consecutive years. An extreme imbalance would indicate revenue inflation, overstatement of earnings, and bogus receivables (Wells, 2001). The total accruals to total assets (TATA) measure the imbalance between accounting and cash profit. All the variables discussed are winsorized at 1st and 99th percentiles to remove the effect of outliers.

Empirical model specifications

This study used panel logistic regression (LR) to understand the signals of financial distress. LR is a linear classification model with the fundamental assumption of optimization of model coefficients by maximizing the log-likelihood function (Zhang *et al*., 2022). It requires fewer restrictive assumptions of multivariate normality and covariance matrices and is comparatively unaffected by outliers due to the nonlinear transformation of data (Pindado *et al.,* 2008). The fixed effect logit model is specified as follows:

$$P\,(Y_{it} = 1/X_i) = \frac{e^{(\alpha_i + x_{it}\beta)}}{1 + e(\alpha_i + x_{it}\beta)}$$

The outcome of the dichotomous variable in period t is denoted by Y_{it}, taking a value of 1 for distressed firms and 0 otherwise. x_{it} is the vector of covariates that predict financial distress (Y_{it}) in period t. β is the vector of slope coefficients of independent variables. α_{it} is an unobserved firm-level fixed effect (intercept). The advantage of this model is that it controls unobserved firm-level heterogeneity. However, when the fixed effect model was applied, it dropped the observations that did not change over time (time-invariant binary indicators), resulting in a drastic decline in the number of observations. In light of these issues, the current study used a random effect model that assumes a firm-level fixed effect (α_0) is normally distributed with μ (mean) of 0 and a σ (standard deviation) of 1. This method considers unobserved and unexplained variability across firms and is more robust than fixed effects, as errors are not assumed to be correlated with the vector of the covariates.

FINDINGS AND DISCUSSION

Descriptive statistics

Table 2-4 provides the descriptive statistics of accounting and market-based variables across all three definitions of financial distress. The results of each non-distressed and distressed firm are presented in Panels A and B respectively. Further, the table shows a comparative analysis based on a t-test to indicate whether a statistically significant difference exists between the two groups. The results suggest that the mean of nearly all profitability variables significantly differs between the two groups. When distress is defined based on financial health (table 2), variables such as ROA, RETA, OPM, and ROE exhibit negative values. Whereas when distress is determined based on the legal outcome (Table 3), OPM and ROE are positive and have a lower value than non-distressed firms indicating that these firms are in the final phase of a downward spiral. When the firm files for insolvency and experiences severe financial problems (Table 4), negative values are reported for all profitability variables except ROE.

As expected, DTA is higher for distressed firms than non-distressed firms, indicating the excessive use of leverage by distressed firms. Moreover, this relation is more profound when the firm files for insolvency and experiences severe financial health issues (Tables 3 and 4). Similarly, a higher value of

DE indicates the usage of excessive debt, and its magnitude is two to three times more than healthy firms. ATR is significantly low for distressed firms indicating the lack of sales-generating capacity of the firm's assets. Similarly, lower values of cash flow variables such as CRTA, OCD, and OCM for distressed firms indicate a decline in the cash flow cushion to service the debts, the poor cash-generating ability of assets, and the inability to translate sales into cash. Further, MCAP is significantly different for distressed firms across all definitions since the market reflects the firms' prospects and deteriorating conditions. The average BTM of the distressed stock is negative, which is prevalent across all the definitions of distress. Similarly, the extremely low value of MVEBVD is recorded for distressed firms.

The descriptive results concerning reporting anomalies are presented in Appendix IV. SGI value is lower for distressed firms, indicating a substantial decline in sales and poor prospects. However, the higher value of CV Sales can be suspicious, given the decline in sales, as it might relate to earnings manipulation. In the financial-health-based definition, the average values of GMI and CV profit are high for distressed firms. It may be because they are in the early stages of distress. However, a low value was reported for firms that filed for insolvency. On an average, distressed firm have a higher value for AQI, DSRI, LEVI, and SGAI across all definitions. The magnitude of the variables is slightly higher for distressed firms that filed for insolvency. The high value of DSRI might indicate an extreme imbalance between receivables and sales, which would indicate inflated revenues. The results also indicate excessive leverage and poor administrative and marketing efficiency. Further, DEPI is also higher for distressed firms across all panels; however, the difference is statistically insignificant. Surprisingly, TATA was lower for distressed firms across all definitions.

Table 2: Descriptive statistics of variables under the financial health-based definition

Variables	Panel A Non-distressed firms			Panel B Distressed firms			t-value
	N	Mean	SD	N	Mean	SD	
ROA	22601	0.043	0.088	759	-0.106	0.119	45.214***
RETA	22601	0.030	0.080	759	-0.107	0.119	45.304***
OPM	22101	0.122	0.241	755	-0.137	0.436	27.952***
ROE	22599	0.105	0.270	759	-0.090	0.958	16.722***
DA	22828	0.556	0.294	759	0.945	0.289	-35.893***
DE	22824	1.705	3.170	759	3.791	10.690	-15.447***
WCTA	22813	0.101	0.247	759	-0.202	0.310	33.024***
CR	22618	1.598	1.520	759	0.769	0.857	14.961***
ATR	22139	0.961	0.735	755	0.445	0.512	19.122***
CRTA	21211	0.063	0.106	745	0.015	0.097	12.145***
OCD	21183	0.159	0.327	745	0.019	0.153	11.666***
OCM	20925	0.081	0.397	741	0.031	0.691	3.242***
MCAP	16112	8.486	2.231	710	6.783	1.785	20.052***
BTM	15965	0.832	3.002	700	-0.472	5.801	10.653***
MVEBVD	15966	3.999	7.193	700	0.484	2.501	12.892***
EMI	20599	1.947	0.667	726	2.395	1.106	-17.281***

Drawing upon the earlier findings, a composite indicator for earnings management referred to as the EM-index was constructed using the methodology of Anderson *et al*. (2009) and Serrano-Cinca (2019). Firstly, only variables with high discriminatory power, such as DSRI, LEVI, SGAI, and CV sales, were selected. Secondly, the variables were rescaled from 1-10, with most EM firms taking the value of 10 and the least taking the value of 1. Thirdly, all four values were summed up and scaled by a factor of 10 to build an index from 1.0 to 10.0. The lower and higher values of the index indicate the absence and presence of reporting anomalies, respectively. As shown in Tables 3, 4, and 5, there is a significant difference between the EM-Index between distressed and non-distressed firms across all definitions. However, the difference is more profound in table 3, indicating firms engage in earnings management during the initial stages of distress, and the usage will decline as a firm approaches bankruptcy.

Table 3: Descriptive statistics of variables under the legal outcome-based definition

Variables	Panel A Non-distressed firms			Panel B Distressed firms			t-value
	N	Mean	SD	N	Mean	SD	
ROA	21775	0.041	0.097	3309	-0.032	0.142	37.985***
RETA	21775	0.028	0.089	3309	-0.035	0.140	34.652***
OPM	21286	0.115	0.272	3114	0.016	0.414	17.430***
ROE	21773	0.102	0.333	3317	0.031	0.570	10.202***
DA	21998	0.561	0.342	3341	0.910	0.713	-45.7957***
DE	21994	1.745	3.682	3357	2.020	6.070	-3.6458***
WCTA	21983	0.098	0.260	3340	-0.077	0.440	32.5137***
CR	21793	1.592	1.559	3276	1.561	1.875	1.0129
ATR	21324	0.968	0.745	3131	0.768	0.734	14.0083***
CRTA	20425	0.064	0.107	3128	0.016	0.110	23.5114***
OCD	20400	0.162	0.329	3115	0.028	0.253	21.7967***
OCM	20150	0.083	0.467	2948	0.030	0.686	5.3247***
MCAP	15385	8.500	2.242	2766	6.591	2.105	41.6037***
BTM	15327	0.778	3.327	2643	-0.184	7.344	10.9655***
MVEBVD	15328	4.082	7.218	2,643	1.271	4.145	19.4748***
EMI	20023	1.726	0.655	2844	1.971	0.859	-17.875***

Appendix V presents the correlation matrix of all the variables in the study. The highest correlation is found between RETA and ROA (0.942).[6] Apart from this, there is no potential collinearity exists between explanatory variables. Further, the variance inflation factor (VIF) reported a value of three to four across all definitions of distress[7] within the acceptable range of 10 (O'Brien, 2007). Findings from the univariate analysis suggest a considerable difference in accounting, market, and reporting anomaly variables between distressed and non-distressed firms. Therefore, it is worth examining these results in a multivariate context using extensive panel data.

Table 4: Descriptive statistics of variables under a combination of financial health and legal outcome-based definition

Variables	Panel A Non-distressed firms			Panel B Distressed firms			t-value
	N	Mean	SD	N	Mean	SD	
ROA	25004	0.032	0.107	278	-0.163	0.164	29.8998***
RETA	25004	0.020	0.100	278	-0.164	0.165	30.008***
OPM	24338	0.103	0.296	273	-0.292	0.580	21.5982***
ROE	25011	0.095	0.364	278	0.081	1.172	0.6226
DA	25240	0.610	0.434	278	1.097	0.448	-18.6157***
DE	25253	1.757	3.967	278	2.387	11.874	-2.5263**
WCTA	25225	0.072	0.303	278	-0.219	0.410	15.8812***
CR	25005	1.586	1.604	278	0.901	1.115	7.0968***
ATR	24391	0.942	0.746	273	0.406	0.463	11.8424***
CRTA	23485	0.058	0.109	267	0.008	0.091	7.5347***
OCD	23466	0.145	0.324	267	0.012	0.123	6.7082***
OCM	23050	0.076	0.501	262	0.029	0.848	1.5103***
MCAP	18008	8.241	2.313	256	5.962	1.565	15.7202***
BTM	17950	0.550	4.541	256	-2.498	8.256	10.4943***
MVEBVD	17,951	3.678	6.928	256	0.129	0.179	8.1969***
EMI	22754	2.021	0.684	263	2.689	1.294	-15.520***

Empirical findings

The regression results on the relationship between financial signals and distress are presented in Table 5 by classifying them into three different panels. Financial health-based definition, legal outcome-based definition, and a combination of these two are used to define distress in Panels A, B and C respectively. Within each panel, three models are presented, i.e., traditional accounting ratios (model 1), the inclusion of market-related variables (model 2), and a combined model where proxies for reporting anomalies are also appended along with other variables (model 3).

As presented in Table 5, all the profitability signals except ROE preserves expected signs and shows a significant relationship with distress across all three definitions highlighting their explanatory power. For instance, ROA is negatively associated with financial distress at a 1% significance level across all panels, indicating a decline in the ability of assets to generate profit leads to distress and non-payment of the debt and other expenditures (Almamy *et al.,* 2016; Dakovic *et al.,* 2010; Li and Faff, 2019; Moch *et al.,* 2019; Ni *et al.,* 2014; Pervan *et al.,* 2018; Pindado *et al.,* 2008). Similarly, OPM exhibits a negative coefficient in both Panel A and C, and the significance increases when combined with variables related to the market and reporting anomalies in Panel A. It suggests that a decline in profit from the core operations leads to financial distress, in line with Korol (2013) and Pervan *et al*. (2018). In contrast, Panel B reported a positive association between OPM and distress across all models. As the descriptive results indicate, ROE reported a counterintuitive (positive) effect.

Concerning finance and leverage signals, the findings reported that the coefficient of DA is significantly positive in both Panel A and B, indicating that a firm with excessive leverage is more likely to become financially distressed (Jacobson *et al.,* 2013; Moch *et al.,* 2019; Ong *et al.,* 2011; Shrivastava *et al.,* 2018; Tsai and Chang, 2010; Zhang, 2015). Similar results were found for DE, conforming to the evidence of Moch *et al*. (2019). However, the DA coefficient in Panel C is positive and statistically insignificant. One plausible reason could be that these firms are in severe distress and have filed for insolvency; they must have exhausted their borrowing capacity as the law restricts credit access to such firms (Stiglitz and Weiss, 1981).

WCTA is positively associated with financial distress across all definitions (Obradovic *et al.*, 2018). Meanwhile, another liquidity signal CR documented an inverse relationship with distress in Panel A and C, indicating a decline in the ability to meet short-term obligations (Jimeno and García, 2017; Korol, 2013; Tsai and Chang, 2010). However, Panel B displays a positive coefficient in all the models (Jimeno and García, 2017). Concerning efficiency, the results confirm a negative association between ATR and financial distress across all panels, indicating that the lower sales-generating capacity of the assets can significantly enhance the likelihood of distress (Altman, 1968; Laitinen, 1991; Shumway, 2001; Zmijewski, 1984).

Surprisingly, cash flow information is observed to be less significant in explaining distress except for CRTA in Panel B, which is negatively associated with financial distress. Therefore, a decline in the ability to generate cash from assets will lead to financial distress (Almamy *et al.,* 2016; Bhandari and Iyer, 2013; Obradovic *et al*., 2018). However, this relation is only valid for the firms which have filed for insolvency. These results conform to the findings of Simons (1994), reported counterintuitive signs for cash flow variables due to the purposeful alteration of cash flow timing.

Concerning market signals, our findings confirm that MCAP is negatively associated with distress. Therefore, a decline in the market value of equity could be a credible signal of distress since market equity near bankruptcy is typically discounted by traders (Chava and Jarrow, 2008; Shumway, 2001). The MVEBVD is significant and negatively associated with financial distress (Almamy *et al.,* 2016; Tsai and Chang, 2010; Wang and Campbell, 2010). A decline in MVEBVD can lead to financial distress, indicating pessimism about the firm's financial soundness among investors. Contrary to the existing evidence, this study observed a positive association between BTM and financial distress risk across all panels, in line with the argument of Fama and French (1995), who reported a high BTM as a signal of financial distress.

Proxy for reporting anomalies (EMI) is incorporated in model 3 across all panels, and the findings are inconsistent, indicating a positive coefficient in Panel A, negative in Panel B, and insignificant in Panel C. The results in Panel A noted that an increase in EMI (presence of reporting anomalies) is positively associated with financial distress. These firms have not yet filed for insolvency; It is probable that these companies will resort to earnings manipulation as a means to safeguard bonuses, reputation, and employment prior to bankruptcy (Agrawal and Chatterjee, 2015). Since publicly traded companies are obligated to provide high-quality financial information and their creditworthiness depends on these statements, they have higher incentives for manipulating earnings. This supports the second hypothesis. However, when the firm files for insolvency (Panel B), all the capacity for further manipulation must be exhausted. In Panel C, firms face severe distress and have filed for insolvency. During those periods, firms will try to secure more cash rather than earnings management due to close monitoring and a lack of further alternative accounting treatments (Park et al., 2021; Xu *et al*., 2021).

The overall finding suggests that the incorporation of the market and reporting anomaly variables, alongside traditional accounting ratios, improves the model's accuracy and is consistent with the findings of Campbell *et al*. (2008) and Balasubramanian *et al*. (2019). This supports the first hypothesis. Model three in panel A has an R square of 0.412, indicating that a combination of accounting, market, and reporting anomaly variables can significantly explain the distress among the firms which have not yet filed for insolvency. However, the model's explanatory power eventually declined for the firms that have reached bankruptcy.

Table 5: Multivariate Results

Variables	Panel A (Financial health-based)			Panel B (Legal outcome-based)			Panel C (Financial health and Legal outcome-based)		
	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3
ROA	-6.824***	-6.448***	-6.952***	-2.427***	-1.426***	-1.207***	-5.213***	-4.418***	-4.498***
	(0.441)	(0.502)	(0.528)	(0.239)	(0.286)	(0.297)	(0.432)	(0.496)	(0.522)
OPM	-0.200*	-0.269**	-0.481***	0.307***	0.389***	0.482***	-0.351***	-0.404***	-0.415***
	(0.117)	(0.132)	(0.150)	(0.0772)	(0.0889)	(0.0951)	(0.126)	(0.143)	(0.157)
ROE	0.128	0.377***	0.410***	-0.0377	0.207***	0.175***	0.366***	0.336***	0.290**
	(0.0917)	(0.100)	(0.102)	(0.0547)	(0.0625)	(0.0637)	(0.108)	(0.115)	(0.118)
DA	1.035***	2.473***	2.701***	1.132***	1.724***	1.812***	0.446***	0.0384	0.270
	(0.161)	(0.240)	(0.243)	(0.0721)	(0.117)	(0.123)	(0.144)	(0.204)	(0.223)
DE	0.0811***	0.0763***	0.0770***	0.0224***	0.0306***	0.0287***	0.0715***	0.0421***	0.0367***
	(0.0791)	(0.0874)	(0.0894)	(0.0502)	(0.0587)	(0.0603)	(0.0111)	(0.0118)	(0.0123)
WCTA	0.0390	0.142	0.572**	-0.337***	0.0278	0.0663	0.623***	0.792***	0.978***
	(0.217)	(0.254)	(0.270)	(0.105)	(0.126)	(0.130)	(0.230)	(0.244)	(0.263)
CR	-0.456***	-0.532***	-0.672***	0.0916***	0.0880***	0.0878***	-0.252***	-0.115	-0.211**
	(0.0753)	(0.0942)	(0.105)	(0.0135)	(0.0162)	(0.0166)	(0.0748)	(0.0744)	(0.0924)
ATR	-1.029***	-1.140***	-1.280***	-0.214***	-0.267***	-0.249***	-1.345***	-1.034***	-1.096***
	(0.103)	(0.127)	(0.135)	(0.0349)	(0.0439)	(0.0454)	(0.180)	(0.196)	(0.204)
CRTA	-0.991	-0.173	-0.582	-2.515***	-3.590***	-3.584***	-0.785	-1.572	-1.469
	(0.725)	(0.976)	(0.991)	(0.350)	(0.436)	(0.454)	(0.945)	(1.524)	(1.659)
OCD	-0.148	-0.307	-0.337	-0.317**	0.0517	0.0420	-0.0636	0.489	0.212
	(0.343)	(0.549)	(0.557)	(0.132)	(0.164)	(0.174)	(0.401)	(1.054)	(1.262)
OCM	0.125*	0.0356	0.0619	0.127***	0.112**	0.148***	0.0909	0.00827	-0.0270
	(0.0746)	(0.0843)	(0.0930)	(0.0414)	(0.0498)	(0.0532)	(0.0806)	(0.0936)	(0.101)
MCAP		-0.145***	-0.174***		-0.255***	-0.248***		-0.0963**	-0.112**
		(0.0262)	(0.0267)		(0.0135)	(0.0139)		(0.0445)	(0.0457)

	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3
MVEBVD		-0.0680*	-0.0397		-0.0259***	-0.0336***		-4.762***	-4.724***
		(0.0374)	(0.0291)		(0.00795)	(0.00896)		(0.553)	(0.578)
BTM		0.145***	0.150***		0.0619***	0.0658***		0.0228**	0.0308***
		(0.0124)	(0.0124)		(0.00636)	(0.00671)		(0.0104)	(0.0108)
EMI			0.272***			-0.189***			-0.0734
			(0.0590)			(0.0366)			(0.0780)
Observations	21,567	16,419	16,049	22,955	17,598	17,205	23,175	17,821	17,403
Log-likelihood	-2231.938	-1797.019	-1714.962	-7695.466	-5924.417	-5687.332	-1091.025	-819.938	-783.805
AIC	4489.877	3626.038	3463.923	15416.933	11880.833	11408.664	2208.049	1671.877	1601.610
Pseudo R2	0.331	0.398	0.412	0.151	0.230	0.231	0.234	0.359	0.368

Standard errors in parentheses
**** p<0.01, ** p<0.05, * p<0.1*

CONCLUSION AND IMPLICATIONS

Despite numerous developments in the literature, an empirical examination of various signals of financial distress in India is scarce, primarily due to the ignorance of actual distress data from IBBI and the usage of the varied definitions of financial distress. This is further augmented by the use of existing bankruptcy prediction models tailored to a specific industry and ignorance of proxies for financial reporting quality in the prediction models. This study has attempted to address these precise gaps in the literature by considering a comprehensive definition of financial distress and constructing a hybrid model that incorporates accounting, market, and reporting anomaly variables to detect the various signals of financial distress.

It is observed that ROA, ATR and DE are significant predictors among accounting variables as they provide credible signals about impending distress across all distress definitions. Contrarily, cash flow information is observed to be less significant in explaining distress. Among the market signals, market capitalization and MVEBVD show substantial explanatory power. Apart from these five signals, all other variables indicate inconsistent coefficients across the different definitions of distress. One plausible reason could be that the signals can significantly vary with the degrees of financial distress. This re-emphasizes the need for understanding the signals among different distress definitions.

Though the developed EM index enhances the model's explanatory power, the results are inconsistent. The findings suggest that the choice of earnings management primarily depends on the degree of financial distress. When a firm is closer to bankruptcy, the firm tends to secure more cash flows than engage in earnings management due to stringent regulations and a lack of further alternative accounting treatments. In the initial phase of distress, firms actively engage in earnings management to avoid debt covenant violations, protect jobs, reputation, and compensation and gain access to credit.

Evidence indicates that combining accounting, market, and reporting anomaly variables can significantly explain the distress. However, when firms reached bankruptcy, explanatory power gradually reduced. The findings provide insight to regulators and managers to recognize the early signals of financial distress. Regulators need to monitor the financial health of corporates to protect the interests of creditors and revive viable firms. This will help to reduce the substantial distress cost faced by various stakeholders.

BIBLIOGRAPHY

(1) Agrawal K., and Chanchal C. (2015a), "Earnings Management and Financial Distress: Evidence from India", Global Business Review 16(5S): 140-154S.

(2) 2019, "Efficacy of Industry Factors for Corporate Default Prediction", IIMB Management Review, 31(1), pp. 71–77.

(3) Ali S., et. al. (2018), "Does Corporate Governance Quality Affect Default Risk? The Role of Growth Opportunities and Stock Liquidity", International Review of Economics and Finance, 58(May), pp. 422–48.

(4) Almamy J., et. al. (2016), "An Evaluation of Altman's Z-Score Using Cash Flow Ratio to Predict Corporate Failure amid the Recent Financial Crisis: Evidence from the UK", Journal of Corporate Finance, 36, pp. 278–85.

(5) Altman E., (1968), "The Prediction of Corporate Bankruptcy: A Discriminant Analysis", The Journal of Finance, 23(4).

(6) Altman, E. et. al. (2019), "Corporate Financial Distress, Restructuring, and Bankruptcy", Wiley Finance series.

(7) Anderson R. et. al. (2009) "Founders, Heirs, and Corporate Opacity in the United States", Journal of Financial Economics, 92(2), pp. 205–22.

(8) Argenti J. (1976), "Corporate Planning and Corporate Collapse", Long Range Planning, 9(6), pp. 12–17.

(9) Arora P., and Suman S. (2022). "Predicting Distress: A Post Insolvency and Bankruptcy Code 2016 Analysis", Journal of Economics and Finance, pp. 604–22.

(10) Ashraf S. et. al. (2020), "Development and Testing of an Augmented Distress Prediction Model: A Comparative Study on a Developed and an Emerging Market", Journal of Multinational Financial Management, 57–58(2020): 100659.

(11) Balasubramanian S. et. al. (2019), "Modeling Corporate Financial Distress Using Financial and Non-Financial Variables: The Case of Indian Listed Companies", International Journal of Law and Management, 61(3–4), pp. 457–84.

(12) Balcaen S., and Hubert. (2006), "35 Years of Studies on Business Failure: An Overview of the Classic Statistical Methodologies and Their Related Problems", The British Accounting Review, 38, pp. 63–93.

(13) Beaver W. (1966), "Financial Ratios As Predictors of Failure", Journal of Accounting Research, 4 pp. 71–111.

(14) Beaver W. et. al. (2012), "Do Differences in Financial Reporting Attributes Impair the Predictive Ability of Financial Ratios for Bankruptcy?", Review of Accounting Studies, 17, pp. 969–1010.

(15) Beaver W. et. al. (2005), "Have Financial Statements Become Less Informative? Evidence from the Ability of Financial Ratios to Predict Bankruptcy", Review of Accounting Studies, 10(1), pp. 93–122.

(16) Beneish M. (1999), "The Detection of Earnings Manipulation", Financial Analysts Journal, 55(5), pp. 24–36.

(17) Bhandari S., and Rajesh I. (2013), "Predicting Business Failure Using Cash Flow Statement Based Measures", Managerial Finance, 39(7), pp. 667–76.

(18) Black F., and Myron S. (1973), "The Pricing of Options and Corporate Liabilities", The Journal of Political Economy, 81(3), pp. 637–54.

(19) Hambrick D., and D'Aveni R. (1988), "Large Corporate Failures as Downward Spirals", Administrative Science Quarterly, 33(1), pp. 1–23.

(20) Campa D. (2019), "Earnings Management Strategies during Financial Difficulties: A Comparison between Listed and Unlisted French Companies", Research in International Business and Finance, 50(July), pp. 457–71.

(21) Campbell J., et. al. (2008), "In Search of Distress Risk", The Journal of Finance, 10(63), pp. 2899–2939.

(22) Chava S., and Jarrow R. (2008), "Bankruptcy Prediction with Industry Effects" Financial Derivatives Pricing, 8(4), pp. 517–49.

(23) Christopoulos A., et. al. (2019), "Investigation of Financial Distress with a Dynamic Logit Based on the Linkage between Liquidity and Profitability Status of Listed Firms", Journal of the Operational Research Society, 70(10), pp. 1817–29.

(24) Daily C., and Dalton D. (1994), "Bankruptcy and Corporate Governance: The Impact of Board Composition and Structure" Academy of Management Journal, 37(6), pp. 1603–17.

(25) Dakovic R., et. al. (2010), "Bankruptcy Prediction in Norway: A Comparison Study", Applied Economics Letters, 17(17), pp. 1739–46.

(26) Eckel N. (1981), "The Income Smoothing Hypothesis Revisited", Abacus, 17(1), pp. 28–40.

(27) Fama E., and French K. (1995), "Size and Book-to-Market Factors in Earnings and Returns", The Journal of Finance, L(1), pp. 131–55.

(28) Franz D. et. al. (2014), "Impact of Proximity to Debt Covenant Violation on Earnings Management", Review of Accounting Studies, 19, pp. 473–505.

(29) Graham, J. et. al. (2005), "The Economic Implications of Corporate Financial Reporting", Journal of Accounting and Economics, 40(1–3), pp. 3–73.

(30) Gupta J. et. al. (2018), "Empirical Comparison of Hazard Models in Predicting SMEs Failure", Quantitative Finance, 18(3), pp. 437–66.

(31) Habib A. et al. (2020), "Determinants and Consequences of Financial Distress: Review of the Empirical Literature", Accounting and Finance, 60(S1), pp. 1023–75.

(32) Habib A. et. al. (2013), "Financial Distress, Earnings Management and Market Pricing of Accruals during the Global Financial Crisis", Managerial Finance, 39(2), pp. 155–80.

(33) Hafeez A., and Kar S. (2021), "Looking Beyond the Financial Numbers: The Relationship Between Macroeconomic Indicators and the Likelihood of Financial Distress", Global Business Review, 22(3), pp. 674–88.

(34) Healy P. (1985), "The Effect of Bonus Schemes on Accounting Decisions", Journal of Accounting and Economics, 7, pp. 85–107.

(35) Healy P., and Wahlen J. (1999), "A Review of the Earnings Management Literature and Its Implications for Standard Setting", Accounting Horizons, 13(4), pp. 365–83.

(36) Hillegeist S., et. al. (2004), "Assessing the Probability of Bankruptcy", Review of Accounting Studies, 9(1), pp. 5–34.

(37) Understanding the IBC: Key Jurisprudence and Practical Considerations - A Handbook, IBBI (2020).

(38) IBBI Quarterly Newsletter for the quarter January - March, 2022, IBBI (2022).

(39) Jacobson T., et. al. (2013), "Firm Default and Aggregate Fluctuations", Journal of the European Economic Association, 11(4), pp. 945–72.

(40) Jan, Ching Lih, and Jane A. Ou. 2012. "Negative-Book-Value Firms and Their Valuation" *Accounting Horizons* 26(1): 91–110.

(41) Jimeno R., and Inmaculada G. (2017), "Dynamic Analysis of Different Business Failure Process", Problems and Perspectives in Management, 15(2), pp. 487–500.

(42) Joseph G., and Roland L. (2006), "Distressed Firms and the Secular Deterioration in Usefulness of Accounting Information", Journal of Business Research, 59(2), pp. 295–303.

(43) Kealhofer S. (2003a.), "Quantifying Credit Risk I: Default Prediction", Financial Analysts Journal, 59(1), pp. 30–44.

(44) 2003b, "Quantifying Credit Risk II: Debt Valuation" Financial Analysts Journal, 59(3), pp. 78–92.

(45) Keasey K. et. al. (2015), "The Determinants of the Costs of Financial Distress in SMEs", International Small Business Journal, 33(8), pp. 862–81.

(46) Khan T. et. al. (2022), "Leverage Strategies of Indian Telecom Sector: A Dynamic Panel Data Approach", Indian Growth and Development Review, 15(1), pp. 139–64.

(47) Kolte A. et. al. (2021), "Financial Assessment of the Indian Retail Sector: Understanding the Future

Direction of the Industry", International Journal of Managerial and Financial Accounting, 13(2), pp. 133–58.

(48) Korol T. (2013), "Early Warning Models against Bankruptcy Risk for Central European and Latin American Enterprises", Economic Modelling, 31, pp. 22–30.

(49) Laitinen E. (1991), "Financial Ratios and Different Failure Processes", Journal of Business Finance & Accounting, 18(5), pp. 649–73.

(50) Lev B. and Ramu S. Thiagarajan. (1993), "Fundamental Information Analysis", Journal of Accounting Research, 31(2), pp. 190–215.

(51) Li C.et. al. (2021), "Chinese Corporate Distress Prediction Using LASSO: The Role of Earnings Management", International Review of Financial Analysis 76.

(52) Li L., and Faff R. (2019), "Predicting Corporate Bankruptcy: What Matters?", International Review of Economics and Finance, 62(July 2016), pp. 1–19.

(53) Lin T. (2009), "A Cross Model Study of Corporate Financial Distress Prediction in Taiwan: Multiple Discriminant Analysis, Logit, Probit and Neural Networks Models", Neurocomputing, 72(16–18), pp. 3507–16.

(54) Mahtani S., and Chandra P. (2018), "An Analysis of Key Factors of Financial Distress in Airline Companies in India Using Fuzzy AHP Framework", *T*ransportation Research Part A: Policy and Practice, 117, pp. 87–102.

(55) Mensah Y. (1984), "An Examination of the Stationarity of Multivariate Bankruptcy Prediction Models: A Methodological Study", Journal of Accounting Research, 22(1), pp. 380–95.

(56) Merton R. (1974), "On the Pricing of Corporate Debt: The Risk Structure of Interest Rates", The Journal of Finance, 29(2), p. 449.

(57) Moch R.,et. al. (2019), "The Effect of Liquidity, Profitability, and Solvability to the Financial Distress of Manucatured Companies Listed on the Indonesia Stock Exchange (IDX) Period of Year 2015-2017", Academy of Accounting and Financial Studies Journal, 23(6), pp.1–16.

(58) Nagar N. and Sen. K. (2016.), "Earnings Management in India: Managers' Fixation on Operating Profits", Journal of International Accounting, Auditing and Taxation, 26, pp. 1–12.

(59) Ni, Jet. al. (2014), "The Determinants of Bankruptcy for Chinese Firms", Review of Pacific Basin Financial Markets and Policies, 17(2), pp. 1–22.

(60) Noga T., and Schnader A. (2013), "Book-Tax Differences as an Indicator of Financial Distress", Accounting Horizons, 27(3), pp. 469–89.

(61) O'Brien R. (2007), "A Caution Regarding Rules of Thumb for Variance Inflation Factors", Quality and Quantity, 41(5), pp. 673–90.

(62) Obradovic D. et. al. (2018), "Insolvency Prediction Model of the Company: The Case of the Republic of Serbia", Economic Research-Ekonomska Istrazivanja, 31(1), pp. 138–57.

(63) Ohlson J. (1980), "Financial Ratios and the Probabilistic Prediction of Bankruptcy", Journal of Accounting Research, 18(1), pp. 109–31.

(64) Ong S. et. al. (2011), "Corporate Failure Prediction: A Study of Public Listed Companies in Malaysia", Managerial Finance, 37(6), pp. 553–64.

(65) Park S. (2021), "Earnings Management of Insolvent Firms and the Prediction of Corporate Defaults via Discretionary Accruals", International Journal of Financial Studies, 9(2), p. 17.

(66) Pervan, Ivica, Maja Pervan, and Tamara Kuvek. 2018. "Firm Failure Prediction: The Financial Distress Model vs Traditional Models", Croatian Operational Research Review 9: 269–79.

(67) Piatt D., and Piatt. M. (2002), "Predicting Corporate Financial Distress: Reflections on Choice-Based Sample Bias", Journal of Economics and Finance, 26(2), pp. 184–99.

(68) Pindado, Julio, Luis Rodrigues, and Chabela de la Torre. (2008), "Estimating Financial Distress Likelihood", Journal of Business Research, 61(9), pp. 995–1003.

(69) Piotroski, J. (2000), “Value Investing: The Use of Historical Financial Statement Information to Separate Winners from Losers”, Journal of Accounting Research, 38, pp. 1–41.

(70) Rashid A., and Abbas Q. (2011), “Predicting Bankruptcy in Pakistan”, Theoretical and Applied Economics, 18(9), pp. 103–28.

(71) Sehgal S. et. al. (2021), “On the Determinants and Prediction of Corporate Financial Distress in India”, Managerial Finance, 47(10), pp. 1428–47.

(72) Sehgal S. et. al. (2021), “A Search for Macroeconomic Determinants of Corporate Financial Distress”, Indian Economic Review, 56(2), pp. 435–61.

(73) Serrano-Cinca C. (2019), “The Use of Accounting Anomalies Indicators to Predict Business Failure”, European Management Journal, 37(3), pp. 353–75.

(74) Shrivastava A. et. al. (2018), “Business Distress Prediction Using Bayesian Logistic Model for Indian Firms”, Risks, 6(4), p. 113.

(75) Shumway T. (2001), “Forecasting Bankruptcy More Accurately: A Simple Hazard Model”, The Journal of Business, 74(1), pp. 101–24.

(76) Siegel F., and Hoban J. (1991), “Measuring Risk Aversion: Allocation, Leverage, and Accumulation”, Journal of Financial Research, 14(1), pp. 27–35.

(77) Simons K. (1994), “The Relationship Between Dividend Changes and Cash Flow: An Empirical Analysis”, Journal of Business Finance & Accounting , 21(4), pp. 577–87.

(78) Singh B., and Mishra A.. (2016a), “Re-Estimation and Comparisons of Alternative Accounting Based Bankruptcy Prediction Models for Indian Companies”, Financial Innovation, 2(1), pp. 1–28.

(79) (2016b), “Re-Estimation and Comparisons of Alternative Accounting Based Bankruptcy Prediction Models for Indian Companies”, Financial Innovation, 2(1), pp. 1–28.

(80) Stiglitz J., and Andrew W. (1981), “Credit Rationing in Markets With Imperfect Information”, The American Economic Review, 71(3), pp. 393–410.

(81) Tian S., and Yu.Y. (2017), “Financial Ratios and Bankruptcy Predictions: An International Evidence”, International Review of Economics and Finance, 51, pp. 510–26.

(82) Tsai B., and Chang C. (2010), “Predicting Financial Distress Based on the Credit Cycle Index: A Two-Stage Empirical Analysis”, Emerging Markets Finance and Trade, 46(3), pp. 67–79.

(83) Voda, Alina Daniela et al. (2021), “Corporate Bankruptcy and Insolvency Prediction Model”, Technological and Economic Development of Economy, 27(5), pp. 1039–56.

(84) Wang Y., and Campbell M.. (2010). “Business Failure Prediction for Publicly Listed Companies in China”, Journal of Business and Management , 16(1), pp. 75–88.

(85) Watts R., and Zimmerman J. (1978), “Towards a Positive Theory of the Determination of Accounting Standards”, The Accounting Review, 53(I), pp. 112–34.

(86) Wells J. (2001), “Irrational Ratios”, Journal of Accountancy, 192(2), pp. 80–83.

(87) Xu C. et. al. (2021), “Real Earnings Management in Bankrupt Firms”, Corporate Accounting and Finance, 32(2), pp. 22–38.

(88) Xu M., and Zhang C. (2009), “Bankruptcy Prediction: The Case of Japanese Listed Companies”, Review of Accounting Studies, 14(4), pp. 534–58.

(89) Zhang, Lili, Trent Geisler, Herman Ray, and Ying Xie. 2022. “Improving Logistic Regression on the Imbalanced Data by a Novel Penalized Log-Likelihood Function”, Journal of Applied Statistics, 49(13), pp. 3257–77.

(90) Zhang L. et. al. (2010), “Corporate Financial Distress Diagnosis Model and Application in Credit Rating for Listing Firms in China”, Frontiers of Computer Science in China, 4(2), pp. 220–36.

(91) Zhang W. (2015), “R&D Investment and Distress Risk”, Journal of Empirical Finance, 32, pp. 94–114.

(92) Zmijewski M. (1984), “Methodological Issues Related to the Estimation of Financial Distress Prediction Models”, Journal of Accounting Research, 22, pp.59–82.

Appendix

Appendix I: Sample distribution by year

Year	Panel A (Financial health-based)				Panel B (Legal outcome-based)				Panel C (Financial health and Legal outcome-based)			
	0	**1**	**Total**	**%**	**0**	**1**	**Total**	**%**	**0**	**1**	**Total**	**%**
2008	1608	12	1620	0.7%	1502	334	1836	22.2%	1783	0	1783	0.0%
2009	1628	16	1644	1.0%	1525	334	1859	21.9%	1806	5	1811	0.3%
2010	1656	28	1684	1.7%	1563	334	1897	21.4%	1842	12	1854	0.6%
2011	1685	31	1716	1.8%	1593	334	1927	21.0%	1876	14	1890	0.7%
2012	1720	25	1745	1.5%	1622	334	1956	20.6%	1910	15	1925	0.8%
2013	1724	44	1768	2.6%	1644	334	1978	20.3%	1929	20	1949	1.0%
2014	1723	55	1778	3.2%	1654	334	1988	20.2%	1925	26	1951	1.3%
2015	1716	78	1794	4.5%	1669	334	2003	20.0%	1914	48	1962	2.4%
2016	1727	81	1808	4.7%	1683	334	2017	19.8%	1918	55	1973	2.8%
2017	1757	73	1830	4.2%	1705	282	1987	16.5%	1932	34	1966	1.7%
2018	1764	74	1838	4.2%	1712	227	1939	13.3%	1913	20	1933	1.0%
2019	1771	78	1849	4.4%	1723	149	1872	8.6%	1887	15	1902	0.8%
2020	1773	79	1852	4.5%	1726	96	1822	5.6%	1846	8	1854	0.4%
2021	1756	96	1852	5.5%	1726	47	1773	2.7%	1825	6	1831	0.3%
Total	**25777**	**854**	**26631**	**3.3%**	**24774**	**3807**	**28581**	**15.4%**	**28100**	**278**	**28378**	**1.0%**

Note: 0 and 1 Indicate non-distressed and distressed firms' year observations, respectively. % denotes the percentage of distressed firm-year observations.

Appendix II: List of accounting and market-driven variables used in the study

Variables	Acronym	Group	Description
Return on assets	ROA	Profitability	Net income / Total assets
Retained earnings on total assets	RETA	Profitability	Retained earnings / Total assets
Operating profit margin	OPM	Profitability	Operating profit / Net sales
Return on equity	ROE	Profitability	Net income / Shareholder's equity
Debt to assets ratio	DA	Financing and Leverage	Total debt / Total assets
Debt to equity ratio	DE	Financing and Leverage	Total debt / Total equity
Working capital to total assets	WCTA	Liquidity	Working capital / Total assets
Current ratio	CR	Liquidity	Current assets / Current liabilities

Variables	Acronym	Group	Description
Assets turnover ratio	ATR	Efficiency	Net sales / Total assets
Cash return on total assets	CRTA	Cash Flow	Operating cash flow / Total assets
Operating cash-to-debt ratio	OCD	Cash Flow	Operating cash flow / Total debt
Operating cash flow margin	OCM	Cash Flow	Operating cash flow / Net sales
Firms market capitalisation	MCAP	Market-driven	Log of market capitalisation
Book-to-market ratio	BTM	Market-driven	Book value of equity/ Market value of equity
Market value of equity to book value of debt	MVEBVD	Market-driven	Market value of equity/ Book value of debt

Appendix III: List of reporting anomaly variables used in the study

Days sales in receivable index	DSRI	$\frac{\text{Receivables}_t}{\text{Sales}_t} / \frac{\text{Receivables}_{t-1}}{\text{Sales}_{t-1}}$
Leverage index	LEVI	$\frac{\text{Total Debt}_t}{\text{Total Assets}_t} / \frac{\text{Total Debt}_{t-1}}{\text{Total Assets}_{t-1}}$
Assets quality index	AQI	$1 - \frac{\text{Current Assets}_t + \text{Property,Plant,and Equipment}_t}{\text{Total Assets}_t})/(1 - \frac{\text{Current Assets}_{t-1} + \text{Property,Plant,and Equipment}_{t-1}}{\text{Total Assets}_{t-1}})$
SGA Expenses index	SGAI	$1 - \frac{\text{Selling,General,and Administrative expenses}_t}{\text{Sales}_t} / 1 - \frac{\text{Selling,General,and Administrative expenses}_{t-1}}{\text{Sales}_{t-1}}$
Depreciation index	DEPI	$\frac{\text{Depreciation}_{t-1}}{\text{Depreciation}_{t-1} + \text{Net Property,Plant,and Equipment}_{t-1}} / \frac{\text{Depreciation}_t}{\text{Depreciation}_t + \text{Net Property,Plant,and Equipment}_t}$
Total accruals to total assets ratio	TATA	$\frac{\text{EBIT} - \text{Cash from operations}}{\text{Total Assets}}$
Sales growth index	SGI	$\frac{\text{Net Sales}_t}{\text{Net Sales}_{t-1}}$
Coefficient of variation of sales	CVSALES	$\frac{\sigma\,(\text{Net Sales}_t, \text{Net Sales}_{t-1})}{\lvert\mu(\text{Net Sales}_t, \text{Net Sales}_{t-1})\rvert}$
Gross margin index	GMI	$\frac{\text{Gross Profit}_{t-1}}{\text{Net Sales}_{t-1}} / \frac{\text{Gross Profit}_t}{\text{Net Sales}_t}$
Coefficient of variation of profit	CVPRO	$\frac{\sigma\,(\text{Net Profit}_t, \text{Net Profit}_{t-1})}{\lvert\mu(\text{Net Profit}_t, \text{Net Profit}_{t-1})\rvert}$

Appendix IV: Descriptive statistics of reporting anomaly variables

Variables	Panel A Non-distressed firms					Panel B Distressed firms					t-value
	N	Mean	SD	Min	Max	N	Mean	SD	Min	Max	
Financial health-based definition											
DSRI	21267	1.175	0.816	0.131	6.893	751	1.549	1.420	0.131	6.893	-11.949***
LEVI	22063	1.020	0.292	0.373	2.797	759	1.117	0.242	0.373	2.797	-9.010***
AQI	22065	1.102	0.530	0.208	4.037	759	1.068	0.443	0.208	4.037	1.730
SGAI	20964	1.084	0.708	0.030	6.015	740	1.214	1.031	0.030	6.015	-4.807***
DEPI	21379	1.033	0.374	0.308	3.162	745	1.039	0.443	0.308	3.162	-0.436
TATA	21381	0.029	0.110	-0.372	0.425	745	-0.063	0.127	-0.372	0.425	22.360***
SGI	21670	1.171	0.633	0.000	5.521	768	0.966	0.726	0.000	5.521	8.759***
CVSALES	22346	0.121	0.155	0.000	0.929	769	0.212	0.226	0.000	0.929	-15.566***
GMI	21424	1.021	0.862	-3.348	5.955	754	0.578	1.733	-3.348	5.955	13.198***
CVPRO	22760	0.151	1.019	-4.743	5.317	770	-0.404	0.910	-4.743	5.317	14.919***
Legal outcome-based definition											
DSRI	20484	1.186	0.913	0.112	8.350	2953	1.420	1.360	0.112	8.350	-12.102***
LEVI	21273	1.021	0.301	0.349	2.905	3238	1.084	0.329	0.349	2.905	-10.854***
AQI	21265	1.103	0.537	0.169	4.197	3254	1.180	0.641	0.169	4.197	-7.479***
SGAI	20189	1.088	0.741	0.033	6.521	2913	1.210	1.030	0.033	6.521	-7.868***
DEPI	20589	1.034	0.380	0.303	3.268	3024	1.041	0.453	0.303	3.268	-0.900
TATA	20405	0.027	0.115	-0.510	0.440	3121	0.004	0.159	-0.510	0.440	9.835***
SGI	20633	1.189	0.658	0.088	5.952	3011	1.143	0.753	0.088	5.952	3.442***
CVSALES	20622	0.127	0.159	0.001	0.963	3008	0.193	0.214	0.001	0.963	-20.385***
GMI	20633	1.012	0.928	-3.902	6.660	3009	0.951	1.466	-3.902	6.660	3.091***
CVPRO	21892	0.145	1.015	-4.792	5.300	3424	-0.052	1.117	-4.792	5.300	10.433***
Financial health and Legal outcome-based definition											
DSRI	23431	1.218	0.990	0.112	8.350	272	1.837	1.868	0.112	8.350	-10.121***
LEVI	24501	1.030	0.306	0.349	2.905	278	1.199	0.308	0.349	2.905	-9.151***
AQI	24488	1.113	0.554	0.169	4.197	278	0.896	0.342	0.169	3.517	6.527***
SGAI	23094	1.102	0.780	0.033	6.521	264	1.415	1.335	0.033	6.521	-6.421***
DEPI	24278	1.005	0.420	0.000	3.239	274	1.052	0.501	0.113	3.239	-1.842*
TATA	25062	-0.027	0.130	-0.546	0.414	276	-0.146	0.201	-0.546	0.414	17.112***
SGI	23884	1.166	0.658	0.000	5.646	273	0.835	0.621	0.000	5.646	8.283***
CVSALES	24586	0.130	0.168	0.000	0.954	274	0.250	0.240	0.000	0.954	-11.743***
GMI	23633	1.008	1.008	-3.902	6.660	272	0.492	2.080	-3.902	6.660	8.248***
CVPRO	25124	0.120	1.039	-4.792	5.300	278	-0.370	0.525	-3.533	5.300	7.854***

Appendix V: Correlation Matrix of all the variables

Variables	ROA	RETA	OPM	ROE	DA	DE	WCTA	CR	ATR	CRTA	OCD	OCM	MCAP	MVEBV	BTM	EMI
ROA	1.000															
RETA	0.942	1.000														
OPM	0.407	0.393	1.000													
ROE	0.336	0.290	0.116	1.000												
DA	-0.442	-0.417	-0.237	0.035	1.000											
DE	-0.052	-0.026	-0.017	-0.376	0.178	1.000										
WCTA	0.405	0.384	0.162	0.026	-0.637	-0.076	1.000									
CR	0.119	0.122	0.044	-0.002	-0.340	-0.091	0.494	1.000								
ATR	0.231	0.227	-0.030	0.173	0.096	0.084	0.138	-0.033	1.000							
CRTA	0.388	0.325	0.235	0.166	-0.101	-0.049	-0.001	-0.101	0.147	1.000						
OCD	0.408	0.338	0.266	0.146	-0.267	-0.099	0.149	0.040	0.077	0.794	1.000					
OCM	0.120	0.109	0.290	0.048	-0.021	-0.021	-0.036	-0.063	-0.038	0.469	0.419	1.000				
MCAP	0.414	0.328	0.281	0.166	-0.250	-0.029	0.162	-0.078	0.014	0.241	0.242	0.091	1.000			
MVEBVD	0.363	0.254	0.131	0.117	-0.434	-0.139	0.305	0.273	0.001	0.182	0.355	0.032	0.379	1.000		
BTM	0.177	0.215	0.139	-0.193	-0.522	0.190	0.376	0.123	0.009	-0.022	-0.004	-0.024	-0.028	-0.054	1.000	
EMI	-0.252	-0.252	-0.318	-0.060	0.131	0.019	-0.119	0.010	-0.159	-0.220	-0.191	-0.116	-0.155	-0.051	-0.083	1.000

Perfect Negative Correlation *Perfect Positive Correlation*

[1] Insolvency and Bankruptcy Code, 2016 (IBC) pertains to the insolvency resolution of all entities in India. IBBI is the regulator body which carries out the provisions of IBC (IBBI, 2020).

[2] CIRP is the process of insolvency resolution for a corporate debtor (CD). The outcome of the CIRP is either an order of resolution plan or the liquidation (IBBI, 2020).

[3] 1459 out of 2220 total firms and 133 out of 250 listed firms under IBC are either defunct or part of BIFR.

[4] CIRP filing until October 14, 2022 is considered for the study.

[5] For legal outcome-based definition all listed firms filed for CIRP are recorded as 1, and 0 for all other listed firms. Out of 334 firms, 126 are already a part of current NSE listed firms (1853-126 = 1727). The rest are either delisted or part of BSE.

[6] RETA is dropped from further analysis due to multicollinearity.

[7] We have examined the correlation matrix of variables under three definitions of financial distress. However, the correlation values were yielded almost similar results. Therefore, only the results of financial health-based definition are reported due to space constraints.

24 CROSS-BORDER INSOLVENCY LAW AND CHALLENGES IN ADOPTING THE UNCITRAL MODEL IN INDIA: A CRITICAL ANALYSIS

- Pranay Agarwal and Ayaan Vali

EXECUTIVE SUMMARY

The UNCITRAL model for cross-border insolvency law (Model Law) is pending to be adopted in India and is touted to be the much-needed solution by several experts for the various cross-border insolvency issues and the legal confusion related to it. However, given the complexity of the legislative framework of the country, several challenges lie ahead before the introduction of the Model Law in the country. The challenges are not only practical hindrances which relate to the successful adoption and implementation of the Model Law but also theoretical or ideological which though may not be apparent but have a significant role in the successful adoption of the UNCITRAL Model Law. In this paper, it is attempted to propound that the Model Law will nevertheless be successful in the Indian insolvency regime but only post addressing these major inherent limitations. In order to fulfill this purpose, the paper follows a dual approach by highlighting the major shortcomings in the adoption of the Model Law through a comparative analysis of the commercially developed nations on a doctrinal level, and subsequently proposing constructive policy recommendations to remedy the same.

Keywords: Model Law, Cross-border insolvency, Theoretical and Practical Problems, Legal Philosophy, Reciprocity, Jurisdictional Issues, Modified Universalism.

INTRODUCTION

The gargantuan rise of technology, trade and commerce has led to an unprecedented rise in the number of multinational entities spreading their wings and entering into borderless business relations that span across various countries and jurisdictions.

This multitude of trade relations leads to a situation where several creditors and debtors are situated at locations in different jurisdictions. This makes the insolvency process consist of an overlap of different laws and proceedings, this situation wherein an insolvent debtor has creditors and or debtors in more than one jurisdiction that is in different countries is referred to as cross-border insolvency or international insolvency.

The international standard with regards to this process of cross-border insolvency is well defined and progressive, however in contrast the Indian perspective on the issue continues to be largely general and primitive in nature. The gold standard for the successful resolution of cross-border insolvency problems across the world has been the adoption of the UNCITRAL Model Law of 1997.[1] It is also a remedy that India seeks to implement, however the mere adoption of the Model Law is not a one size fits all solution that would instantly cure India of its complex cross-border insolvency problems. The implementation of the Model Law in India requires several questions to be answered and in order to do so, firstly the authors have analyzed the problems that the Indian insolvency landscape faces, India has always had a complex socio cultural and socio-economic environment, and this is the case with regards to cross-border insolvency as well; as a result of this, there exist problems which are unique to India, the paper has thus first presented a socio historical analysis in order to systematically delve into and understand the particular problems that have plagued the Indian cross-border insolvency landscape right from its inception and how these problems have continued to spill over into contemporary times.

Secondly, the adoption of the Model Law in the Indian landscape also poses certain challenges, and in the subsequent parts of the paper the authors have analyzed the major theoretical and practical issues that affect the adoption of the UNCITRAL Model Law in India.

Finally, the authors have through the aegis of this paper built upon this analysis and provided future policy recommendations for the same in order to neutralize both these sets of problems and sought to answer the question as to how India can integrate successfully in an environment where in domestic laws would coincide with foreign regulation.

INSOLVENCY REGIME IN INDIA: A SOCIO HISTORICAL PERSPECTIVE

Cross-border insolvency prior to the enactment of the IBC

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) that came into effect on May 28, 2016 was enacted with the aim to consolidate the insolvency and bankruptcy process in India and to provide a more simplified and streamlined process for the same.

Prior to the enactment of the IBC, the Indian corporate insolvency regime was governed by a host of legislations, these included primarily the Indian Companies Act 1956,[2] which later was replaced by the Companies Act, 2013[3] for body corporates and for individuals the insolvency process was governed by the Presidency Towns Insolvency Act 1909[4] and the Provincial Act 1920.[5]

Apart from these primary legislations that dealt with the insolvency and bankruptcy regime in India at large, there have also been several studies that have been conducted in order to explore the specific incorporation of cross-border insolvency provisions in India prior to the enactment of express provisions under the IBC; For the instances of research for this paper, the authors have looked at two leading committee reports that were present pre-IBC as mentioned below:

High Level Committee on law relating to the insolvency and winding up of companies

The first express mention of incorporating a cogent insolvency regime in India dates back to the High-Level Committee on 'Law relating to the Insolvency and Winding up of Companies' in 2000[6] under the chairmanship of Hon'ble Justice V. Balakrishna Eradi.

Chapter 6[7] of the Committee Report (Provisions of Insolvency Law of other countries which may be incorporated in Companies Act, 1956) primarily dealt with this particular aspect of cross-border insolvency and its enactment in India. The Committee highlighted that the adoption whether fully or partly of the UNCITRAL Model Law in cross-border insolvency was of an immediate concern, the Committee held that the Model Law should be implemented in India albeit with specific modifications in order to suit the needs of the Indian insolvency landscape.

The Committee was of the view that in order to strike an equitable balance among Indian and foreign creditors it was of utmost importance to incorporate specific provisions concerning the UNCITRAL Model Law into the Indian legal landscape. At the time the Committee wanted to pursue this aim by expressly amending Part VII of the Companies Act, 1956.

In order to fulfil this aim, the Committee prepared a four-point plan, outlined below:

a) An inbound request would be placed for the recognition of foreign proceedings towards the enacting state.

b) This would be followed by an out bound request from a Court or Administrator of the enacting state.

c) Followed by coordination proceedings in two or more concerned states, and

d) Finally, this would be culminated by the participation of foreign creditors in insolvency proceedings that would take place in the respective enacting states.

Taking a closer look at these recommendations, it is to be noted that this inbound-outbound request mechanism can be seen as a precursor to the current reciprocity agreement mechanism that is in existence.

Furthermore, the Committee in Chapter 7[8] (Suggestions and Recommendations of the Committee) recommended that the articles present within the UNCITRAL Model Law should be referred to in the form of substantive provisions, and these substantive provisions can in themselves be reproduced as a schedule to the Companies Act, 1956. Further the Committee made the bold recommendation that this should be applicable to all cross-border insolvency cases.

However, despite the positivist aim of the report and the Committee highlighting that the facilitation of such a mechanism was necessary it did not delve into the particular specifics of the same, a few pressing matters that come to the fray, with regards to this would be for instance:

a) What manner of dispute resolution would be followed in case of potential disputes that would arise in concurrent foreign proceedings in enacting states?

b) What exactly would be the binding nature of the coordination proceedings that would take place among two or more enacting states?

c) How exactly would the legal transplantation of the articles from the UNCITRAL Model Law take place to fit the Indian legal scenario, what subsequent modifications would be required for the same?

d) Whether the adoption of the Model Law would include retrospective application of the same, how exactly would it be applicable to ongoing cross-border insolvency proceedings and what transitionary measures would be required for the same?

These are a few important questions that were largely left unanswered by the Committee.

The Report of the Advisory Group on Bankruptcy Laws – May, 2001

The Report of the Advisory Group on Bankruptcy laws[9] was released in 2001 under the leadership of Dr. NL Mitra, and presented a much more detailed view with regards to the issue of cross-border insolvency structure in India and how it could be streamlined, particularly 'Problems and Issues in Practice: A look at the Reciprocity Issue' heading of the report dealt with this very specific issue.

An analysis of the Report helps us understand that the report emphasized on the importance of choice with regards to cross-border transactions. Further the Report stated that it was paramount to promote cooperation between the courts and other competent authorities of India and other foreign states that were involved in cases of cross-border insolvency and that it was important to create legal certainty for facilitation of trade and investment.

Finally, it was important to have a streamlined cross-border insolvency regime in India in order to ensure protection and maximization of value of the debtors' assets. On a broader plane this question of law is pertinent given the -

a) The development of international trade that occurs across international borders.

b) The development of transnational and multinational institutions that emerge through building up of transborder organizational structures.

c) The development of organizational relations that occur through chain organization structure of subsidiaries and joint ventures.

d) Finally, due to the development of complexity in cross-border relations.

The Report noted that at the time the Indian legal system did not contain any provisions concerning cross-border relations and that Indian law concerning cross-border insolvency was outdated and was in no way comparable to the standards set and required in the international setting and as such the Indian law seemed to stand apart and alone from the rest.

A critical analysis of the 2001 Report of the Advisory Group

a) Determination of origin and domicile of a company

Firstly, the determination of domicile of origin of a company, with regards to the Indian Companies Act, 1956 and its modern successor, the answer is fairly simple that a company registered in India would have an Indian domicile. Interestingly however, as per the Indian Income Tax Act,[10] even if a company had been registered outside India but was having its management and control in India, it would be considered for the purposes of insolvency and corporate taxation in an Indian company.[11]

Furthermore, the prevailing view was that the domicile of shareholders has no influence in determining the domicile of the company.[12] This confusion with regards to determination of domicile among statutes is problematic particularly with regards to determination of foreign main and non-main proceedings and determining the country of origin for cross-border insolvency proceedings.

b) Separate proceedings in the Indian domain

Secondly the Report noted that Indian laws concerning insolvency and winding up were closely in line with principles of English common law. Particularly the Presidency Towns Insolvency Act, 1909 and the Provincial Act, 1920. However, these two acts never made any explicit reference concerning cross-border insolvency in India. As a result of this, Indian laws concerning insolvency would not have any extra territorial operation or jurisdiction.

Therefore, if a foreign company was to be taken into liquidation outside India, its Indian segment of business would have to be treated as a separate matter altogether. This in essence would lead to the creation of an isolationist perspective and create a divide with regards to insolvency proceedings in the international domain and in India. This lack of uniformity with international standards is one of the major defects that the Report outlined.

c) Lack of recognition of foreign proceedings

Finally, the third problem that the Report outlined is that though there were several statutory provisions such as section 13[13] and section 44A[14] of the Civil Procedure Code, 1908 (CPC) that dealt with foreign judgments and their subsequent recognition. There still existed a lacuna in law with regards to the recognition of foreign proceedings, at the time neither the CPC or any other law dealt with the recognition of foreign proceedings. It was in order to fill this lacuna that the committee championed the adoption of the UNCITRAL Model Law.

The Committee further iterated that the definition present in the CPC was inadequate to deal with insolvency proceedings whether that be for liquidation or reorganisation.[15] Flowing from this, Indian law did not recognize a foreign insolvency official as having the locus to represent a foreign company, Indian courts thus are unlikely to give any form of aid or assistance to a foreign liquidator or other insolvency official if this treatment would be prejudicial to the company's creditors on the basis of how those creditors are or would have been treated under equivalent Indian law insolvency proceedings.

Thus, in order to overcome all these problems mentioned hitherto, the Committee recommended the adoption of the UNCITRAL Model Law, the Committee felt that the adoption of the model would help ensure a fair and efficient administration of cross-border insolvencies and bring India on par with international standards.

The modern cross-border insolvency regime: IBC and Draft Part Z

The IBC

Moving towards the contemporary perspective on cross-border insolvency, the IBC is the primary piece of legislation that aimed to make the insolvency resolution process more quick, robust and efficient. It is essentially a consolidation of laws concerning the insolvency resolution process of companies, limited liability partnerships, partnership firms and individuals. It was formed by repealing certain former outdated laws such as the Presidency Towns Insolvency Act, 1909 and amending certain others such as the Indian Partnership Act, 1932.

Ever since its commencement, the IBC has seen a paradigm shift evolving from its nascent stage to a Code that is able to tackle the various challenges that India faces today, this was achieved by maintaining harmony between amendments and judicial precedents, however the current legal position with respect to cross-border insolvency still seems to remain confined largely to the discussion stage. As a result, despite a lot of discussion and deliberation since 2018 there is still a lack of a comprehensive set of laws or regime that deal with cross- border insolvency in India.

Presently there are two express provisions concerning cross-border insolvency that are present within the IBC. These are sections 234[16] and section 235[17] of the Code; These two provisions were inserted as enabling provisions following the recommendations of the Joint Parliamentary Committee (Joint Committee on the Insolvency and Bankruptcy Code, 2016).[18]

In brief, section 234 empowers the Central Government to enter into bi-lateral agreements with foreign jurisdictions in order to resolve cross-border insolvency issues and streamline the insolvency process and section 235 in contrast empowers the Adjudicating Authority (AA) to issue letters of request to the courts of countries which have entered into bilateral agreements with India subject to the provision of section 234, this section was created in order to aid the insolvency process against the assets of corporate debtor (CD) that are located outside India.

These sections, although sounding good in theory, have largely failed in practice. As India is yet to enter into any sort of bilateral agreement with any country that would make these clauses enforceable. A closer reading of the sections would also help one ascertain that these provisions are largely general in nature and there is still a lack of a comprehensive framework on the topic of cross-border insolvency and how it can be dealt with in India.

- For instance, although mentioning that India is to enter into an agreement with other countries, the sections barely list out how this specific arrangement would operate. Since this agreement would simply be 'India specific' and not give any inherent advantage to countries entering into such an agreement in contrast to the provisions of a much more general adoption such as the UNCITRAL Model Law which has been adopted by 50 countries since 1997, countries have hesitated to enter into these agreements.

- The sections fail to outline the intricacies of such an agreement, how disputes would be settled if issues arise due to jurisdiction or in final settlement. This lack of clarity is another reason why the adoption of reciprocity agreements has failed.

- Finally as highlighted earlier, even if such a reciprocity agreement was entered into, how foreign judgments would be implemented in India is a key issue as, the CPC, the main mechanism for enforcing judgments from foreign jurisdictions is not wide enough to include all insolvency orders such as orders regarding reorganisation processes, administrative and interim orders. This in essence would render several foreign orders unenforceable in India, this once again disincentivises countries from entering into reciprocity agreements with India.

These facts were also agreed in the 2018 Report of the Insolvency Law Committee (ILC)[19] which highlighted that sections 234 and 235 although good in conscience do little to address the complex issues that often arise with the process of cross-border insolvency.

For instance, although the IBC does provide for extensive domestic laws concerning insolvent enterprises, at present there is no standard instrument to restructure firms that are present in cross-border jurisdictions and although foreign creditors can make claims against a domestic company the IBC at present does not allow for automatic recognition of any insolvency proceedings in other countries.[20]

It was to resolve these concerns relating to cross-border insolvency in India that the ILC was set up which proposed the adoption of the Model Law and the incorporation of Draft Part Z within the IBC in its two-part Report.

Draft Part Z

The ILC formulated Draft Part Z in the second part of its Report which was heavily inspired by the UNCITRAL Model Law and imbibed within itself the key highlights of the same.

The ILC in order to justify its adoption of Draft part Z in its Report highlighted the following reasons:

a) The existing provisions with respect to cross-border insolvency contained in sections 234 and 235 of the IBC did not provide a broad or an exhaustive framework for cross-border insolvency matters.

b) The enforcement mechanism of foreign judgements under CPC is not wide enough to incorporate all the insolvency orders.

c) Adoption of Model law would help in increasing foreign investments as it would provide avenues for recognition of foreign insolvency proceedings which in turn would strengthen coordination between domestic and foreign insolvency proceedings.

d) The Model law would help provide flexibility to protect the public interest and would also help in giving priority to domestic proceedings.

THEORETICAL AND LEGAL PHILOSOPHICAL ISSUES

The topic of cross-border insolvency has become quite important in recent times given the growing importance of multinational companies (MNCs) and foreign currencies in international trade.[21] This is more evident from the fact that in the pre-globalization era the topic of cross-border insolvency was characterized merely as an academic subject of minor importance.[22]

However, such deliberations even after the advent of globalization were largely restricted to the pragmatic issues arising from such insolvencies. The reason for this was the uniform principle of *Lex fori concursus* which long acted as the main assumption in differentiating between the choice of forum and choice of law.[23]

With the changing needs of the commercial world as well as with the growth of cooperation between the nations to develop a uniform system to resolve such cross-border insolvency issues, the main assumption of *Lex fori concursus* was not limited to a single approach.[24] Furthermore, the need to look at the theoretical aspects of cross-border insolvency was furthered by the introduction of the Model Law which provided another outlook to look at the problem.

Approaches to cross-border insolvency

The problems of jurisdictions and choice of forum in cross-border insolvencies are not a new phenomenon and have been a subject of deliberation for quite a while.[25] However, traditionally such issues were majorly resolved by partitioning the insolvency law or the jurisdiction along the national borders.[26] As per this territorial approach, the classical concepts of sovereignty and jurisdiction are given prominence and thus in simple terms, it permits the local courts to take control of the local assets in accordance with the local laws. This approach is popularly known as territorialism.

Before the advent of the Model Law, territorialism acted as the default system for all cross-border insolvencies due to its actual *in rem* control over the assets, which makes it simple and predictable.[27] Under this approach, a separate and independent case is pursued in each forum in which the debtor's assets are located. Although the main criticism of this approach has been regarding the inconsistencies and redundancy accompanied with it, which makes it a less economically efficient approach, it is believed that the proper cooperation between the nations can bring harmony in the law and their relations.[28] However, the pragmatic difficulties pertaining to the after effects of adopting such an approach and the need to bring out clear and comprehensive reciprocity which makes the already accepted Model Law more attractive.[29]

Due to the inherent disadvantages of the territorial approach, various scholars advocated for a more uniform system where the insolvency proceedings are governed by one law in a single forum irrespective of the location of the assets of the company. Therefore, the paradigm gradually shifted towards the 'universal' approach.[30] Under this approach, there must be the presence of a treaty or convention between certain nations through which the nations surrender their sovereignty and choose a uniform mechanism to resolve such cross-border insolvencies.[31]

Nevertheless, it is often observed that the states which are governed by their national interest are likely to avoid such agreements on the international level.[32] Furthermore, devising a uniform mechanism will be tangibly discriminatory towards the interests of some nations and often leads to a neglect of their legal philosophy, thus making them hesitant to enter in such agreements.

Territorialism and universalism fall on the two opposite extremes of a plane, both of which lead to a common middle ground - a more neutral approach. Due to various problems associated with both the territorial and universal approaches, the scholars and legal analysts created a hybrid or modified model to combine the benefits of both the approaches.[33] This new approach came to be known as modified universalism.

Under this approach, the insolvency proceeding will be conducted in one jurisdiction and the laws of that jurisdiction will be binding upon the foreign creditors as well. Undoubtedly, the element of sovereignty is considered essential for the implementation of such a decision and the local courts therefore have been given the discretion to weigh the local interests of the creditors in order to recognize the decision.[34] It is important to note that the UNCITRAL Model Law is largely based on the modified universalism approach which can be seen from its recognition to both main and secondary proceedings.

While the Model Law in this regard can be seen as a perfect solution to the complex nature of cross-border insolvencies in that it provides certainty, uniformity and has provided a solution for most of the practical problems, the inherent limitations of modified universalism continue to hinder its progress. One of the major problems in this regard is the hesitance of the ancillary courts to assist the foreign state's extraterritorial laws, thus creating inefficiencies.[35] Moreover, the problem is amplified by the fact that such practice avoids the debtors and creditors to file for the cross-border insolvency as per the modified universalism mechanism.

In this respect, many scholars have suggested moving towards another hybrid model of secondary insolvency.[36] However, it is pertinent to note that modified universalism can still provide an apt solution for the process of cross-border insolvency suitable to Indian conditions and requirements which is also showcased by the earlier examples of US and Japan.

Comparative analysis of foreign jurisdictions

The relevance of foreign jurisdictions in the case of cross-border insolvencies can be said to be paramount as given the whole point of the Model Law is to bring uniformity in its approach. However, since the advent of the Model Law, the scholars have been persuading the Government to adopt the Model Law while providing a comparison with the other developed nations and the consequences of such adoption.[37]

Furthermore, a comparative analysis of the mechanisms in other jurisdictions on a doctrinal level is required for justifying the adoption of the Model Law in India as well as to correct the approach that has been adopted since through the challenges faced by these nations in the adoption process. Moreover, a comparative analysis will provide the much-needed reasoning on the adaptability of the Model Law and the criteria or factors of such adaptability which are inherent in some legal systems.

For this purpose, the authors in this paper provide for a comparison of the legal systems of the commercially developed nations like USA, Singapore and Japan who have successfully adopted the Model Law to resolve the issues of cross-border insolvency. Through this study, the paper seeks to analyse the relevant laws, legal history and philosophy and the nature of the insolvency laws of these nations in order to give a holistic outlook over the subject.

USA

The US adoption of the Model Law derives its authority from the Chapter 15 of the Bankruptcy Code 1978, the main legal authority for the insolvency law in the US. If seen from the objectives and application of the Chapter 15, the US had changed its stance from the territorial approach to that of modified universalism by including foreign parties and concurrent foreign proceedings with respect to same debtor within its legal landscape.[38]

It is pertinent to note that the US and its legal system is characterized by its capitalistic ideology and the free market. The reason for American inclination towards protecting the commercial interests of the people and their businesses also lies in the dark economic history of stagflation in 1970s which ultimately led to the enactment of a robust Bankruptcy Code to protect the decreasing investing sentiments while protecting the already depleted commercial market.[39] The US adoption of the Model Law therefore can be looked at as not a rare occasion where it surrenders its sovereignty for greater commercial interest, a bigger national interest. However, the adoption of the Model Law did not impact the 'debtor-centric' nature of the American insolvency principles.[40]

The American adoption of the Model Law is characterized by its interpretation of the term 'Centre of Main Interest' (COMI) of the debtor company where the main proceedings will be initiated.[41] While the COMI has not been defined clearly under US insolvency law, it is interesting that the American courts have instead adopted the narrow approach taken by the European courts.[42] Nevertheless, the American model provided under Chapter 15 has not adopted the Model Law in toto and has made several reforms as to decrease the value of the secondary proceedings,[43] thus indicating its intention to retain the beneficial aspects of the territorial approach.

Singapore

Singaporean laws are often taken as the epitome of efficient commercial laws in both the substantive and procedural sense, due to the nation's high commercial value owing to its successful implementation of the laws.[44] The insolvency proceedings in Singapore are governed by the Insolvency, Restructuring and Dissolution Act, 2018 (IRDA) along with the Singapore Companies Act. In this respect, the country has lately adopted the Model Law through the Companies Act and IRDA.[45]

While the Singaporean insolvency mechanism has largely adopted the major principles of the Model Law, it is pertinent to highlight that the creditor centric nature of the law has not been changed,[46] which not only forms the backbone of the Singaporean insolvency regime but also represents the basic political ideal of the country. In this regard, the commercial laws of the country have largely kept in line with the basic ideals of the country, in order to prioritize the welfare of the citizens by trickling down the maximum benefits of the market.[47]

This high creditor centric approach of the Singaporean insolvency law is also the main reason for late adoption of modified universalism by such a commercially developed nation, which posed as a major challenge in the harmonization of the two approaches. This sovereignty factor which is inherent in the territorial approach is an important facet to ensure the welfare of the citizens and also one that serves as one of the main reasons for India's hesitancy towards adopting the Model Law.[48]

Nevertheless, the growing international trade in the island nation along with the desire to boost the economy of the country provided the incentive to change the outdated territorial approach followed by the subsequent adoption of the Model Law in order to attract more foreign investment.[49] This is also evident with the introduction of the restructuring procedure in the form of scheme of arrangement around the same time. While it cannot be denied that the adoption of the Model Law has diluted the rights of the citizens to a certain extent, the state has transplanted it in a more harmonious manner to preserve the basic principles of 'creditor-centrism' and 'citizen first'.

Japan

The Japanese insolvency regime has often been cited as the quintessential example of the territorial approach.[50] While the scholarly opinion is divided on the issue of the territorial approach in the insolvency laws of Japan which was apparent by its express provisions, the Japanese courts have often divulged from this approach, thus making the position uncertain.[51]

The Japanese insolvency regime however was decisively reformed in light of the rapid globalization and increasing foreign investment by the country which was reflected by the Recognition of and

Assistance for Foreign Insolvency Proceedings Act in 2001 through which the Japanese insolvency law adopted the Model Law as well as provided for robust restructuring and liquidation mechanisms.

The Japanese adoption of the Model Law has been largely influenced by the Chapter 15 of the US Bankruptcy Code, thus adopting most of the principles of the Model Law.[52] The reason for such a mechanism is the legal philosophy of the Japanese legal system and insolvency regime. The Japanese insolvency regime took birth in the wake of the economic bubble of 1989 which led to the creation of a liquidity trap for various companies coupled with low rates of return.[53] Therefore it becomes pertinent to note that both the American and Japanese insolvency regimes developed in similar kinds of situations and are reformed on the same pretext.

However, unlike the US model, the Japanese insolvency law remains a creditor centric model thereby adopting a hybrid approach. This is more evident by the restructuring laws of the country where the creditors are given superior rights irrespective of the nature of their debt while also considering the most favorable outcomes for both creditors and the debtor.[54]

From a broad and detailed perusal of the legal mechanisms and the philosophies behind the adoption of the Model Law in different jurisdictions, it can be inferred that the key to the successful adoption of any law is the inherent harmony between the two which has to be deduced by the legal history, then socio-economic conditions and the philosophical ideals behind such law. While there can also be an absence of inherent harmony, it is important to understand that the affinity has to be established while keeping the basic legal values of the law intact.

If seen from the perspective of India, the absence of the inherent harmony has since resulted in the legislative hesitancy to adopt the Model Law. However, the examples of US, Japan and Singapore show that a successful transformation from the territorial approach to modified universalism while preserving the basic nature of the insolvency regime is possible.[55]

PROBLEMS AND ISSUES IN PRACTICE: A LOOK AT THE RECIPROCITY ISSUE

Model Law and differential treatment

India has been known for its commercial ties since time immemorial, dating back to times when the trade connections could be seen between the Indian states and the mighty Roman empire. In the current context as well, India is seen as one of the prime destinations for MNCs to invest due to its high market size and the additional state incentives.[56] While from an economic perspective, such implications of a globalized world are viewed from the optimistic eyes, the situation is quite complex from a legal perspective.

MNCs generally tend to locate their operations in other countries due to the cheap labor and high market demand.[57] For this particular purpose, the companies either get their branches registered as per the laws of that country or are continued to be governed by the laws of their own parent nation. In the latter scenario, the MNCs therefore only take control over the foreign assets while depriving the laws of the country to apply over those assets. In this situation, it is easy to infer that some countries though have adopted the Model Law to resolve the cross-border insolvency issues, some other commercially developed nations have been skeptical of a unified approach.[58]

With the Model Law not being implemented uniformly in all jurisdictions, the differences inherent in the domestic insolvency laws of various countries will continue to govern the cross-border insolvency proceedings. This will be more evident in the case of those countries who have not adopted the universal approach of Model Law and are continued to be governed by the territorial approach. While it may be contended that the Model Law can still be made applicable to the companies of those countries who have not adopted the Model Law, the wise decision of the ILC comes in between.[59]

The complexity of the situation can be understood by the fact that the implementation of the Model Law in India though may bring uniformity for certain countries, other countries will still prefer to be governed by the territorial approach. This will lead to differential treatment among the companies with respect to their nationality, thereby unbalancing the investment sentiments towards them.

Resolution through reciprocity agreements

The reciprocity agreements are already provided for in the existing insolvency code to resolve the cross-border insolvency cases in India.[60] However, it is pertinent to observe that the provisions of reciprocity with respect to different countries will become more or less obsolete with the adoption of the Model Law. This trend is also based on the legal developments seen in the commercially developed nations who have previously adopted the Model Law.[61] Though it would not be wrong to infer that most of the nations who adopted the Model Law did not have such type of provision in the first place, the lack of a clear reciprocity provision to compensate for the Model Law is missing in India as well.

Nevertheless, the introduction of the proper reciprocity framework in the Indian insolvency regime may not be enough for successful implementation of the agreements. In this respect, it is important to understand that the success of these agreements depends on the welfare provided to the creditors and investors by the legislations of other jurisdictions and the certainty in the mechanism.[62] While not only insolvency laws but also other international conventions and legal mechanisms endeavor to achieve these two objectives, the authors believe that both goals can be achieved through one wise step in the case of insolvency laws. The reason can be understood by the fact that the certainty in the commercial laws results into economic benefits thereby reducing the chances of haircuts to the creditors.[63]

In this regard, a major economic repercussion of such reciprocity agreements will be the differential treatment towards the companies and their creditors. The magnitude of this differential treatment can be further estimated by the approach followed by the country with which such an agreement has been made. Therefore, the banks and institutions will be put in a dilemma who then have to consider the factor of insolvency mechanism of foreign jurisdiction before lending to such foreign companies. If explained in economic terms of cost benefit analysis and rational choice theory,[64] the creditors will therefore consider two factors before making a rational choice - (a) nature and approach of the insolvency law of foreign jurisdiction and, (b) reciprocity.

The choice can be further explained as when the law of the other jurisdiction is unfavorable or rigid towards the creditors, the creditors will lend less if the reciprocity agreement exists and vice versa. However, with reciprocity important to resolve the dilemma of cross-border insolvency, the nature and approach of the insolvency regime of other nations has to be looked into before making any constructive suggestion.

In this respect, the authors in this paper have taken the reference of a few commercially developed countries that harbor strong commercial ties with India such as Germany, the Netherlands, Taiwan and China and have attempted to analyze the problem by studying the nature and character of the insolvency laws within these legal setups in order to review the feasibility of reciprocity with them.

Germany

The German insolvency regime mainly centers around the Insolvency code (Insolvenzordnung, InsO) or its precursor the Bankruptcy Code (Konkursordnung, KO). For the purpose of analysis, it is pertinent to mention that the objective of both the codes has been the collective, non-discriminatory satisfaction of creditors on a pro rata basis, thereby indicating its creditor-centric nature.[65]

Furthermore, the German codes provide for the liquidation and restructuring of large companies which although is similar to the principles envisaged by the IBC are still distinctly different. Nevertheless, from the point of cross-border insolvency, the German insolvency code adopts a universal approach and allows for the secondary proceedings with respect to the German assets only.[66]

The Netherlands

The necessity of analyzing the prospects of reciprocity with the Netherlands can be understood through the recent case of *Jet Airways* which acted as a wakeup call for the adoption of the Model Law in India.[67] However, it is quite paradoxical that the adoption of Model Law will not be able to resolve the insolvency cases arising from the Netherlands.

The Dutch Bankruptcy Act (Faillissementswet) along with the European Regulation on Insolvency Proceedings largely governs the Dutch insolvency regime. If compared to the IBC, the Bankruptcy Act although has been lately reformed to include the provisions for restructuring and out-of-court settlement, the law stands different from IBC in most aspects.[68] Nevertheless, the object of the Act remains a creditor centric one.[69] While the cross-border insolvency issues are not specifically dealt in the Bankruptcy Act, its approach can be inferred to be territorial from the judgement in the Yukos Oil Case.[70]

Taiwan

Unlike the German and Dutch insolvency regimes, the Taiwanese insolvency laws are much more comparable to the IBC in terms of the binary system including both restructuring and liquidation.[71] Furthermore, the insolvency laws provide for the efficient mechanism of the out-of-court settlement.[72]

The nature of the Taiwanese law can be classified to be inclining towards the creditors in order to ensure maximum recovery and highest priority to the creditors. Nevertheless, the Taiwanese insolvency regime is more or less territorial in approach giving priority to the proceedings of its courts with the exception of the Chinese courts.[73]

China

The approach of the Chinese insolvency regime is quite different from the other nations given its stature as a state-controlled capitalistic state. In this respect, while the nature of the Chinese law is creditor-centric, it is more inclined to its citizens' welfare, thus highlighting its territorial approach. This is more evident by the Chinese dual system where the first preference is given to the liquidation proceedings for maximum recovery and the second reference is given to the restructuring to save the business, depending on the directions of the court.[74]

From the above analysis, it is important to understand that the reciprocity can be helpful in two ways. From one perspective, the lack of affinity towards the laws of the European countries like Germany and the Netherlands makes it apparent to have a reciprocity agreement with such countries in order to avoid the economic repercussions and ensure smooth trade.

If seen from another perspective, the territorial approach adopted by the countries like China and Taiwan with whom India shares deep trade ties may create confusion in the minds of creditors on the issues of jurisdiction, thus adversely impacting the welfare of the creditors. In such situation, no reciprocity will make it easy to enforce the rights of the Indian creditors which are discriminately classified under the Chinese regime.

Therefore, from the above analysis, it can be suggested that the Indian Government should look into the four factors in order to determine reciprocity which are - (a) Political and commercial relations with the nation which will decide the terms of reciprocity with the nation and the economic and commercial effects of such reciprocity, thus affecting its necessity as well; (b) nature or object of law of the other jurisdiction for harmonized mechanism to deal with the cross-border insolvency; (c) procedure adopted by the law to ensure a harmonized and effective mechanism and; (d) approach adopted towards resolving the cross-border insolvency.

Hindrances to reciprocity agreements

The importance of reciprocity agreements can be realized by considering the situation where in the Model Law has been implemented without providing for reciprocity. In such a case, the companies originating or having its operations in those countries which has adopted the Model Law will be subsequently governed by the Model Law and its principles. However, in case of those companies originating in the non-Model Law nations, the problems which the model sought to resolve will remain unchanged thus ensuing chaos and confusion.[75]

However, the reciprocity agreements also suffer from major setbacks which are relevant to be considered for proper implementation of the Model Law. Although the problems have briefly been addressed in the report of the ILC, the authors in this paper seek to address them in detail thus filling the gaps left by the committee.

Lack of clarity

The IBC already provides for reciprocity agreements under sections 234 and 235. However, they have largely been rendered ineffective due to other countries seeing them as highly unfavorable and uncertain. The major reason for such perception is the lack of clarity which is inherent in the law itself. In this respect, it is important to highlight that the sections have not addressed the subject of dispute settlement which can arose due to jurisdiction or in the final settlement,[76] thereby filing to outline the intricacies of the agreement formed.

Furthermore, the implementation of the judgments of foreign courts after granting them recognition is a major issue. While the CPC acts as the main mechanism to enforce such judgments in India,[77] the present mechanism is not wide enough to include all insolvency orders such as the orders regarding reorganisation processes and administrative and interim orders. This in essence will render several foreign orders unenforceable in India which once again disincentivizes countries from entering into reciprocity with India, thus forming a vicious cycle.

India centrism

As has been so far observed, India has failed to enter into any reciprocity agreement concerning the resolution of cross-border insolvency. While the blame of such inaction has to be placed on the Government, the legal framework provided by the IBC is not at all favorable to incentivize the other nations to enter into such agreements.[78]

Apart from making the Indian courts and Government eligible to enter into such agreements, the sections barely list out how this specific arrangement would operate. In this respect, it is pertinent to infer that the India being a country with territorial approach, gives more importance to the sovereignty and the welfare of its citizens and therefore, will enforce only those judgments which are in its national interest.

Since such agreements are simply 'India specific' and do not give any inherent advantage to the countries entering into reciprocity agreements in contrast to the more equitable principles of the Model Law, the countries have so far hesitated to enter into such agreements.[79] Nevertheless, with the implementation of the Model Law, the problem of the 'India specific' agreements cannot be ignored and will continue to detriment the commercial relations with the countries which are yet to adopt the Model Law.

Adverse economic impact

The economic prosperity and gains are one of the major considerations behind the adoption of the Model Law. Since the Liberalisation, Privatisation and Globalisation reforms of 1991, the most recent decades of the commercial history of India are known as the period of liberalism, thus making the current reforms in the insolvency law quite relevant from an ideological perspective.[80] Furthermore, it is important to understand that the hindrances caused by the reciprocity provisions could cause unease among the investors, thus giving a major setback to India's dream of climbing up higher in the Ease of Doing Business rankings.

Nevertheless, the authors also believe that the opposite of the same is also true and the adverse economic impact due to differential treatment of reciprocity and lack of clarity in the area will instead hinder the development of the reciprocity in the first place. Therefore, the economic value of reciprocity has to be considered for a proper value analysis.

In this respect, all the countries referred to in this section share important trade ties with India. While Germany is the seventh largest foreign direct investment (FDI) contributor in India,[81] the Dutch market became the biggest export destination for the country in the EU.[82] Moreover, India shares deep political ties with Taiwan since the Nehruvian era which led to several economic partnerships between the two nations.[83] China on the other hand, though is considered as regional rival in both political and economic terms, the animosity has not impacted much with various Chinese MNCs entering the Indian market.[84]

If seen from the quantum of investment, Germany is often regarded as the gateway of Europe for Indian investment due to large number of Indian companies having their operations in Germany.[85] Similarly, there are over 200 Dutch companies present in India while the same is also conversely true for Indian IT companies.[86] While there has been a reduction in the Chinese and Taiwanese investment due to political reasons, the cumulative FDI inflows is still much higher than most of the nations.[87]

With things for India in terms of commercial aspects going good with the non-Model Law nations, the adoption of the Model Law and the absence of a clear and unbiased reciprocity agreements may lead to the downfall of such economic indicators, affecting the Indian economy. While it may be contended that the economic benefits of the Model Law far outweigh the risks of non-adoption, the need for a proper framework for reciprocity with the non-Model Law nations cannot be denied.

PRACTICAL PROBLEMS WITH THE ILC RECOMMENDATIONS: AN ANALYSIS OF PART DRAFT Z

Pre-initiation exclusion

The ILC in its Draft Part Z, has particularly excluded non-banking financial companies (NBFCs) that have been notified by the Central Government and further in addition to the exclusion of these critical financial companies, the Cross Border Insolvency Rules/Regulations Committee (CBIRC) had recommended the exclusion of utility and infrastructure services. This pre-initiation exclusion of such systematically important companies can prove problematic in the long run, as this would prevent such companies from availing the benefits of the Model Law if it were to be adopted.

The aspect of the CD and a foreign company

An interesting aspect of the Draft Part Z is that cross-border insolvency proceedings can only be initiated against CDs, thus as far as the IBC is concerned, sections 3(7)[88] and sections 3(8)[89] provides the ambit for CDs.

The ILC highlighted that for the purposes of Draft Part Z, a CD would include foreign companies. The Code does not define a 'foreign company' however it allows for the incorporation of definitions from other acts such as the Companies Act, 2013. There are issues however with regards to this definition for instance.

In our current scenario, if a situation arises where a foreign company having a place of business in India is unable to pay off its debts to domestic creditors, the latter may initiate winding up proceedings for the unregistered business under section 375 of the Companies Act, 2013. This inadvertently would lead to a duality of procedure in cases where the debtor is unable to pay off its debts to domestic creditors and does not voluntarily undergo insolvency.[90]

The Ministry of Corporate Affairs (MCA) is yet to notify whether foreign companies would be considered as unregistered companies. Thus, if a foreign company had a subsidiary in India, the subsidiary would constitute a separate legal entity and the shares that the foreign parent company owns would be subject to cross-border insolvency proceedings as envisaged in the case of *Vodafone v. Union of India case*.[91]

Now as per section 2(42)[92] of the Companies Act, 2013 for a company to be considered as a foreign company under IBC, it must have some form of business in India. The problem with such a conception is that it fails to recognize a business setup where in a company with no presence in India may have unpaid domestic creditors. These domestic creditors would be unable to benefit from Draft Part Z as the said companies would not be considered 'foreign companies' as due to the existing definitions, they have no business in India.

This inadvertently leads to the exclusion of a large class of domestic creditors, the CBIRC has recommended to separately define 'foreign companies' under Draft Part Z as it would help in application to entities that are incorporated with limited liability under the laws of a foreign country as originally envisioned under the proviso to clause 1(2), however this recommendation is yet to borne fruit but it is one that is critical to ensure the security of a vital class of creditors to strengthen the cross-border insolvency framework in India.

Clause 2(C) of Draft Part Z: The concept of establishment

Clause 2(c) of Draft Part Z defines establishment, this definition is particularly important as the Model Law limits recognition as foreign non main proceedings to proceedings in countries where the debtor has an establishment. The Committee deliberated on whether the requirement to carry out the economic activity 'with human means' must be omitted from the definition of 'establishment' in order to account for internet-based companies, such as e-commerce companies. In the end the committee did not reach a conclusion as to what amendment is to be made. This is problematic as in the current evolving digital age, if the present definition is to be followed it would completely exclude internet-based companies from the ambit of the UNCITRAL Model Law and by extension Draft Part Z of the IBC. It would thus prevent foreign non main proceedings to be initiated against internet-based companies or companies working in a strictly environment in India.

Article 6 of the UNCITRAL Model Law: Public policy exception

Article 6[93] provides receiving countries the right to refuse to take any action covered under the Model Law, including denial of recognition or relief, if such action would be manifestly contrary to the public policy of the country that receives the application for recognition. Although the UNCITRAL Guide to Enactment recommends that the interpretation of public policy must be narrow several countries such as Singapore have omitted the word 'manifestly'. What this means is that for instance Singapore courts can deny recognition of reliefs granted by Indian courts on insolvency issues, citing 'public policy' issues without adhering to any defined or strict parameters.

Article 9 of the UNCITRAL Model Law: The right to access

Article 9[94] allows foreign representatives to directly seek remedies from the courts in relation to foreign proceedings. This means that formal requirements such as registration, licenses and consular action are dispensed in such situations. The Committee did not deliberate as to what procedure is to be followed with regards to this and rather stated that the onus is on the Central Government to deliberate upon this. A major issue is that foreign lawyers cannot practice law in India. The Committee recommended grouping these foreign representatives into another class of their own but has failed to provide as to what specific regulatory oversight would be applicable to such a class.

POTENTIAL RECOMMENDATIONS FOR ADOPTING MODEL LAW

Legislative reciprocity and certainty

The reciprocity agreements have not been provided by the Model Law to ensure uniformity and certainty in the mechanisms adopted for the resolution of the cross-border insolvency. Moreover, the reason behind the non-inclusion of reciprocity agreements also lies in the fact that such inclusion will practically leave the Model Law operationally ineffective.[95]

However, lately some jurisdictions have deviated from this approach and have adopted the reciprocity agreements along with the Model Law in order to resolve the cross-border insolvencies even with the non-Model Law nations.[96]

In this respect, it is pertinent to note that reciprocity has not been clearly defined in any law and has largely been dependent on the whims and fancies of the party nations. Nevertheless, from a broader aspect, the reciprocity can be classified into two - (a) substantive and (b) legislative.[97] India's approach till today has remained that of substantive reciprocity as per which the foreign proceedings in India will only get limited and conditional recognition depending on the treatment given to the Indian courts by the foreign jurisdictions.

Substantive reciprocity is very similar to the territorial approach and therefore has a lot of practical value due to its inclination towards the elements of 'judicial sovereignty' and 'national interest'. However, substantive reciprocity runs opposite to the principles propounded by the Model Law and those propounded by modified universalism. Furthermore, the adverse economic and political impact on the international plane makes it quite an inefficient choice in the long run.[98]

On the other hand, legislative reciprocity gives recognition to the foreign proceedings only from those jurisdictions which have either adopted the Model Law or have a similar legislation. Therefore, it can be easily inferred that post the adoption of the Model Law, the reciprocity will be built with only those nations which have similar law as India's, thus ensuring both efficiency and harmony.[99] While this mechanism can be criticized on imposing a hard decision on the state thus giving room for discretion to the courts, it is also suggested that some regulations can be framed to provide for a certain mechanism to enforce such reciprocity.[100]

In this regard, classification has to be made between the affinity and non-affinity states like China and Taiwan with whom special long-term agreements should be forged to ensure the rights and welfare of the creditors while maintaining the business in operation. Moreover, more clarity has to be given by providing an effective and clear legal mechanism for not only governing such reciprocity, but also tackling problems regarding the dispute resolution.

Modified universalism and harmony: Learning from the Japanese experience

Since its inception, the modified universalism approach has attracted various commercially successful nations due to its balanced approach. This was also showcased by the enactment of the Model Law by the UNCITRAL to resolve cross-border insolvencies and its subsequent adoption by several big players across the globe over time.

However, if seen from the examples of Singapore and Japan, the adoption of the Model Law has to be brought in harmony with the existing insolvency regime. India being a creditor centric nation, has adopted its insolvency law majorly from the US, UK and Australian regimes which forms the basic principles of the IBC.[101] Therefore, it can be speculated that the common law principles of the Indian insolvency regime will come in the way of a smooth adoption of the Model Law.[102]

Nevertheless, in this respect, the Japanese experience provides ample guidance where the harmony was not brought by a forceful legal transplantation but by a gradual process.[103] This not only helped in its wide acceptance over the country but also helped in comprehending the different approach adopted by the Model Law, thereby bringing greater efficiency in terms of ground level implementation.

With India also marching towards adopting the Model Law to bring greater certainty and uniformity, the Indian courts and Government should take initiative to make the law flexible enough to balance the complexities of the Model Law and the modified universalism.

Moreover, the move of the Government may be criticized on the ground level due to the removal of the safety cap for the creditors. The Japanese experience in this regard, helps the Government to tackle such ground level problems, thereby ensuring a proper and efficient implementation of the Model Law once adopted. Therefore, it is recommended that the adoption of the Model Law should be conducted gradually in stages beginning from the tribunals recognizing the foreign courts and their decisions to framing effective regulations to govern such recognition.

Modification of the term 'Establishment'

If the Model Law is to be successfully adopted, the term 'Establishment' should be modified and the term 'with human means' should be excluded in order to extend the application of Model Law and Draft Z to internet-based companies and companies operating in strictly electronic environments. This is similar to the American Model that has excluded this term.

Public policy and Article 6 of the Model Law

Article 6 notably carves out the public policy exception where in a court of law can refuse to acknowledge a decision taken as per UNCITRAL Model Law if the action is manifestly contrary to the public policy of a state. As stated earlier as per the guide to enactment of the Model Law, UNCITRAL recommends a narrow interpretation of Article 6, this would evidently refer to the retention of the word 'manifestly' while applying the law in Indian context.

However, when it comes to public policy, the Indian landscape is very culturally diverse and much more heterogenous as compared to other legal landscapes where in the UNCITRAL Model law has been applied.

Thus, a narrow interpretation of Article 6 in the Indian context might lead to causing more harm than good. India with its culturally diverse and complex socio environment would be in a much better position incorporating an article that can deal with a wide range of social issues and thus Article 6 should be incorporated in the Indian context by removing the word 'manifestly'. In order to give our courts sufficient judicial breathing space to determine issues of public policy and social interest that demand attention during cross-border insolvency proceedings that would take place following the adoption of the UNCITRAL Model law.

Representation to foreign representatives

As per Article 9, a foreign representative is entitled to apply directly to a court in a state that has adopted the UNCITRAL Model law. This particular provision would thus allow foreign representatives an easier route of legal representation in the concerned states and help the circumvent several judicial measures as well. However, in a country like India with an already overburdened judicial setup, direct representation of foreign entities could lead to a huge increase in claims which would further hinder the insolvency resolution process.

This is in addition to the fact that foreign lawyers cannot practice in India. Thus, in order to ensure foreign representation but also maintain the efficiency of the insolvency process in India; a representative system can be followed, where in rather than direct representation of foreign entities in Indian courts, the concerned foreign representatives are represented through Indian legal channels before the courts of law.

CONCLUSION

Cross-border insolvency proceedings in India have been effectively governed by the territorial approach adopted by the IBC and the laws preceding it. It cannot be denied that India had opportunities to adopt the Model Law in the past as well, the lawmakers saw the substantive reciprocity propounded by the territorial approach to be more relevant at that time as compared to the modified universalist approach.[104] However with the changing times and the commercial stature of the country, India also began producing MNCs which have their operations in various developing and developed countries.[105] With the adoption and implementation of the Model Law still pending in the country, the legislators and policy makers are working towards a more liberal approach in the interest of economic gains.[106]

If seen from the Indian perspective, the hesitation of the legislators with respect to the adoption of the Model Law can be understood from the then socio-economic conditions of the country as well as the then prevalent legal philosophy behind commercial laws. The implementation of the IBC was a major revolution in the Indian insolvency regime which suggested a change in the legal philosophy from creditor centrism to that of group solution and restructuring.[107] Furthermore, the moves of the Government to make the commercial laws more liberalized makes the hesitation unfounded in contemporary times.

However, as the paper suggests, the adoption of the Model Law is not free of challenges. In this regard, the insolvency regime in India still suffers from the inclination of the stakeholders towards the creditor centric model and the territorial approach. Through a comparative study, it has been shown that the bias towards the territorialism can be tackled through understanding the socio-economic conditions and the legal requirements of the country, thus providing an opportunity to adopt the modified universalism while keeping the basic ideals of the insolvency regime intact.

The paper also addressed the biggest practical challenge of such an adoption, that is the issue of jurisdiction and explored the relevancy of the reciprocity agreements for this. While exposing the inherent defects in the current reciprocity framework and propounding for the development of a proper framework to give more certainty, it is concluded that the adoption of the Model Law will not take away the relevancy of the reciprocity agreements and the same will continue the govern the relations between the non-Model Law nations.

The findings along with the relevant recommendations proposed by the authors in this paper are believed to ensure smooth adoption of the Model Law in India, serving both the commercial interests and welfare of the society. In this regard, it should be noted that the recommendations have been made while assuming the adoption of the Model Law in the near future. Furthermore, it is not contended or disputed that modified universalism is the best approach to deal with the cross-border insolvencies.

However, as the modified universalism is uniformly recognized as the most realistic and practically effective among its other alternatives, it is believed that India will also someday or the other adopt the Model Law, thus recognizing the importance of the uniformity and certainty in the system. While the suggestions and analysis of the paper may be said as irrelevant due to no present intention to adopt the Model Law and the analysis being already conducted by the ILC at several instances, the recent developments have shown that there is a still long way to go for the successful adoption and implementation of the Model Law in the country.

[1]UNCITRAL Model Law on Cross- Border Insolvency, 1997.

[2] The Companies Act, 1956 (India).

[3] The Companies Act, 2013 (India).

[4] The Presidency Towns and Insolvency Act, 1909 (India).

[5] The Provincial Act, 1920 (India).

[6] Report of the High-Level Committee on Law relating to Insolvency and Winding up of Companies, 2000.

[7] *Ibid.*, Chapter 6.

[8] *Ibid.*, Chapter 7.

[9] Report of the Advisory Group on Bankruptcy Laws, 2001.

[10] The Income Tax Act 1961 (India).

[11] *Ibid.*, Section 2(26).

[12] Private international law recognises that the fact that majority of shareholders of a company are Indians will not make it an Indian domicile company, even if it is incorporated elsewhere. See, Paras Diwan, "Private International Law", Deep & Deep Publications, 1993, p. 382. *In Re Travancore National etc. Bank Ltd*., (1939) Mad. 318, Rao, J., said that the domicile of a company is the place considered by the law to be the centre of its affairs which in the case of (1) a trading company is its principal place of business, i.e., the place where the administrative business of the corporation is carried, and (2) in the case of other corporations, it is the place where its functions are discharged. In short, the test of domicile of a company is the same under the Indian law as it is under the English law. It should be kept in mind that the domicile of the company is entirely distinct and independent from the domicile of its members or shareholders.

[13] Section 13, CPC.

[14] Section 44(a), CPC.

[15] Section 2(6) defines "foreign judgment" as the judgment of a foreign court. The same section defines a judgment as the statement given by the judge of the grounds of a decree or order. This definition is restrictive and excludes proceedings on insolvency like reorganisation.

[16] Section 234, IBC.

[17] Section 235, IBC.

[18] Report of the Joint Committee on the Insolvency and Bankruptcy Code, 2016.

[19]Insolvency and Bankruptcy Board of India, Report of the ILC, 2018.

[20] Economic Survey, "Monetary Management and Financial Intermediation", Chapter 04, para 4.66 to 4.68.

[21]While the international insolvencies were discussed in the past, it was just a complicated question of private international law. See Becker J. D. (1981), "Transnational Insolvency Transformed", 29 Am. J. Comp.L. 706, 707.

[22]The transnational insolvencies were like 'rare birds' in the pre 1970s as was also highlighted by the long hiatus between the *Swedish Match* and *Herstatt* cases. See Paulo Fernando Campana Filho (2009), "The Legal Framework for Cross-Border Insolvency InBrazil", 32 Hous J Int'l L 97, 102.

[23] Westbrook J (1991), "Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum", 65 Am. Bankr. L.J. 457, 459.

[24]The UNCITRAL model was formulated with the object of promoting the transnational trade and to bring harmony and coordination between the countries for a peaceful and efficient resolution of the cross-border insolvencies. See "UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation", 2014 UN Publ. 31.

[25]The problems rose by the increase in the cross-border insolvencies and their discussions can be traced back to middle ages. In this respect, reference can be taken of the treaty signed between the Verona and Trent for transfer of debtor's assets in 1204 and the Pope's coordination of Ammanati Bank insolvency involving the interests of various European nations like Portugal, Italy, Spain, England, Germany and France in 1302. Furthermore, the first treaty regarding the

resolution of the cross-border insolvency was signed between Holland and Utrecht as back as 1679. For more understanding on the history of the cross-border insolvencies, see Nadelmann K. H., "Conflict of Laws: International and Interstate" (CUP 1972).

[26] Wood P. (1995), "Principles of International insolvency", Sweet & Maxwell.

[27]LoPucki L. (1999), "Cooperation in International Bankruptcy: A Post-Universalist Approach", 84 Cornell L. Rev. 696, p. 742.

[28]LoPucki M. L. (2000), "The Case for Cooperative Territoriality in International Bankruptcy", 98 Mich.L. Rev. 2216, 2218.

[29]Kim C. and Smith J. (1992), "International Insolvencies: An English-American Comparison with an Analysis of Proposed Solutions", 26 Geo. Wash. J. Int'l L. & Econ. 1, 5.

[30]While it cannot be estimated with certainty about the exact time when the paradigm started shifting towards a more liberalised universal approach, the shift had probably occurred following the Bankhaus I.D. Herstatt K.G.a.A., Israel-British Bank (London) Ltd., and Banque de Finacement, S.A. cross-border insolvencies in the mid-1970s. See Charles D. Booth, 'A History of the Transnational Aspects of United States Bankruptcy Law Prior to the Bankruptcy Reform Act of 1978' (1991) 9B.U. Int'lL.J.1, pp. 27-37.

[31]Goode R. (1997), "Principles of Corporate insolvency law", Sweet & Maxwell.

[32]Hill A. (1960), "Governmental Interest and the Conflict of Laws", Univ. Chic. L. Rev. 463.

[33]For a proper scholarly commentary, see Anne Nielsen A. et al. (1996), "The Cross-Border Insolvency Concordat: Principles to Facilitate the Resolution of International Insolvencies", 70 Am. Bankr. L.J. 533, 534.

[34]Ouatu M. (2014), "Modified Universalism for cross-border insolvency: Does it work?", Univ. of B.C.

[35] Supra Note 27, pp. 728-30.

[36]The secondary proceedings, as a system is already prevalent in Switzerland. For a comprehensive understanding on the secondary proceedings, see Hans Hanisch H. (1993), ""Universality" Versus Secondary Bankruptcy: A European Debate", 2 Int'l Insolvency Rev. 151.

[37] Fernandez G. (2021), "Cross-Border Insolvency in India: A Resistance to Change", 29 Tul J Int'l & Comp L 99.

[38] Bankruptcy Code 1978, section 1501 (US).

[39] Report of the Commission on Bankruptcy Laws of the United States, (1973) Part I.

[40] Bankruptcy Code, sections 1501 and 1519 (US).

[41] Bankruptcy Code, section 1517 (US).

[42]As per the EU jurisprudence, the COMI is presumed to be that region or country where the registered office of the company or the business it situated. The same was propounded in the cases of *In re SPhinX Ltd.*and*In re Tri-continental Exchange Ltd*.See *U.N. Commentary on Int'l Trade L., Insolvency Law: Interpretation and application of selected concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to centre of main interests*,(2011) U.N. Doc.A/CN.9/WG.V/WP.99, 3.

[43] Bankruptcy Code, section 1519 (US).

[44] Montineri C. (2019), "The United Nations Commissions on International Trade Law (UNCITRAL) and the Significance of the Singapore Convention on Mediation", 20 Cardozo J Conflict Resol 1023.

[45]Companies Act 1967, section 354B and Sch X; Insolvency, Restructuring and Dissolution Act 2018, Part 11 and Sch III.

[46] This is particularly evident through the Article 6 of the IRDA as per which an exception is provided for the public welfare. Moreover, creditor centric provisions have also been retained. See IRDA, Art 22 and 23.

[47]Yeo V. and Gan P.(2006), "Insolvency law in Singapore", Roman Tomasic ed, Insolvency Law in East Asia, Ashgate.

[48]Mannan M. (2016), "Are Bangladesh, India and Pakistan Ready to Adopt the UNCITRAL Model Law on cross-border Insolvency", 25 Int'l Insolvency Rev 195, pp. 204-206.

[49]See Insolvency & Public Trustee's Office press statement, 'Changes to bankruptcy regime to cultivate a calculated risk-taking culture and foster a climate of greater tolerance for failure', Annex A para 2,. Also see, Lee Suet Lin Joyce, 'Is Singapore's insolvency regime excessively pro-creditor' (2003) 12 Int'l Insolvency Rev. 37.

[50]Warren E. and Westbrook J. (1996), "The law of debtors and creditors", Aspen, p. 886.

[51]For a comprehensive understanding on the working of the Japanese insolvency code in practice, see Anderson K. (2000), "The Cross-Border Insolvency Paradigm: A Defense of the Modified Universal Approach Considering the Japanese Experience", 21 U Pa J Int'l Econ L 679; Horikoshi H. (2003), "Guide to Japanese Cross-Border Insolvency Law", 9 Law& Bus.Rev.Am. 725.

[52]This was reflected more clearly *In re Kojima* case where it was held that Japanese rules and insolvency priorities are consistent with the US model. Also see, Frank Bennett, Jr., Preference Rules in Japanese Bankruptcy Law, in Hiroshi Oda ed., Japanese Commercial Law in the era of Industrialization (OUP 1994).

[53] Among the larger and more notorious Japanese insolvencies in the 1990s are Maruko (1991); Ken International (1991); Kizu Credit Bank (1995); HyogoBank (1995); Hokkaido Takushoku Bank (1997); Yamaichi Securities (1997); Mita Industrial (1998); Nippon Credit Bank (1998); the Long-Term Credit Bank and its subsidiary Japan Leasing Corporation (1998); Nagasakiya (2000); and Sogo Department Store (2000). For a comprehensive understanding, see Stacey Steele, 'Insolvency Law in Japan' in Roman Tomasic ed, *Insolvency Law in East Asia* (Ashgate 2006).

[54]Supra Note 51, pp. 739-750; Sakai H. et al. (2018), “Reflections on a Revolution in Japanese Business Restructuring Proceedings: An Insolvency Practitioner’s Perspective of the Early 21st Century and Future of Japanese Insolvency Law”, 92 Am Bankr LJ 387.

[55]It is pertinent to highlight that many major common law countries like USA, UK, Canada and Australia have changed their domestic law on the lines of cross-border insolvency cooperation. See Andre J. Berends, ‘UNCITRAL Model Law on Cross-Border Insolvency: A Comprehensive Overview’ (1998)6 Tul. J. Int’lComp. L. 309; Jenny Clift, ‘UNCITRAL Model Law on Cross-Border Insolvency - A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency’ (2004)12 Tul. J. Int’l & Comp. L. 307;IritMevorach, ‘On the Road to Universalism: A Comparative and Empirical Study of the UNCITRAL Model Law on Cross-Border Insolvency’ (2011) 12 Eur. Bus. Org. L. Rev. 517.

[56]Seth D. (2022), “Multinational Companies optimistic about India’s growth prospects, CII survey shows”, *Livemint,* October 17.

[57]See Chikr I. and Cosset J. (2001), “Diversification strategy and capital structure of multinational companies”, 11(1) J Multi Fin Mgmt 17, 24.

[58]It should be noted that the Model Law has not achieved the same level of acceptance as compared to other UNCITRAL instruments like the Vienna Convention on the International Sale of Goods. However, it has still outperformed many other instruments like the 2001 New York Convention on the Assignment of Receivables in International Trade. See Smith E. (2016), “The UN Receivables Convention Goes to the Senate”, *Morgan Lewis,* February 17.

[59]It is important to understand that the recommendation of ILC was contrary to the report of the UNCITRAL Working group on Model Law. See Report of the Working Group on Insolvency Law on the Work of its 20th Session (Vienna, 7-18 October 1996). Nevertheless, the ILC made the recommendation while considering the socio-economic conditions of the country.

[60] Supra Note 16 and 17.

[61]Chatterjee S. & Chandani R. (2021), “Comparative Jurisdictional Study of Cross-Border Insolvency”, 1 Law Essentials J 155, 161-64.

[62]See Yamauchi K. (2007), “Should reciprocity be a part of the UNCITRAL Model Cross-border Insolvency Law?”, 16(3) Int’l Insol Rev 145, 167.

[63]*Ibid*. Also see, Meredith E. (2017), “Bilateral Insolvency Agreements: A Two-Sided Solution for Reciprocity in Cross-Border Insolvency”, 8 Geo Mason J Int’l Com L 379.

[64]The cost benefit analysis is an economic analysis as per which the costs or the cons and the benefits or the pros are treated in a quantifiable manner for a tangible comparison. The concept however supports the classic economical assumption that every individual is a rational being in the sense that he will choose only that option for maximizing its own utility or welfare. For a detailed understanding on the Cost Benefit Analysis and the Rational choice assumption, see Donald M. Taylor et al., ‘Cost Benefit Analyses for your group and yourself: The rationality of decision making in conflict’ (2004) 15(2) Int’l J Con Mgmt 110.

[65]Amend A. (2022), “Restructuring and Insolvency in Germany”, CMS Legal.

[66]*Ibid*. Also see, Kamlah K. (1996), “The New German Insolvency Act: Insolvenzordnung”, 70 Am Bankr LJ 417.

[67] See Vishal Vyas V. (2019), “Jet Airways Cross-border Insolvency Proceedings”,*M&A Critique*, November 1.

[68]Khatavkar P. (2021), “India’s Rendezvous with Cross-Border Insolvency and Its Suggested Marriage to the UNCITRAL Model Law on Cross-Border Insolvency”, 4 Int’l JL Mgmt & Human 1209.

[69] *Ibid*.

[70] It was held that Russian judgment had territorial force only and the legal effects attached to the pursuant to Russian law could not be invoked in the Netherlands. See Barbara F.H. Rumora- Scheltema, ‘The Dutch Supreme Court Yukos Rulings: From Territoriality to Universality’ (2015) 12 Int’l Corp Rescue 112; for a better understanding of the case and its aftermath.

[71]Liu R. (2016), “Seeing the Elephant: Taiwan’s Challenges and Opportunities in India”, 16 Pros J 49, 62-74.

[72]See Francis A. and Andrews N. (2006), “Insolvency law in Taiwan: The Interplay between official and unofficial law”, Roman Tomasic , Insolvency Law in East Asia, Ashgate 2006, pp.148-151.

[73] Tomasic R. et al. (2009), “Insolvency Law Administration and Culture in Six Asian Legal system”, 6 Aus J Corp L 248, 276.

[74] Harmer R. (1996), “Insolvency Law and Reform in the People’s Republic of China”, 64 Fordham L Rev 2563.

[75]Supra Note 62, pp. 163-169.

[76]Parisi F. And Ghei N. (2003-2004), “The Role of Reciprocity in International Law”, 36 Cornell Int’l L J 93.

[77]A foreign proceeding is enforced in India if it fulfils the conditions mentioned under Section 13 of the Code of Civil Procedure, 1908.

[78]Supra Note 37, p. 111.

[79]Makharia N. (2020), “The Dire Need for an Elaborate Framework for Cross-border Insolvency in India”,*IBC Laws,* July 24).

[80]"A Short History of Indian Economy 1947-2019: Tryst with Destiny and Other Stores”, *Livemint,* August 14, 2019.

[81] More than 1700 German companies are active in India, providing around 400,000 direct and indirect jobs. Also it is important to note that Germany is the 7th largest foreign direct investor in India and Germany’s total foreign direct

investment in India from 2000 until June 2020 amounted to approx. USD 12 billion. 'Indo-German Economic Relations' (*German Missions in India* 2022).

[82] In FY 22, the Netherlands was India's fifth largest export destination, a leap from its 10th position just the year prior as Indian exports jumped 94 percent. 'India-Netherlands Relations' (*Embassy of India, The Hague* 2022).

[83]The relationship gained substantial momentum after Taiwan decided to initiate a "New Southbound Policy", which synchronized well with India's latest "Act East Initiative". Also at present, India and Taiwan started negotiations for a free trade agreement (FTA) in December 2021 which is a significant step towards a deeper and broad-based bilateral economic engagement. See Tanvi Madan, 'The India opportunity for Taiwan' in Tania Garcia-Millan et al. eds., *Perspectives on Taiwan* (CSIS 2019).

[84]Here it is important to highlight that during 2021, the overall trade with China saw an increase of 43.2% over the same period last year, with our exports reaching USD 28.03 billion (increase of 34.3%) and imports reaching USD 97.58 billion (increase of 46.12%). 'Trade and Economic Relations' (*Embassy of India, Beijing* 2022).

[85] Indian corporate entities have invested over EUR 6.5 billion in Germany, especially in sectors of IT, automotive, pharma and biotech. See German Missions in India, (n 81).

[86]There are over 200 Indian companies present in the Netherlands, including all the major IT companies such as TCS, HCL, Wipro, Infosys, Tech Mahindra as well as Sun Pharmaceuticals and Tata Steel. Mishra A. R. (2022), "Netherlands jumps 5 places to become India's 5th largest export destination", *Business Standard*, 16th May.

[87]For a comprehensive discussion on the trilateral trade relations between India, China and Taiwan, see Abhijit Mukhopadhyay, 'India Taiwan FTA in the making' (*ORF* 30th May, 2022).

[88] Section 3(7), IBC.

[89] Section 3(8), IBC.

[90] Section 375(3)(b), The Companies Act, 2013.

[91] MA 434 (2021).

[92] Section 2(42), The Companies Act, 2013.

[93]UNCITRAL Model Law on Cross-border Insolvency 1997, Article 6.

[94]UNCITRAL Model Law on Cross-border Insolvency 1997, Article 9.

[95]This thinking is mainly developed due to the South African model of reciprocity where a lack of certainty and a robust mechanism of reciprocity has made the Model Law dead letter. See Smith A. and Boraine A. (2002), "Crossing Borders into South African Insolvency Law: From the Roman-Dutch Jurists to the UNCITRAL Model Law", 10 Am. Bankr. Inst. L. Rev. 136, 190.

[96] The ILC report cites South Africa, Mexico and Romania as three jurisdictions which have included a reciprocity requirement in their legislation incorporating the Model Law. See Report of the Insolvency Law Committee on Cross-border insolvency (MCA 2018), 18.

[97]See Chakraborty S. (2020), "Reciprocity Requirements in India's Adoption of the UNCITRAL Model Law on Cross-border Insolvency", IndiaCorpLaw.

[98]See Handa H. (2018-19), "Orchestrating the UNCITRAL Model Law on Cross-Border Insolvency in India", 1 Int'l J.L. Mgmt. &Humans 3.

[99] Supra Note 97.

[100]It is pertinent to highlight that a part of the ILC recommendations is to adopt the Model Law with the reciprocity clause. See Sinha R. (2018), "Insolvency Law Committee on Cross-Border Insolvency", *PRS India*, November 1.

[101] Kukreti A.(2021), "Insolvency Reforms in India: History, Growth and Cross-border Issues", 4 Int'l JL Mgmt & Human 2820.

[102]While the Model Law can be said to be largely based on the European civil law principles, the common law principles do not hinder its adoption. This is also evident from the fact that various common law countries like USA, UK, Australia, New Zealand and Canada have successfully adopted the Model Law. See Mason R. (2012), "Cross-Border Insolvency and Legal Transnationalism", 21 Int'lInsolvency Rev. 105.

[103]A non-uniform approach can be seen to be taken by the Japanese courts since the decision in International Management Business *K.K. v. Fincamera S.A.* in 1981 where the territorial approach was upheld. Nevertheless, the approach gradually shifted through a purposive and broader interpretation of the Japanese insolvency code to give recognition to foreign proceedings which gave the much-needed base for the adoption of the Model Law. See e.g. *In re, Bank Uoremu*, 1589 *In re, Hanrei Jiho*, 86; *In re, Kojima*, 177 B.R. at 701-02; Taniguchi Y. (1987), "International Bankruptcy and Japanese Law", 23 Stan. J. Int'l L. 449, pp. 461-62.

[104] Singh S. (2019), "Duality of Regime to Handle Insolvency of Foreign Companies in India", 10 Indian J.L. & Just. 155, pp. 156-59.

[105]Kumar N. (2007), "Emerging TNCs: trends, patterns and determinants of outward FDI by Indian enterprises", 16(1) Transnational Corporations 1.

[106]Kaushal A. and Gurjer S. (2018), "Implications of India Adopting the UNCITRAL Model Law on Cross-Border Insolvency", IndiaCorpLaw.

[107]I. Kokorin (2021), "The Rise of 'Group Solution' in Insolvency Law and Bank Resolution", 22 Eur Bus Org Law Rev, pp. 781–811.

25 IMPACT ASSESSMENT OF AVOIDANCE TRANSACTIONS UNDER IBC

- Ravindra Beleyur

EXECUTIVE SUMMARY

This paper is an attempt to understand impact assessment of avoidance transactions in revival and liquidation processes conducted as per the Insolvency and Bankruptcy Code, 2016 (IBC/ Code). Insights are drawn from judgements made in avoidance transaction petitions and analysis of data available about all processes which have resulted in liquidation and successful resolutions up to a particular date. Issues and challenges related to avoidance transaction and recommendations to address the same are also listed in the paper along with constraints as well as scope for future research.

Keywords: Avoidance Transactions, Preferential, Undervalued, Extortionate, Defrauding Creditors, Wrongful Trading, Fraudulent Trading, Impact Assessment.

INTRODUCTION

Equal and equitable distribution of realisations on *pari-passu* principle among all the creditors during the revival process of an insolvent debtor or liquidation process of a debtor is the primary objective of collective proceedings under bankruptcy/insolvency law across the globe. In most of the insolvency cases, all the creditors including the secured creditors end up in getting paltry sums. The shortfall for these creditors could be attributed to the erosion of value of a debtor. Such an erosion could happen for genuine economic/business reasons as well as on account of intentional acts of the promoters, directors and management many times with ulterior motives. Erosion of value of a debtor because of genuine business/economic reasons is understandable since there is always risk involved in any business. However, erosion of value of a debtor because of ulterior motives to make sure that assets of the debtor are taken away to deny the genuine rights of creditors is unacceptable and unlawful. This is the reason for including powers for claw back or transaction avoidance actions in any insolvency/bankruptcy law.

INDIAN LAW – IBC

Sections 43 to 50 and section 66 of the IBC deal with preferential, undervalued, fraudulent and extortionate transactions (PUFE). PUFE transactions are prejudicial to the interest of a corporate debtor (CD) and all the creditors of the CD.

Insolvency Professional (IP) has a duty to ensure enhanced recovery to all creditors and maximization of the value of the assets of the CD by filing appropriate applications before the Adjudicating Authority (AA). In terms of the provisions of regulations and the Code, IP is required to determine avoidance transactions, form an opinion and file an avoidance application with the AA within a specified time frame, for necessary relief.

The IBC requires an IP to scrutinize PUFE transactions where look back period is one to two years for certain transactions based on whether it is with unrelated party or related party and without any look back period where fraud is involved, for value maximisation.

Diversion/siphoning of CD's funds/assets as well as gross negligence in not protecting CD's interest and the interest of all stakeholders is not uncommon when many promoter directors foresee impending insolvency / bankruptcy of such CDs. Realising this critical aspect, on a continuous basis, the Insolvency and Bankruptcy Board of India (IBBI) has brought in various amendments related with implementation of IBC to strengthen the effectiveness of IBC. While the law empowers an IP, it also casts a duty on him/ her for timely identification of transactions and seeks reliefs from the AA. It is pertinent to note that while IPs are expected to exercise their appropriate professional judgment and diligence to undertake evaluation, they may require assistance of independent experts in examination and quantification of complex transactions, and they do take support of forensic audit professionals.

OBJECTIVE

In this research, the author intends to examine the impact assessment of avoidance transactions under IBC. In general, the creditors are forced to take quite huge haircuts in successful resolutions which have happened under IBC after the statute was implemented with effect from December 1, 2016. Haircuts have happened since liquidation values of such CDs have been far less than the total admitted claims. It is not uncommon that reasons for such a big gap between the high value of admitted claims and the low value of liquidation values could be due to the fact that lot many such CDs were defunct much before the corporate insolvency resolution process (CIRP) was initiated and also on account of many avoidance transactions done by promoter directors/fraud inflicted on the CDs. There is a need to understand the reasons for huge gap between the values realised and the admitted claims of many of the successful resolutions as well as in liquidations and find out how much of this gap or shortfall could be attributable to avoidance transactions.

In this connection, the author has initiated this study with an endeavor to examine:

- whether Resolution Professionals (RP)/Liquidators have been able to trace avoidance transactions, wherever there are such shortfalls and filed appropriate applications;
- even when RPs/Liquidators have identified avoidance applications and filed appropriate applications, whether appropriate orders have been passed within a reasonable time frame by the AAs;
- when such orders have been passed by AAs, have they got challenged before Appellate Authorities; and
- whether such favourable orders regarding avoidance transactions have got executed and whether concerned creditors have been able to get any benefit out of such execution of favourable orders.[1]

This kind of impact assessment needs to be done on a continuous basis. This would facilitate identifying issues faced in each of the stages and would ultimately help in addressing the issues from a multi-disciplinary perspective. As a result, there could be substantial scope for behavioral change in attitudes and approach of the promoter directors in the long run; this ultimately can give lot of trust and confidence in the system for investment which could provide impetus to growth financing through equity and credit markets – which could include foreign direct investment.

INDIAN EXPERIENCE – RESEARCH FINDINGS

The author has done research on the data available in public domain, data collected from IBBI and review of the orders passed by AA, National Company Law Appellate Tribunal (NCLAT) and Hon'ble Supreme Court. Observations on author's review of data and orders are listed under the two broad headings of analysis of data and review of orders in the following sections.

Analysis of data

The value of avoidance transactions applications filed till December 31, 2022 is to the tune of ₹ 2.83 lakh crore; the value of applications disposed turns out to be about ₹ 41,300 crore whereas the value of favourable orders being only about ₹ 5,000 crore.

Table – Gist of avoidance applications filed/disposed till December 31, 2022[2]

(₹ in crore)

Sl.	Nature of transactions	Applications Filed		Applications Disposed		
		Number of transactions	Amount involved	Number of transactions	Amount involved	Amount clawed back
1	Preferential	132	15054.37	34	603.13	31.47
2	Undervalued	17	884.78	3	355.76	-
3	Fraudulent	165	63738.09	20	1024.81	3.90
4	Extortionate	3	70.68	-	-	-
5	Combination	530	203145.84	86	39330.63	5048.08*
Total		**847**	**282893.76**	**143**	**41314.33**	**5083.45**

*In the matter of Jaypee Infra, possession of 758 acres out of total 858 acres of land was given back to the CD. The 858 acres of land was earlier valued at ₹ 5,500 crore. Therefore, proportionate value is considered.

The author has analysed the data obtained regarding processes which yielded successful resolutions and which resulted in liquidations till June 30, 2022 as reported by IBBI in their quarterly newsletter for the quarter ended June 30, 2022 and data obtained regarding avoidance transactions shared by IBBI (which included data regarding dates of filing applications and dates of passing orders wherever available). Some observations drawn from the analysis are listed below:

- A total of 2220 CIRPs yielded successful resolutions or ended up in liquidation process. Out of 2220 CIRPs, 517 cases (23%) yielded successful resolutions and the remaining 1703 cases (77%) ended up in liquidation process. The admitted claims in these 2220 CIRPs are ₹1.6 million crore.
- 517 CIRPs were conducted by 329 IPs resulting in successful resolutions yielding resolution plan value of ₹ 235 thousand crore against the total admitted claims of ₹ 767 thousand crore. This essentially means that all the creditors together had to take a haircut of ₹ 532 thousand crore – i.e., about 69% of their admitted claims.
- Of the above 517 successful CIRP cases, 175 (34%) were defunct as on the date of commencement of CIRP and yielded resolution plan value of about ₹ 15 thousand crore (6.2% of the total realisation of successful CIRPs).
- Of the 517 successful CIRPs conducted by 329 IPs, 119 IPs have filed avoidance applications in 153 CIRPs and the haircut taken by the creditors is to the tune of about ₹ 268 thousand crore in these 153 CIRPs which translates to a haircut of 64%. In respect of these cases, IPs have filed avoidance applications for about an amount of ₹ 37 thousand crore. There have been favourable orders in respect of five cases to the tune of only ₹ 39.41 crore. Similarly, there have been unfavourable orders passed in 26 cases and in 122 cases, adjudication is still going on.

- Of the above 1703 CIRPs ending in liquidation conducted by 794 IPs, the admitted claims for all the creditors are to the tune of about ₹ 820 thousand crore. Of the1703 CIRPs conducted by 794 IPs ending in liquidation, in 328 CIRPs (19% of liquidation cases) conducted by 251 IPs (32% of IPs), avoidance applications have been filed; the admitted claims for all the creditors in these 328 cases is to the tune of about ₹ 334 thousand crore.

- Of the 1703 CIRPs ending in liquidation, dissolution orders have been passed in 261 cases and realisation value is available only for 151 dissolved liquidation cases. The value realized in these 151 dissolved cases is about ₹ 2 thousand crore against the admitted claims of ₹ 38 thousand crore which essentially mean that creditors in these cases had to take a haircut of 94% of their admitted claims. In respect of these dissolved liquidation cases, 14 IPs have filed applications for avoidance transaction in 14 dissolved cases for a value of ₹ 1,385 crore. Of these applications filed, two cases have been disposed with a direction for investigation by the Ministry of Corporate Affairs (MCA) and five cases have been dismissed and in the remaining seven cases, adjudication is going on.

- Of the 1703 CIRPs ending up in liquidation, 1442 liquidations have not yet ended in dissolutions which have been conducted by 726 IPs and admitted claims in these cases is to the tune of about ₹ 767 thousand crore. In respect of these liquidation cases, 236 IPs (33% of IPs) have filed applications for avoidance transaction in 310 liquidation cases (22% of the cases) for a value of about ₹ 125 thousand crore (16% of the admitted claims). Of these applications filed, nine cases have been disposed favourably for a contribution of ₹ 21.08 crore with a direction for investigation by the MCA and 26 cases have been dismissed and in the remaining 275 cases, adjudication was still going on.

- 813 avoidance applications were filed for a total value of about ₹ 229 thousand crore. In 332 number of CDs in which CIRPs is still going on, IPs have filed avoidance applications for a value exceeding ₹ 63,000 crore; of which there have been favourable orders in three cases for a value of about ₹ 5,050[3] crore and unfavourable orders in respect of 21 cases; 309 cases are still going on.

- Out of 813 cases of avoidance applications filed, orders are passed in 99 cases and a total of 83 unfavourable orders have been passed; favourable orders have been passed only in 16 cases during the last five years.

- It is significant to note that the value of total admitted claims is to the tune of about ₹ 838 thousand crore in respect of 1739 CIRP cases which yielded successful resolutions or ended up in liquidation for which no avoidance applications have been filed by 773 IPs.

- Of the above total 517 successful CIRPs, in 364 CIRPs conducted by 255 IPs, the haircut taken by the creditors could be at least to the tune of about ₹ 226 thousand crore assuming of 64% haircut. No avoidance applications have been filed in respect of these cases.

Number of days for disposal in respect of 96 avoidance applications and days taken till November 17, 2022 in respect of 689 applications which were still going on:

- Average time taken per application for disposal of 96 avoidance applications is 542 days.

- Average time taken per application for disposal has been reducing year on year from 606 days in 2018 to 304 days in 2021.

- Average time per application in respect of avoidance applications not yet disposed as on November 17, 2022 upto that date is 959 days.

- Average time taken by an IP for filing avoidance applications from the CIRP commencement date upto November 17, 2022 is 320 days.

- Average time taken by an IP for filing avoidance applications from the CIRP commencement date till November 17, 2022 has increased from 244 days during 2018 to 348 days during 2020 and 433 days during 2021 possibly on account of the impact of COVID-19 pandemic and it has reduced to 297 days during 2022 upto September, 2022 (the last of date of filing as per the data available).

There is no doubt that the COVID-19 pandemic also has also been one of the major reasons for the delays in adjudication process.

Review of orders passed by AAs

The author has gone through 70 orders passed by AAs/Appellate Authorities under IBC, Hon'ble High Courts and Hon'ble Supreme Court of India related with avoidance transactions.

Some of the relevant observations, reasons/ rationale for passing favourable or unfavourable orders are as per the *Exhibit-1*.

Significant Findings

a) No avoidance applications have been filed in more than 78% (1739 of 2220) of the CIRP cases which yielded in successful resolution or ended in liquidation during the period from December 1, 2016 until June 30, 2020.

b) Of the 897 IPs who conducted 2220 cases, 64% of the IPs did not file any avoidance applications in 1739 cases.

c) Of the 813 avoidance applications filed, only about 12% of the applications (99 in numbers) were disposed off during a time span of six years.

d) Of the 99 avoidance applications disposed off, there have been favourable orders only in 16% of such disposals (16 in numbers) and the value of such favourable orders is only to the tune of about ₹ 5,000 crore.

e) There have been significant delays in adjudication of avoidance applications.

f) Many avoidance applications have been dismissed in view of *Venus Recruiters judgement* in light of the non-adjudication of avoidance applications before the approval of the resolution plans.

g) Dismissal of avoidance applications for non-prosecution by IPs.

h) Huge disclaimers by forensic auditors / transaction auditors in their reports.

i) Lack of material evidences to prove the avoidance transactions including 'high degree of proof', which is attached to the 'fraudulent intent'.

CHALLENGES FACED BY IPs IN FILING AVOIDANCE APPLICATIONS

The IPs do face many challenges related with investigation into the affairs of the CD, identifying, determining and filing applications related with of the avoidance transactions. The challenges faced are not listed in any specific order though many IPs consider lack of information/ data as a very important constraint.[4]

a) Lack of availability of information/data limitation/obtaining documentary evidences to prove the transactions: The information/ data for any avoidance transaction need to emanate mainly from data/information connected with the books of accounts and the supporting evidence to such books of accounts maintained by a CD. In many instances, books of accounts do not get handed over by the ex-directors/ management to IPs and even when there are directions from AA after IPs file appropriate applications under section 19(2) of IBC.

b) **Inability of IPs to take physical custody and control of assets/documents of CDs:** The author has personal knowledge of a few cases (who have corporate/ banking experience) where IPs after they have been appointed as IRP, RP or Liquidators have not cared to take physical custody and in a few cases never even to visit important business places like the only factory of the group which is the only real going concern business where all operations of manufacturing and selling is going on. It is not out of context to mention that in some of the disciplinary cases on IPs, disciplinary committee of IBBI has noticed that no applications seeking cooperation was filed under section 19(2) of IBC.

c) **Time constraints for investigations/ getting effective forensic audit reports:** Delay and non-receipt of all data also results in delay in investigation by IP, forming a prima facie opinion and take a decision in getting the forensic auditor appointed and also in getting an effective forensic audit report.

d) **Lack of funds or/ and non-approval/ non-ratification of expenses to be incurred or incurred by CoC for appointing forensic auditor:** It is IP's sole responsibility to get a forensic auditor appointed when she/he finds such a need for supporting her/his prima facie view; but authority to approve the cost of such forensic audit vests with the committee of creditors (CoC) and there are cases when CoC is unwilling to approve the cost of the forensic audit especially when such CD is defunct and it is the members of CoC who think that they need to put good money after the bad money. Issue of lack of funds could also be a major matter especially for continuing litigation after approval of a resolution and after dissolution in cases of liquidation.

e) **Delays at NCLT for adjudication:** The author does acknowledge that COVID-19 pandemic has affected adjudication of litigations pending before all courts, tribunals and other forums delivering justice to all litigants. This has affected all NCLTs also. The issue of huge pending cases along with some delays in appointment of members of NCLTs has resulted in delays in adjudication of cases before NCLT in general and more so in respect of avoidance applications.

f) **Uncertainty of continuing applications after the plan is approved by CoC:** *Venus* order has added this uncertainty though that order is not applicable in all cases yet AAs have considered this as a major reason for dismissing many avoidance applications.

g) **Estimating value of PUFE transactions:** All PUFE transactions are not very straight forward ones where IPs know the exact amount which has gone out of the system and a pre-determined interest to be added to such diverted/ siphoned off amounts. It is hard to determine the value in cases where the major part of the business or the whole business itself is shifted where the benefits are denied to the CDs during the remaining period in which the transferee of the business would enjoy for an infinite period or for the remaining part of life cycle of such businesses; the case in point could be like in a *Net 4 India* case discussed earlier.

h) **Capability issues related with IPs**. It is a fact that not all IPs were well equipped to understand the possibility of avoidance transactions since they had come from various backgrounds which did not necessarily have anything to do with financial analysis and understanding on a day today basis and many practising professionals did not have knowledge of running a business and its intricacies.

WAY FORWARD

It is seen from the above study that the implementation of the law related with avoidance transaction has not been very impactful during the infancy of six years of IBC. It is not that it is an exceptional situation in India only. It is stated in a paper published in the year 2000 related with impact assessment of avoidance transactions in UK and Australia[5] that it was felt that the petitions filed related with avoidance transactions were not yielding expected results since the law was not assisting Liquidators and Trustees in UK; contrarily, the related law in Australia was assisting Liquidators and Trustees much better than at UK. The author is of the view that there is a need for action from various stakeholders like IPs, IBBI/IPAs, NCLTs and the Government to improve the current situation. Some of the thoughts of author related with the matter are listed as follows:

IPs

Reconciliation of admitted claims to fair market value whatever could be ascertained

IP has a duty to find out the reasons for the insolvency of the CD. IP should be in a position to reconcile the value of the total admitted claims of all creditors with the fair market value of the CD and whenever there is a huge gap between the two, she/he should be able to explain with the plausible reasons which could be on account of genuine business collapse in view of economic/ business conditions beyond the control of directors and management and if there is any further gap after finding these valid reasons, it could be on account of PUFE transactions which the IP needs investigate and ascertain. An indicative template of such reconciliation which an IP could do is similar to *Exhibit-2*.

Importance regarding physical custody and control

Every IP once appointed as IRP, RP or Liquidator needs to make every endeavor to take physical custody and control of the CD as early as possible without any fuss without any excuse of the business location being away from her/his headquarters or any other reasons. Taking of immediate custody and control could help in avoiding any possibility of losing some of the critical documents as well as any key employee who may leave within a short time after commencement of CIRP. If the IP is not able to get the physical custody and control, she/he should immediately file an appropriate application regarding non-cooperation under section 19(2) of IBC with the rule 11 of NCLT Rules, 2016 and insist AA to pass an order under its discretion.

Identification of 'twilight period'

IPs need to investigate and endeavor to identify the twilight period and a certain date / period by which directors knew that initiating CIRP of the CD was imperative and they failed to be diligent in taking appropriate action to avert the financial crisis further and also file an appropriate application to initiate CIRP if it were to be the only choice as such.

Endeavor to file with more diligence and obtain maximum evidential documents as far as possible

IPs need to be much careful and diligent in collecting evidential documents and filing such valid documents when filing their applications instead of just relying on the transaction/ forensic audit reports.

Timely filing of applications for avoidance applications

There is a tendency among many IPs that avoidance applications are filed only after they receive transaction/forensic audit reports. The author is of the view – based on his experience that it is not necessary for any IP to wait for the final transaction/ forensic audit report in all cases. It is possible for IPs to file avoidance applications as and when they notice any major avoidance transaction – e.g., if an IP notices that funds have been transferred to promoter directors and related parties two years before CIRP commencement and may be also after CIRP commenced but before or even after IRP took custody and control and it is very obvious, she/he should go ahead and file relevant applications without waiting for all the avoidance applications to be filed at one go.

IPs to revive avoidance applications dismissed by AAs based on Venus earlier order

Many avoidance applications have been dismissed by AAs just by quoting earlier *Venus* order or drawing inferences based on the same without looking into the merits of the specific cases and there are cases where IPs themselves have withdrawn cases or preferred not to continue to prosecute based on the earlier *Venus* order. Now that, the earlier *Venus* order has been overturned by a larger bench, concerned IPs need to revive such dismissed, withdrawn/ non-prosecuted avoidance applications.

IBBI/ IPAs

Regulatory bodies like IBBI and IPAs have a huge role to play in developing and improving the insolvency ecosystem. There is no doubt about these regulatory bodies having been alert in watching the development on a continuous basis and having taken appropriate actions from time to time.

The IBBI had realized regarding non-filing of avoidance applications and bottlenecks/ challenges faced by IPs to investigate and come to a prima facie opinion and recognizing these issues, IBBI has proactively brought many amendments to IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations), circulars and taken initiative to amend IBC also through a consultative process.

Very significant changes made to inculcate a behavior to file avoidance applications in a timely manner and also to support IPs to obtain information/ data could be listed as follows:

- Regulations specifying timelines for filing avoidance transactions
- Filing of forms related with compliance more specifically in respect of
    - taking custody
    - filing application related with non-cooperation
    - filing of PUFE transactions
    - filing of a separate form if compliance related with certain aspects not done within the timeline – including for PUFE transactions
- Empowering IRP/RPs by specifically mentioning about data/information support could be taken from financial creditors, auditors etc., in CIRP Regulations
- Issuing a detailed document related with red flags connected with avoidance transactions to create more awareness
- Imposing higher penalty than many other non-compliances for non-filing of avoidance application where required
- Fixing a maximum cap of CIRP assignments to be undertaken by an IP at a given time to 10 CIRP assignments
- Taking disciplinary actions against IPs whenever there have been contraventions related with filing of avoidance transactions apart from many other issues.

It is not out of place to mention that all the three IPAs have been conducting training, workshops, seminars related with avoidance transactions as capability building measures for all IPs on a very continuous basis. The Indian Institute of Insolvency Professionals of ICAI has come out with draft related with 'Avoidance Transactions under IBC – improving outcomes' by forming a study group which is not yet released.

IBBI and IPAs need to have an exclusive research section to monitor the effectiveness of filing of avoidance transactions by IPs for better compliance and better outcome. IPAs have been thinking of peer review of IPs and it needs to get implemented in an effective manner at the earliest for members of all the three IPAs.

IBBI could take measures to initiate regulating of transaction/ forensic auditors related with IBC matters on a similar line as Registered Valuers (RVs) since there have been many issues related with transaction/ forensic auditors' reports during the adjudication of avoidance applications, until a separate regulatory body is formed for regulating transaction/ forensic auditors.

Government of India

Government of India could make some important amendments to IBC to bring more clarity to avoid ambiguity and also for improving effectiveness of realisations from avoidance applications.

Amendments

a) Burden of proof

It may be appropriate for bringing an amendment regarding the burden of proof shifting to the ex-directors and ex-management especially when the transactions are with related parties. Similarly, if the ex-directors and ex-management do not handover all documents including books of accounts as well as related supporting documents in a professional manner, then also the burden of proof should be on the ex-directors and ex-management irrespective of whether the transactions are with related parties or otherwise.[6]

b) Introduction of a section which makes the directors' personal liability unlimited if they have not kept the books of accounts and failed to prepare financial statements

Section 300 of the Companies Act, 1993 of New Zealand provides for the court to declare the personal liability of the directors of a company in liquidation to be unlimited if it is unable to pay all its debts and such company has failed to comply with the provisions related with keeping of accounting records and preparation of financial statement or group financial statements. This declaration is done only when the liquidator makes an application before the court and the court is convinced that the failure to comply has contributed to the company's inability to pay all its debts, or has resulted in substantial uncertainty as to the assets and liabilities of the company, or has substantially impeded the orderly liquidation.

Introduction of a similar section in the Companies Act, 2013 in India may help in deterring the directors in charge of the company non-compliance of the company for keeping books of accounts and preparation of audited financial statements upto date. This is more so when it is seen that the books of accounts is not available in respect of lot many companies for which CIRPs have been initiated and many which have gone into liquidation as well as absolute non-cooperation by the directors who were managing the company before the company entered into red zone of inability to pay its debts.

c) Introduction of new sections or modification of the existing sections to cover certain aspects of inquiry into company's dealings and arrest absconding contributory, director or former director

Section 244 of the Insolvency, Restructuring and Dissolution Act, 2018 (IRD Act) of Singapore deals with inquiry into company's dealings and section 157 of IRD Act deals with the power of bankruptcy court to arrest absconding contributory, director or former director. There is a need for bringing in new sections or modify the existing sections of the Companies Act, 2013/ IBC which allows NCLTs to summon to appear before the court - any officer of the company, any person who was previously an officer of the company, any person known or suspected to have in his or her possession any property of the company or supposed to be indebted to the company, any person whom the court thinks capable of giving information concerning the promotion, formation, business, dealings, affairs or property of the company, including any banker, solicitor or auditor as well as for absconding persons or who are indulging in concealing or removing her/his property and give directions for arrest concerned person, seize the documents/assets or/and direct NCLTs to exercise such inherent powers if already bestowed under the existing law without hesitation.

d) Amendments to IBC – many are clarificatory in nature

Many amendments are needed to bring more clarity. There is already a notice issued by the MCA for certain amendments vide its notice dated December 23, 2021 related with certain issues related with avoidance transactions which included clarificatory amendments raised because of *Venus judgement*. The amendments (inclusive of the proposed) needed could be listed as follows:

a) Adjudication of avoidance applications could be continued even after approval of resolution plans including aspects related with manner of distribution of the expected recoveries

b) Timeline for avoidance applications to start from the date of CIRP application and time between such an application and the date of commencement of CIRP to be part of the look back period.

c) Correct presumably the clerical error of not including 'Liquidator' under section 66(1) of IBC and not mentioning about liquidation and Liquidator under section 66(2) of IBC.[7]

d) Allow creditors to file avoidance applications in the event RP or Liquidator fails to file the avoidance applications.

e) Timeline to dispose section 19 applications related with non-cooperation

Government of India is contemplating to bring amendments related with admission of CIRP applications in IBC. In line with the same, Government of India should fix a definite timeline for quicker disposal of section 19 applications filed by IPs in most of the cases linking with Rule 11 of NCLT Rules, 2016 which give ample power for AAs to exercise their discretion in giving specific directions/ orders to the ex-directors and the management to cooperate with IRP, RP and Liquidator.

e) Capacity / Capability building NCLTs

Government of India needs to look at capacity and capability requirements in respect of functioning of NCLTs/ NCLATs and may need to facilitate better functioning of NCLTs. These necessarily should include increasing the strength of members of NCLT, facilitating training related with dealing of avoidance transactions since members come from very diverse backgrounds. There could be a need for Government of India could think of putting certain specialized benches only for adjudicating avoidance applications.

Should there be a review of the modus of functioning of members of various NCLT benches (if such a practice is not yet there) to draw best practices of certain members / benches and sharing such practices among all the existing members and new members which improves the overall system in the long run, is a thought which runs through the mind of this author. This is a consideration which the Government of India should think about, if such a review process is not yet being formally there, that too done continuously on a periodic basis.

f) **All NCLT orders to be made available on public domain**

MCA to make sure that all orders of all NCLTs across India to be available on the public domain right from December 1, 2016. The author understands that MCA has a very ambitious project of seamless integration and development of a systems related with IBC in the near future and such a project needs to consider this aspect also in its scope to facilitate research.

g) **Regulation of forensic auditors similar to valuers**

There could be a need for setting up of a system to regulate like RVs in respect of transaction/ forensic auditors who do such transaction/forensic audits connected with CIRPs and liquidation cases on similar lines which may facilitate standardizing forensic audit aspects more aligned with objectives of IBC.

AREAS OF FURTHER RESEARCH

The author was quite ambitious while giving a proposal to write the research paper on the topic he chose. But, he did realise that this topic requires a very continuous exhaustive research. In this context, author thinks it appropriate to list down further areas of research which may be needed to go into nitty-gritty of the issues involved and find solutions to the issues on an ongoing basis:

a. **Understanding reasons for filing or non-filing by IPs** – whether it is related with challenges they face including that of non-availability and non-cooperation of in providing information/ data or/and is it also to do with exposure, background and experience of IPs.

b. **Reasons for the delay in adjudicating by AAs** – whether to do with capacity issues only or something to do with some other challenges faced by members of NCLT.

c. **Issues related with non-adjudication of section 19(2) applications** by AA even in applications filed with a request for giving directions exercising Rule 11 of NCLT Rules, 2016 relating to non-cooperation of ex-directors and management in handing over information/ data, control and custody of CDs.

d. **Possibility of amending the statute/s to shift the burden of proof** in very clear terms on the ex-directors and management wherever the transactions are with the related parties or/ and wherever any avoidance application is based on the audited/ unaudited books of accounts to handed over by the directors or/and management to IPs; wherever directors / management has not handed over books of accounts, such instances to be considered as suppression of information which could be considered as fraud[8] and if any application of avoidance is filed in such circumstances by an IP based on whatever information which he could collect for an avoidance application, the burden of proof needs to shift to those who have not handed over the information and documents to IP. It is 'not' uncommon that directors/ management/ related auditors come with excuses like books of accounts including supporting documents got washed away in a flood, service provider of an ERP system has discontinued their services, hard disks in which the data are/were available with CD or the service provider or the auditors got damaged and unable to retrieve the data in spite of all efforts to recover.

CONCLUSION

There is no doubt, that there is ample possibility to improve the impact and effectiveness of avoidance powers under IBC by bringing a few changes in the law and facilitate better implementation of the law with some of the concerted action as suggested in this paper.[9] The proactiveness of the Government of India and IBBI in responding to various issues and challenges as and when faced by various stakeholders by making relevant changes needs to be appreciated. In the long run, better implementation of avoidance powers of IBC would also result in bringing behavioral change in debtors because of the deterrence. This would ultimately have the possibility of creating more trust and credibility in the legal and business ecosystem facilitating higher investment by the genuine investors including foreign investors.

BIBLIOGRAPHY

1. Boraine A. (2000), "A Perspective on the Doctrine of Voidable Dispositions in South African Insolvency Law", Insolv. Rev., Vol. 9, pp. 65-90.
2. Ravi A. (2022), "Avoidance Actions under the IBC: Learnings and Challenges", IBBI's Annual Publication – IBC: Ideas, Impressions and Implementation; and UNCITRAL Legislative Guide on Insolvency , Part I and II (2004), para 151-152.
3. Trunk A. (2000), "Avoidance of Transactions under the New German Insolvency Code", Int. Insolv. Rev., Vol. 9, pp. 37-46.
4. Avoidance Transactions under IBC - Improving Outcomes by IIIP of ICAI (Draft of Study).
5. Batra S. (2017), "Corporate Insolvency Law and Practice", EBC Publishing (P) Ltd
6. Editorial-Ian F. Fletcher, (2000) Int. Insolv. Rev., Vol. 9, pp. 1-3.
7. Jay Lawrence Westbrook, (2010), "Global View of Business Insolvency System", Martinus Nijhoff Publishers
8. Report on transactions avoidance laws (ceril report 2017/1), September 26, 2017, By: Wo3eddrking party on Transactions Avoidance Laws Reporter: Professor Reinhard Bork
9. The avoidance of pre-bankruptcy transactions: An economic and comparative approach (2018), Chicago Kent Law Review.
10. Aurelio gurrea-martinez (2018), "The avoidance of pre-bankruptcy transactions: An economic and comparative approach", Singapore Management University.
11. The Harmonisation of Transaction Avoidance-(Oriana Casasola), Norton Journal Article, 2020.
12. The Historical Development of Insolvency Law Francis Forbes Society For Australian Legal History Introduction To Australian Legal History Tutorials The Hon T F Bathurst Chief justice Of New South Wales Sydney 3 September 2014.
13. F. Fletcher I. (2009), "The Law of Insolvency" published by Sweet & Maxwell Limited.
14. Parry R. et al. (2018), "Transaction Avoidance in Insolvencies", Oxford University Press.
15. Vriesendorp R. D. and Van Koppen F. P. (2000), "Transactional Avoidance in the Netherlands", Int. Insolv. Rev., Vol. 9, pp. 47-64.
16. Keay A. (2000), "Transactional Avoidance: Critical Aspects of English and Australian Law", Int. Insolv. Rev., Vol. 9, pp. 5-36.
17. UNCITRAL Legislative Guide on Insolvency Law published by United Nations Publication Sales No. E.05. V.10.
18. +/- 60 NCLT/ NCLAT orders disposing off avoidance applications - not listed individually.

Exhibit-1

SI.	Case details	Key issue/s addressed	Impact of the decisions
1.	Venus Recruiters Private Limited v. Union of India and ors. W.P.(C) 8705/2019 & CM APPL. 36026/2019-High Court of Delhi-order dated November 26, 2020 And LPA No. 37 & 43 of 2021 High Court of Delhi order dated January 13, 2023.	Maintainability of avoidance transactions applications after the approval of resolution plan, locus-standi of ex-RP to pursue avoidance applications and who is entitled to receive proceeds from such applications.	Based on the original decision of Hon'ble High Court stating such avoidance applications cannot be pursued, many NCLTs have dismissed avoidance transaction applications. The larger bench of the Hon'ble High Court has clearly stated that such applications can be pursued by ex-RPs even after closure of CIRP and successful resolution applicant cannot claim such proceeds if not covered in the approved resolution plan and such proceeds could go to the creditors who have suffered haircuts.
2.	63 Moons Technologies Ltd. v. The Administrator of Dewan Housing Finance Corporation Ltd.- Company Appeals (AT) (Insolvency) No. 454, 455 and 750 of 2021- NCLAT New Delhi order dated January 27, 2022	Fair valuation of recoverable avoidance transaction applications filed by RP.	Compulsion for resolution applicants to value avoidance transactions in a fair manner while submitting their resolution plans or leave the benefits to the creditors who have suffered haircuts.
3.	Anuj Jain Interim Resolution Professional For Jaypee Infratech Limited v. Axis Bank Limited Civil Appeal Nos. 8512-8527 of 2019 dated February 26, 2020	Mortgage of properties of CD in favour of lenders of associate companies without having received any benefits and such lenders to associate companies be considered as creditors of CD	Creditors who have lent to associate / holding companies on the mortgage of properties of CD cannot be considered as creditors of the CD and if CD has not got any benefit from such mortgage of CD's properties, such mortgage needs reversal.
4.	Mr. Rajesh Agarwal v. Reserve Bank of India – Writ Petition No. 19102/2019- High Court of Telangana order dated December 10, 2020 and Supreme court order in Civil Appeal No. 7300/2022 dated March 27, 2023	Necessity of banks to share forensic audit reports before declaring their accounts as fraud account	Duty cast on bankers (before declaring as fraud account) and RPs/Liquidators (in CIRP / Liquidation cases) to share contents of transaction / forensic audit reports to the concerned directors and management of the company / CD.
5.	Edelweiss Asset Reconstruction Company Ltd v. Net 4 India Limited- (IB)-409(PB)/2017- National Company Law Tribunal: New Delhi Principal Bench- order dated May 7, 2021	Shifting of entire business including a trademark (assigned for a negligible value of ₹ 1,000) to an associate company to the absolute detriment of all the creditors of the corporate debtor when the promoter director could foresee impending insolvency.	Emphasizing the role of RP and directors/ management in CIRP: ➢ RP is authorised to set the record in place and correlate the information provided, and to draw inferences, and accordingly from one side to run the company, from other side to take necessary actions against the pitfalls evident from the presence of record or absence of record.

SI.	Case details	Key issue/s addressed	Impact of the decisions
			➢ Directors / management does not take shelter of lack of evidence when they themselves have not provided the same or take shelter under non-availability of evidence – e.g., washed under flood ➢ RP not required to prove all actions of directors / management when no information is available to correlate fraudulent actions and he can report such actions.
6.	Amardeep Singh Bhatia v. Abhishek Nagori Liquidator for Asian Natural Resources (India) Ltd.- NCLAT New Delhi- order dated November 28, 2022	Existence of inherent power of the AA.	Reconfirmation of the following: ➢ That there is no time limit for fraudulent actions ➢ 'Misrepresentation' or 'False Representation and suppression' is a fraud under Indian Penal Code, 1860; Contract Act, 1872 and Companies Act, 2013 ➢ AA's power to order for Investigation under section 213 of the Companies Act, 2013
7.	Prasant Chandra Rath (Suspended Director of Corporate Debtor) v. Surya KantaSatapathy (RP)- NCLAT order dated September 30, 2022	Eligibility of an MSME promoter when such a promoter's resolution plan is pending for approval of AA when an application for avoidance filed by RP is also pending before the AA.	➢ Need for adjudication of avoidance application/s before MSME's promoter's resolution plan could be considered. ➢ RPs to avoid filing resolution plans of MSME promoters for approval when avoidance applications have been filed by them only since it affects MSME promoter's eligibility under section 29A.
8.	Mrs. Renuka Devi Rangaswamy, RP of M/s. Regen Infrastructure and Services Pvt. Ltd. v. M/s. Regen Powertech Pvt. Ltd- Comp. (AT) (CH) (Ins) No. 357 / 2022 & IA/814/2022 – dated October 10, 2022	Need for high degree of evidence in fraud cases	RPs to noteabout the need for 'High Degree of proof', which is attached to the 'Fraudulent Intent' and as a result more compelling evidence to satisfy the conscience of Tribunal whenever avoidance applications are filed under section 49 and section 66 of IBC.
9.	M Shibu Job Cheeran and others. v. M Mr. Ashok Velamur Seshadri,Liquidator of M/s. Archana Motors Limited,- Comp. (AT) (CH) (Ins) No. 350 / 2021 & IA/ 727/2021 – dated March 1, 2023	Treatment of entries made in the financial statements in the books of CD resulting in erosion of value of CD which were detrimental to the interest of other creditors.	Reconfirmation of the intention of filing avoidance applications: ➢ AA has powers to pass suitable orders including directors to contribute from their personal assets if it is found that any person has carried on the business of the CD with an intention to defraud its 'creditors' or other 'stakeholders'. ➢ Concealment of true financial position of the CD could also establish fraudulent purpose. ➢ The word 'any person knowing

SI.	Case details	Key issue/s addressed	Impact of the decisions
			parties to' may be wide enough to cover even those who could not be said to have carried out business directly but in somehow, directly or indirectly, participated in the fraudulent act of the CD. ➢ The fiduciary duties of the directors of the CD to preserve the assets of the company
10.	Mainzeal Property & Construction Ltd (in liquidation) (Mainzeal), decided by the Court of Appeal and now before the Supreme Court of New Zealand relevance for section 66(2) of IBC.	Responsibility of directors while committing any new obligations in the vicinity of insolvency.	Reconfirmation of the high level of responsibility of directors in the vicinity of insolvency: ➢ Section 135 and section 136 of the New Zealand Companies Act, 1993 imposes similar duties on the directors as section 66(2) of IBC. These two sections deal with reckless trading and duty in relation to obligations entered into with creditors of a company. ➢ These sections discuss about the duty of directors not to carry on company's business in a manner likely to cause substantial risk of serious loss to the company's creditors and not to incur any obligations with any creditor when she/he knew that the company would not be in a position to fulfil its obligations at the time such a commitment was made ➢ A well-known construction company which went into liquidation in 2013 and the deficit to the creditors was to the tune of USD 110 million to its unsecured creditors. ➢ It was held that the date by which the directors should have known that they could not avoid bankruptcy; however, they are liable for the specific obligations entered into after January, 2011 under section 136 and referred the matter back to the trial court to decide on the amount to be contributed related with the matter. **Author's view** In the absence of any relevant detailed case law in India related with section 66(2) of IBC, study of this case law could provide all IPs a good base for filing avoidance transactions for breach of section 66(2) of IBC. This also provides a

Sl.	Case details	Key issue/s addressed	Impact of the decisions
			guidance to IPs for the need of determining 'Twilight Period'[10] and more so about identifying a specific date by which the directors should have initiated filing of a bankruptcy petition before a bankruptcy court for revival or liquidation as the case may be.

Exhibit 2-: Sample of a Reconciliation statement to be prepared by RP/Liquidator to make sure the gap between Admitted Claims and Fair Market Value is explainable

Particulars	Rs. Crores
Admitted claims of all stakeholders	1,700
Of which Interest	450
Admitted claims without interest	**1,250**
Fair market value of all assets	65
Gap to be explained by RP / Liquidator	**1,185**
Genuine business loss - say - genuine bad debt	250
Losses due to lower operations - business reasons	150
Gap after genuine reasons	**785**
Possible avoidance transactions	
Payments to related parties during lookback period	150
Undervalue transaction - say sale of asset at lower than market value	30
Missing inventory - because of inflated stocks for drawing power	225
Inflated receivables by booking fictitious sales to satisfy drawing power	250
Total value of avoidance applications to be filed without interest element	**655**
Gap which is still unascertainable	**130**

[1] The author submits that he was not able to study all the aspects of whatever has been stated here.

[2] Extracted from the IBBI's Quarterly Newsletter for the quarter ended December 31, 2022.

[3]About ₹ 5000 crore is related with Jaypee Infratech Limited case related with cancellation of security/mortgage of CD's land in favour of lenders of associate /holding company.

[4] Adopted from Draft of Study on 'Avoidance Transactions under IBC - Improving Outcomes' by IIIP of ICAI.

[5] Conclusion drawn based on observations in a article: Transactional Avoidance: Critical Aspects of English and Australian Law by Andrew Keay in INSOL International Review, Vol. 9, 2000 "While liquidators and trustees in Australia appear to be finding the provisions dealing with the major avoidance provisions, preferences and transactions at an undervalue, to be effective, for the most part, liquidators and trustees in England get little assistance from the Insolvency Act, apart from where someone who is known as "a connected person" in liquidations or "an associate" in bankruptcies, is involved. In fact the law against preferences, apart from where connected persons or associates are involved, is virtually dead, as indicated by the lack of recent cases."

[6]This thought is taken from Net 4 India judgement.

[7] It would be bizarre if Liquidator does not have right to file avoidance transactions under section 66(2) when an Official Liquidator has/had enormous powers to investigate into misfeasance of directors under the Companies Act, 2016.

[8] See Net 4 India order.

[9] Author has come across a very extreme view of a speaker at a recent conference held by Asian Development Bank stating that the litigations related with avoidance transactions are very time consuming and costly and as a result it would be worth doing away with avoidance transactions in Insolvency/Bankruptcy laws. In Author's view, it is not an appropriate view since existence or non-existence of avoidance powers in Insolvency/Bankruptcy law affects the behaviour of debtors in the long run.

[10] Batra S., "Corporate Insolvency: Law and Practice", Chapter 12 –Twilight Period, EBC Publishing (P) Limited. This is an interesting and relevant resource for all IPs to refer to regarding discharge of duties of IPs related to importance of filing of avoidance applications and need for identifying the 'twilight period'.

26 ASSET RECONSTRUCTION COMPANIES IN INDIA: STILL A RELEVANT CHANNEL FOR RESOLUTION OF STRESSED ASSETS POST IBC?

- *Shashank Sharma and Ajay Kumar Kansal*

EXECUTIVE SUMMARY

This paper examined the efficacy of asset reconstruction companies (ARCs) in providing timely resolution vis-à-vis the Insolvency and Bankruptcy Code, 2016 (IBC/Code) channel in India, comprising of select indicators namely, time taken for resolution and corresponding asset realisation ratios. The initial sections of the paper presented an overview of the resolution regime in India, followed by the data analysis. Findings suggests that IBC channel may be ranked as the quickest amongst ARCs and other channels of resolution, although time-delay rates exceeded the enacted provisions. Moreover, reducing the time-delay rates may significantly prevent further erosion of the asset realisation values. In addition, considering the potential, ARCs may stay relevant and continue to operate as support for other channels. Furthermore, time-bound resolution has emerged as the most important factor in ARCs' future efficacy, followed by foreign direct investment (FDI) infusion and regulatory easing. In addition, an international experience of select countries, particularity related to bad banks and perspectives of experts on the future efficacy of ARCs has been explored. Analysis ascertained that, the key design elements of recently established bad bank in India are laudable, nonetheless, it may evolve further in the coming years. Likewise, relatively higher trend of stressed assets in India versus other economies necessitate proactive continued commitment towards the resolution process.

Keywords: Stressed Assets, Insolvency, Asset Reconstruction, Bad Bank, Default, Resolution, Revival
JEL Classification: G00, G01, G33, G20, G34, G38

INTRODUCTION

Since the beginning of 1980s, more than 130 economies (developed and developing) had faced problem of stressed assets, intermittently (RBI, 1999). A systemic evolution of financial reporting took place since then, which navigated through policy, regulatory, and legal reforms. Illustratively, during 1992-93, the profitability 12 out of 27 public sector banks (PSBs) turned negative after changes in reporting related to asset classification and capital adequacy (*ibid.*). The Government has been continuously working for the resolution of stressed assets, whether during the industrialisation phase, where the Sick Industrial Companies Act, 1985 (SICA) was enacted followed by the Board for Industrial and Financial Reconstruction in 1987 (BIFR); Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDB Act); Securitization and Asset Reconstruction of Financial Asset and Enforcement of Security Interest Act, 2002 (SARFAESI) and most recently IBC.

A pattern related to resolution reforms surfaced in the literature - that the ultimate goal of the Government has been the 'time-bound resolution'. Thus, timing may be considered as a crucial variable in classification, recovery and resolution of stressed assets. To achieve this goal, globally, Governments has always been banking on alternative resolution frameworks, as legacy systems in place were rather time consuming or less efficient (Osuji, 2012). Consecutively, in India, ARCs were evolved in

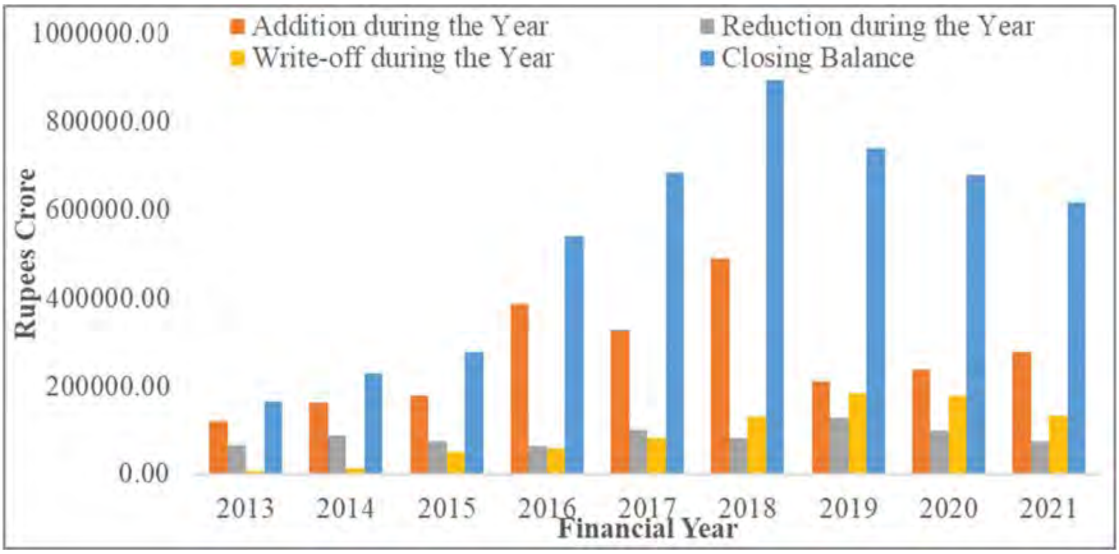
2002, which relieved banks from in-house management of stressed assets and the work related to recovery/resolution may be handled through a company with expertise (RBI, 2021).

Various models of ARCs, such as 5:95 and 15:85[1] has evolved over the time, though, efficacy of ARCs has not been satisfactory (RBI, 2021a). In addition, with the enactment of IBC the resolution/recovery ratio has been improved to some extent. However, in all the resolution channels, the goal of time bound resolution is yet to be achieved in the foreseeable future.

In India, there are 29[2] existing ARCs and most of them are privately owned with majority of Asset Under Management (AUM) are with three big ARCs. Furthermore, stressed assets are rising in the recent past and projected to rise in the future (RBI, 2022), may serve as an opportunity for the stressed asset market in the coming years (Crisil *et al*., 2019). Post IBC, Government has even endorsed a thought to establish the Public Sector Asset Rehabilitation Agency (GoI, 2017). Recently, privatisation of PSBs have been announced in the budget speech of 2021-22 (GoI, 2021) while, majority of the stressed assets are with PSBs, with a marginal amount of gross non-performing assets (NPAs) written-off every year (Chart 1).

Chart 1: Movement of gross non-performing assets inventory in PSBs

(₹ in crore)

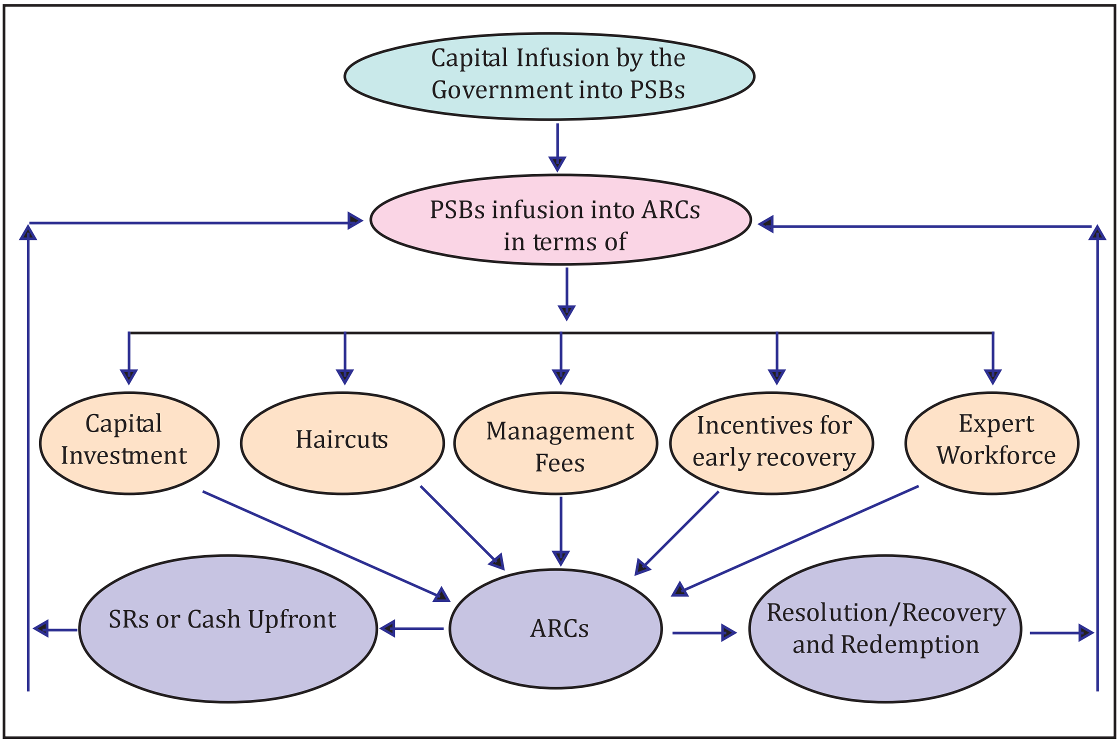


Source: Annexure VI, Author's compilation based on data sourced from RBI.

Furthermore, National Asset Reconstruction Company Limited (NARCL), with majority public stake, backed with Government guarantee has been granted licence on October, 2021 (GoI, 2021a). Since then, the said bad bank model has been in limelight. The PSBs may invest their time and money[3] into ARCs, thereby exchanging stressed assets with security receipts (SRs) may cause reasonable conflict of interest as presented in Chart 2 and discussed in later sections.

Moreover, Central Vigilance Commission (CVC) has been involved in investigating the cases comprised of asset transfer to ARCs and framing standard operating procedures (SOPs) for fraud prevention (Bhansali *et al*., 2020).

Chart 2: Flowchart of the present business model of ARCs in India



Source: Compiled by author.

Thus, during these evolving and challenging times, contingent events may occur followed by policy and regulatory facilitations. Accordingly, the paper, has analysed the stressed asset situation in India with special reference to ARCs/bad banks and the international experiences of select advanced and emerging economies, which may be helpful to move forward.

The paper has been organised into six sections, beginning with introduction followed by coverage of select review of literature. It then presents the problem statement, whereas prospective research design has been covered in later part of the paper. Data analysis and results has been covered thereafter followed by the conclusion and recommendations. Finally, a list of references has been presented followed by relevant annexures.

REVIEW OF LITERATURE

Ito and Hashimoto (2007) discussed the restructuring process during the crisis of 1997 in Malaysia. The sectoral analysis of non-performing loans (NPLs) situation indicated that manufacturing and real estate has been the majority contributors of NPLs. Moreover, the bad banks and swift measures of the Malaysian Government may be associated with successful containment of the crisis in 2002, with corrective measures such as, capital infusion into banks, mergers, setting up pertinent Asset Management Companies (AMCs), and other fiscal measures such as, pegging of exchange rates, capital control and fiscal packages. These AMCs finally closed its operations in 2003, followed by the reorganisation of the banking sector into ten resultant groups.

Bhagwati *et al.* (2017) explored the stressed assets issue in India and contribution of ARCs as resolution provider in the recent past. The performance of ARCs has been termed as limited. However, a sense of responsibility still lies with ARCs to improve the resolution business, as the fixed costs has been incurred, already. Moreover, study indicated that, ARCs have the potential to cater to the future needs of the stress resolution market, even without the increase in FDI limits. Furthermore, corporate borrowers have defaulted in larger numbers with limited fear of consequences. Thus, strict supervisory reviews and greater due diligence is needed in the near future from RBI.

Crisil *et al.* (2019) has empirically presented the situation of ARCs in India and observed the rising stressed assets in the banking sector, with 70% of them from corporate sector, which may serve as an opportunity for restructuring companies. Sector-wise classification indicated that textiles, power, infrastructure, and steel sectors have large share of stressed assets. Also, recovery rates post IBC have improved but resolution compliance in a timely manner, still remains a challenge. Similarly, recovery rates of ARCs are moderately low, however, evolving regulations and other parallel resolution channels has pushed the attention towards working for quicker results.

Dreyer (2021) has presented a comprehensive series of events occurred in Thailand during the operational period of Thai Asset Management Company (TAMC), its design elements, ownership structures and key features such as, profit-loss sharing arrangements with transferor financial institutions (FIs). Select issues such as, staffing issues, and other notable transparency issues have been surfaced and linkages has also been formed to the greater focus on public institutions, moral hazard behaviours in public banks and political pressure for quicker resolutions. Moreover, IMF and the World Bank reports has been quoted, which raised the similar concerns over time. Time delays in resolution has been linked to vintage stressed asset acquisition from public banks over the period.

Dreyer (2021a) explored the Malaysian bad bank '*Danaharta*' and events that ensured its success. Study indicated that the bad bank model has been well planned and executed with certain checks and balances in place such as, establishment of supporting agencies and overseeing committees, with auditing provisions. Key highlight has been the key performance indicators (KPIs) set for time and recovery rates, assisted in achieving overall 58% recovery rate within three years timeframe, ahead of schedule. Also, study indicated that the diverse funding sources and presence of Government guarantee, strong political will, supportive infrastructure and transparency has contributed to its success.

RBI (2021a) have noted that recognition of stressed assets and deterioration of assets quality has been an issue in Indian banking sector in the recent past. Since the beginning, asset resolution mechanism has been facing issues, and ARCs in India are facing similar rough trends since its introduction. ARCs have been evolved through many events, such as, changes in their capital portfolio, increase in FDI limits and certain regulatory facilitations. Presently, around 62% of the total AUM are with top three ARCs with stable profitability and rising assets acquisition ratios. Furthermore, data indicated that majority of resolution process (35.6%)[4] through ARCs is occurring using rescheduling of payments of debt. Similarly, international experience of other countries indicated the presence of public sector model and sunset clause in the majority of AMCs,[5] which is not the case with India, presently.

Tam and Fulmar (2021) discussed the bad bank, *Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria* (SAREB), established by the Spanish Government in 2012, with 55% private stake. The key objective was purchasing stressed assets from banks[6] and recover them over the period of next 15 years, using borrowed funds from the European Financial Stability Facility, with Government guarantee. However, most of the underlying assets were associated with already stressed real estate assets. In addition, a reasonable conflict of interest existed, owing to involvement of associated transferor FIs. SAREB is still active and, the private investors expected returns have not been realised until 2019.

Lawson (2021) empirically analysed the independent audit reports submitted on UK Asset Resolution Limited (UKAR), a bad bank established by UK Government in 2010, for the resolution of two of country's leading mortgage lending institutions. These lending institutions were facing distress issues even after nationalisation in 2008. The study indicated that the resolution framework has been a true takeover, where both the said nationalized institutions were acquired by UKAR and they continued operations as subsidiaries. Furthermore, the arrangement turned out to be consistently profitable, until its wind up in 2021.

Rao (2022) specified that insolvency situation, does not necessarily mean that there is no hope. However, from the perspective of a creditor, a going concern entity is preferably more valuable than liquidated entity, and this thought may form part of the basic principles of resolution reforms, provided that, the debtor has the willingness to do well, otherwise, liquidation is a better prospective decision. Recently, IBC may be appreciated in terms of policy decisions, e.g., power shift from debtors to creditors and landmark amendments like section 29A, but still there are few challenges that may need to be addressed, like deteriorating asset quality and haircuts.

RBI (2022a) revisited international experience related to bad banks across different countries, its key design elements, its financing, acquisition and pricing strategies. Moreover, certain legalities, challenges and core competencies have been covered. Similarly, Indian bad bank has been explained around the context, and a view has been formed that the resolution channels must complement each other, whereas recent formation of bad bank in India may serve as an initial push to start the credit cycle. However, continued commitment and efforts of the Government, greater transparency in operations may prevent time and public money leakages efficiently.

PROBLEM STATEMENT

The following alarming issues has surfaced during the review of literature and few of them has been explored further:

- What would be the prospective situation of Indian ARCs/bad banks in the absence of sunset clause, after privatisation of PSBs?
- Banks are facing haircuts over stressed asset transfers to ARCs. However, ARCs are resolving only 35.6% of cases - through rescheduling the payment of debts. How is that justified?
- How will ARCs establish themselves as an efficient resolution channel of stressed assets in presence of vintage stressed assets?
- How is the purchase consideration justified during transfer of stressed assets?
- PSBs are investing their time and money into ARCs, just to sterilize their financial statements comprising of stressed assets? Is there any reasonable cause to not term it as conflict of interest?
- What would be the prospective outcomes of ARCs going into distress themselves? Are they 'too big to fail'? If they do fail, what would be the prospective channel of resolution?
- Capital infusion by the Government and opportunity cost of setting up ARCs backed by Government guarantee is justified?
- Asset realisation as a percentage of total claims made vs. time delay?
- Book value or net realisable value (NRV) – what would be ideal for buying stressed assets? Is there a requirement of an accounting standard or a competitive environment amongst ARCs?
- Public/private or hybrid model of ARCs - Which would be best fit for India?
- How NARCL has an edge over other already established ARCs?

RESEARCH DESIGN

Based on the problem statements, select issues has included in the objectives of the paper are as follows:

a) Efficacy of time-bound resolution of ARCs vis-à-vis IBC.

b) Asset realisation ratio[7] and its association with time-delay in providing resolution - ARCs vis-à-vis IBC.

c) International experience of AMCs, particularly bad banks in other similar economies.

First and second objective has been serviced statistically, with secondary data sourced from the RBI and the Insolvency and Bankruptcy Board of India (IBBI) databases. Variables used for analysing IBC were 'time taken for resolution' and 'asset realisation ratio' sourced/computed from published database of corporate insolvency resolution process (CIRP) resolution plans (IBBI, 2022). Total 231 data points for each variable reflecting the period from August, 2017 to March, 2020[8] has been analysed using binary logistic regression. In addition, data have been converted into monthly frequency time-series by taking mean values related to corresponding months, as explained in the particular section. Furthermore, as per the provisions of IBC, time taken beyond 330 days served as threshold value for conversion of 'time taken for resolution' variable into dummy variable 'time event' with two categories, 'delay' or 'no delay', respectively. Following is the underlying expression used in the analysis;

$$\text{logit} = Li = B_0 + B_1X_1$$

Where, DV = 'time event' and predictor variable = 'asset realisation ratio'.

Similarly, for analysing ARCs, variables taken were 'SRs redemption rate' as dependent variable in lieu of time event as explained in the particular section and 'asset realisation ratio' as independent variable, sourced from published database of RBI. Annual frequency data points from 2003-04 to 2019-20 have been taken and analysed using bivariate linear regression, with the following expression;

$$y=a+b_1x_1+e$$

Where, DV = 'SRs redemption ratio' and IDV = 'asset realisation ratio'.

Further to the analysis, Hodrick-Prescott filter (HP filter) have been used on the time series data for addressing the trend and cyclicity component, specifically mentioned in the concerned sections, using the following expression;

$$\min_t \left(\sum_{t=1}^{T} (y_t - T_t)^2 + \lambda \sum_{t=2}^{T-1} [(T_{t+1} - T_t) - (T_t - T_{t-1})]^2 \right)$$

Where, λ = 100/14400, taken as smoothing parameter, prescribed for yearly/monthly frequency data time series, respectively.[9]

For data visualisations, logarithmic trend charts have been derived and presented in concerned sections using MATLAB. Also, SPSS has been used for analysing time series models performed in the analysis.

In addition, a perspective of industry and domain experts has been captured through a brief questionnaire and presented as a separate section. Select subject matter experts have been contacted, comprised of mostly chartered accountants working in the stressed asset market as Insolvency

Professionals or Registered Valuers. 40 experts had registered their responses and participated in the discussion. Out of total 200 data points collected, 160 have been analysed using 'multilayer perceptron artificial neural networks tool' in SPSS containing four hidden layers, where DV = future efficacy of ARCs and contributing factors taken namely, timely resolution, regulatory easing and FDI infusion. List of questions asked have been placed in Annexure I.

Finally, few emerging and advanced countries has been analysed for international experiences, using indicators, namely; time taken for resolution and corresponding total stressed assets ratios. Moreover, experiences pertaining to select similar and proactive economies have been explored further and presented, with special reference to bad banks.

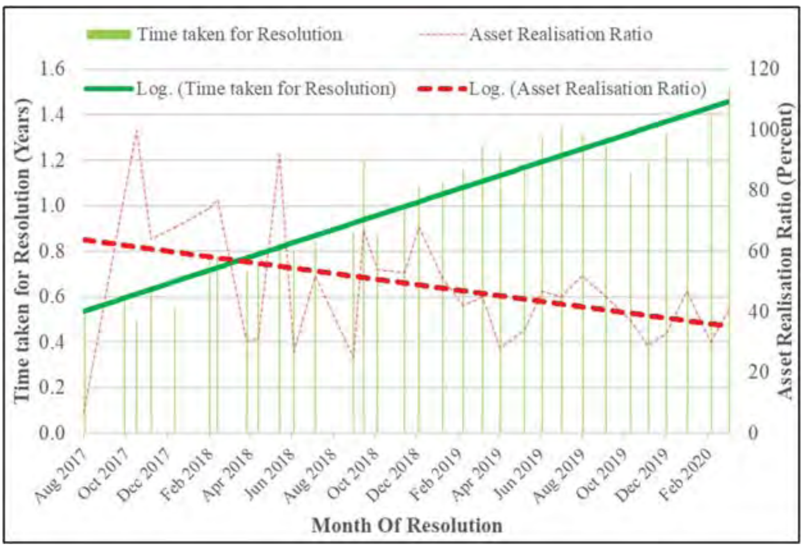
DATA ANALYSIS AND RESULTS

IBC

IBC has been instrumental in the resolution of stressed assets in India with time-bound resolution laws, with a maximum time-delay provision of 330 days has been enacted. However, the performance of other existing channels of resolution has always been cumbersome with prolong time-delays existed in providing the resolution. Since 2016, IBC has shared the workload of resolution and results are visible as CIRPs ending with either a resolution plan or liquidation, and many cases were also withdrawn due to full settlements. However, the ultimate goal of time-bound resolution sparsely achieved, as evident by the analysis of published database of CIRP ending with a resolution plan (IBBI, 2022) - with majority of the cases took more than 330 days for resolution, with an overall average of 1.36 years[10] (Chart 3).

Further to the analysis, total 231 cases of CIRP from the published data source have been converted into monthly frequency time-series by taking the average values corresponding to the particular month, resulted into 32.0 data points related to 32.0 months starting from August, 2017 to March, 2020. For calculating the asset realisation ratio, the total realisable amount by financial and operating creditors has been taken as a percentage of total amount involved. Furthermore, logarithmic trend series have been presented for the data visualisation (Chart 3).

Chart 3: Movement of the 'Time taken for resolution' (years) and 'asset realisation ratios' (percent) w.r.t corresponding month of resolution - CIRPs ending with a resolution plan under IBC



Source: Compiled by the author using data sourced from (IBBI, 2022)

In addition, for analysing the association of asset realisation ratio with time-delays in providing resolution under the business-as-usual scenario, binary logistic regression has been used on the data presented in Chart 3. For the analysis, threshold value of maximum 330 days has been taken to convert the 'time taken for resolution' into binary variable 'time event' (Table 1).

Table 1: Binary encoding of the dependent variable 'time event'

Value	Binary Coding
NO DELAY *(Time taken for resolution<330 days*)*	0
DELAY *(Time taken for resolution>330 days*)*	1

** As prescribed under section 12 of IBC*
Source: Annexure II. Computed by the author.

Hence, 'time event' has been taken as dependent variable and 'asset realisation ratio' as predictor variable. Further to the analysis, time-series data has been refined using HP filter for avoiding cyclicality and seasonality, and smoothed data series has been obtained by using the prescribed smoothing parameter λ for monthly frequency data.

Results of the binary logistic regression indicated the beta value of -0.630, with odds ratio of 0.533 which is less than 1.0. Thus, with incremental change in the asset realisation ratio, the odds of falling into the target group encoding 'DELAY' may decrease, as complimented by the corelation matrix with value of -0.998. Also, model summary indicated Nagelkerke R Square value of 0.833, which indicated that 83.3% variations in the dependent variable has been explained by the predictor variable (Table 2).

Furthermore, Omnibus Tests of Model Coefficients determined the good model fit with significant results (p-value<0.05) and the model has described the data well. Similarly, Hosmer and Lemeshow Test also indicated significant results with low difference between the observed and predicted values. Finally, model classification table suggested that model correctly classified the data with an overall accuracy of 90.6%.

Table 2: Brief results of the binary logistic regression using DV = time event and IDV = asset realisation ratio

<table>
<tr><th>Step</th><th colspan="2">-2 Log likelihood</th><th colspan="2">Cox & Snell R Square</th><th colspan="2">Nagelkerke R Square</th></tr>
<tr><td>1</td><td colspan="2">12.130[a]</td><td colspan="2">.611</td><td colspan="2">.833</td></tr>
<tr><td colspan="2"></td><td>B</td><td>S.E.</td><td>df</td><td>Sig.</td><td>Exp (B)</td></tr>
<tr><td>Step 1*</td><td>ARR</td><td>-.630</td><td>.269</td><td>1</td><td>.019</td><td>.533</td></tr>
<tr><td colspan="7">* Variable(s) entered on step 1: ARR = 'Asset Realisation Ratio'.</td></tr>
</table>

Source: Annexure II. Computed by the author.

Therefore, the analysis indicated that with the reduction in time delay, more value for the asset may be realised and further erosion of asset realisation due to time delays may be prevented. The complete results of the model have been placed in Annexure II.

ARCs

ARC's business operations are unique in a manner, considering all other channels of resolution concentrated on the on-balance sheet models of resolution. Whereas, ARCs operate on off-balance sheet model, where property in stressed assets are transferred to ARCs for prospective resolution by exchanging SRs. In the process, the seller may conserve its time and energy and concentrate on its core business, while the sold stressed assets are serviced/repaired *'ad interim'*. However, this *'ad interim'* period has been stretched to eight years as evident in the literature (RBI, 2021), vs. 1.36 years related to IBC.

Furthermore, annual accounts of ARCs,[11] includes certain disclosures, limited to legal compliance only. However, in order to be more transparent - voluntary disclosures in public domain, related to duration of time taken for resolution may be more valuable, which may be individually tracked to the life-cycle of acquired stressed asset. Accordingly, redemption rate of SRs has become a critical indicator, related to timing analysis, associated with the stressed asset turnover rate during resolution process (RBI; 2021a, p.165).

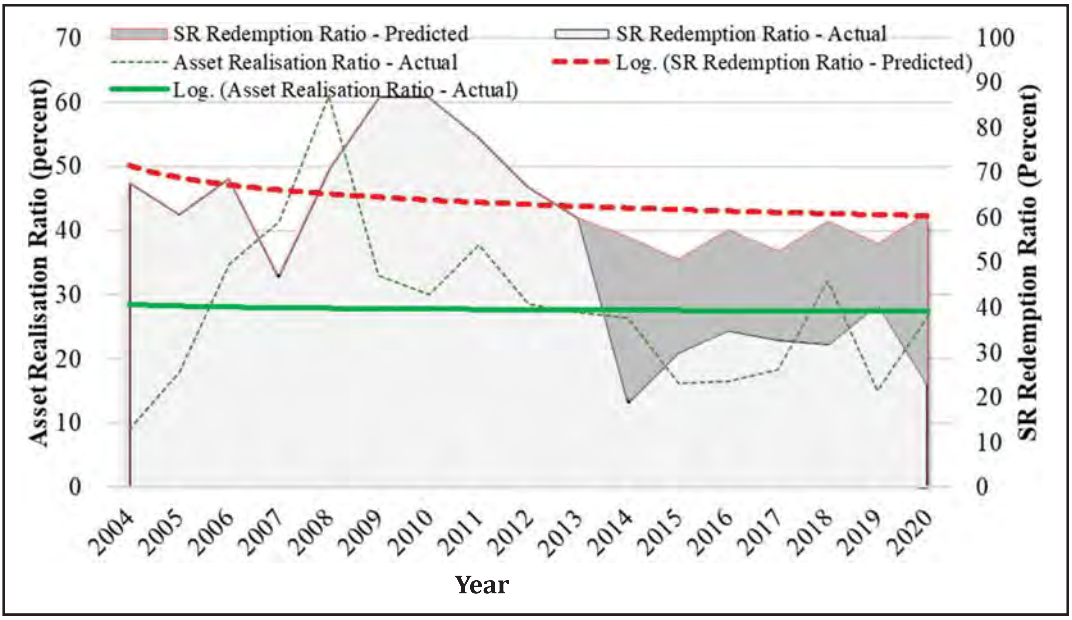
Thus, for the association analysis, annual frequency data has been sourced from RBI for the period 2003-04 to 2019-20, for 'SRs redemption rate' taken in lieu of time-factor as dependent variable and 'asset realisation ratio' as independent variable for the corresponding year. However, considering the fact that there has been an eight-year delay in the SR redemption process, data beyond 2012-13 may represent SRs not-fully-redeemed due to resolution-work-in-progress.

To overcome this situation, time-trend regression has been performed using 'forecast' function of excel, by taking data from 2003-04 to 2012-13 as input for predicting the values of SR redemption rate for the period 2013-14 to 2019-20 (Chart 4).

The dark shaded region in the Chart 4, represents the gap between 'actual and predicted' values of SR redemption rate. Assuming business-as-usual scenario, moderate confidence bound been considered. However, proactive efforts/macro-environment changes may achieve optimistic/upper confidence bound results in the future. In addition, for the purpose of data visualisation, logarithmic trend series has also been presented.

Chart 4: Movement of SRs redemption rate (actual and predicted) and asset realisation ratio w.r.t corresponding financial year related to ARCs

(percent)



Source: Compiled by the author using data sourced from RBI (2021, p.32) and RBI (2021a, p.158)

Further to the analysis, time series data for the dependent variable – 'SRs redemption ratio – actual' and predictor variable – 'asset realisation ratio - actual' has been refined using HP filter for avoiding cyclicality and seasonality, and smoothed data series has been obtained by using the prescribed smoothing parameter λ for yearly frequency data. Furthermore, the following underlying hypothesis has been assumed for performing bivariate linear regression using SPSS.

H1: There is a significant positive impact of the 'asset realisation ratio - actual' on 'SRs redemption ratio – actual'.

Results indicate that the independent variable has significantly predicted the dependent variable, $F(1,989.6) = 48.136$, $p<0.001$. Moreover, $R^2 = 0.762$ value indicated that the model explained 76.2% of the variations in SR redemption ratio (Table 3).

Table 3: Brief results of the binary linear regression using DV = SRs redemption ratio and IDV = asset realisation ratio

Hypothesis	Regression Weights	B	t	p
H_1	ARR→SRR*	3.161	6.938	0.000**
F (1, 989.6)	48.136			
R	0.873			
R^2	0.762			
Results = H_1 supported				

*** p<0.05. *ARR = 'asset realisation ratio – actual' and SRR = 'SRs redemption ratio – actual'*

Source: Annexure III. Computed by the author.

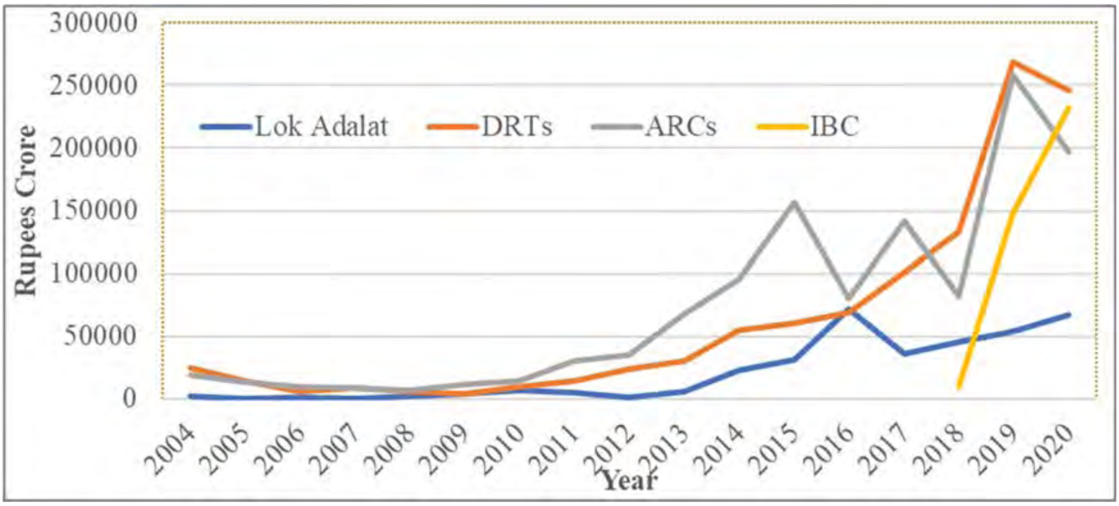
Hence, results validate the hypothesis that maximisation of realisable value of the asset may have significant positive impact on SR redemption rate, and resultant reduction in time-delay. The research may be hypothetically extended by taking the dependent variable as – 'SRs redemption ratio – predicted' and predictor variable as – 'asset realisation ratio – actual'. The complete results of the model have been placed in Annexure III.

ARCs vis-à-vis IBC

Historical trends associated with resolution of stressed assets in India entailed the requirement of an optimal resolution channel, which may provide timely resolution and value maximisation to the assets realised. As evident in the Chart 5, a sharp decline in the trendline of ARCs since the introduction of IBC established the fact that majority workload of ARCs has been shared by IBC, followed by Debt Recovery Tribunals (DRTs), whereas Lok Adalat remained unaffected.

Chart 5: Amount involved in various channels of resolution related to stressed assets of banks w.r.t corresponding financial year.

(₹ in crore)



Source: Annexure IV. Compiled by the author using data sourced from RBI (2021a, p158).

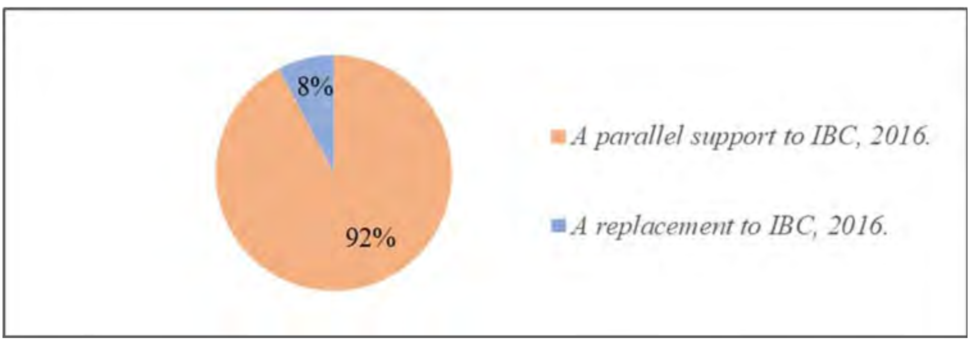
Assuming the fact that this trend continues, the ARC's performance may likely improve after sharing of workload, however, results may be more evident in the next few years when actual SRs redemption ratio supersedes 'SRs redemption ratio – predicted' trendline as presented in Chart 4. Similarly, considering the fact that the efficacy of time bound resolution of IBC is better than ARCs, higher confidence bound may likely be achieved.

Experts Perspective

The future outcomes may depend on various macro-economic and policy factors. Accordingly, this additional sub-section presented an expert's perspective. Select subject matter experts with related domain expertise, have been approached for a discussion regarding the foreseeable future of ARCs. Responses received from 40 experts has been incorporated and summarised as follows:

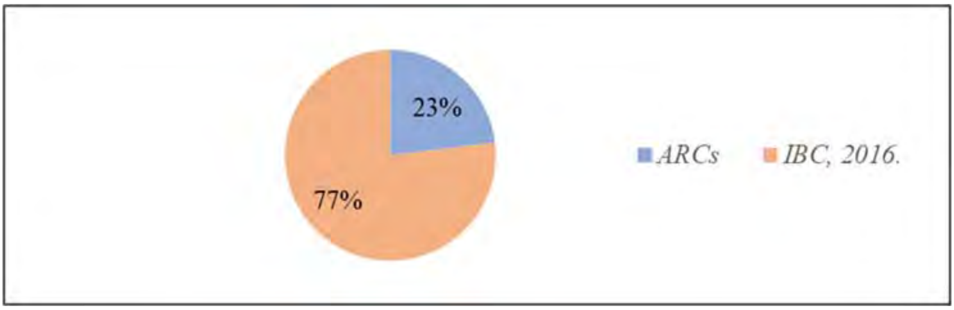
- Total 37 out of 40 experts agreed that ARCs may stay useful, as a resolution provider, in the near future. However, its role may stay as a parallel support to IBC and other channels of resolution (Chart 6).

Chart 6: ARCs, as a resolution provider, in the stressed assets market in the near future



Source: Annexure I.

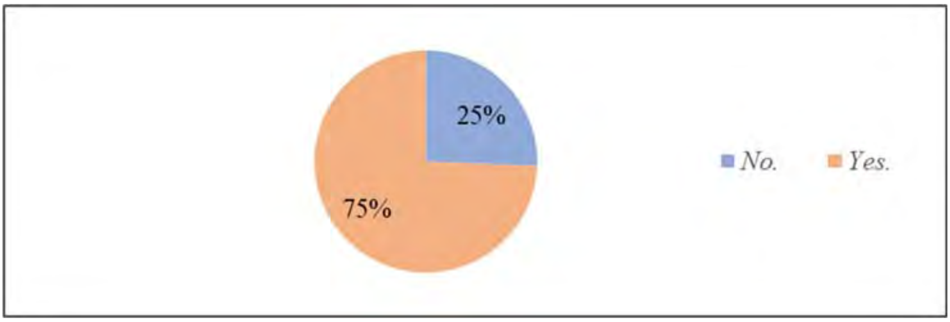
Chart 7: Which channel of resolution will provide timely and appropriate resolutions in the near future



Source: Annexure I.

- Total 30 out of 40 experts believed that IBC may continue providing timely and appropriate resolution, as compared to other channels in the near future, considering the procedural delays in acquiring the stressed assets by ARCs (Chart 7).
- However, 30 out of 40 experts believed that with Government involvement and proactive management, ARC's may improve in the future. Also, RBI's control must stay in place with appropriate policy and regulatory easing, to facilitate ARCs to concentrate more on retaining asset quality. Also, considerable amount of SRs written off every year may be a concern (Chart 8).

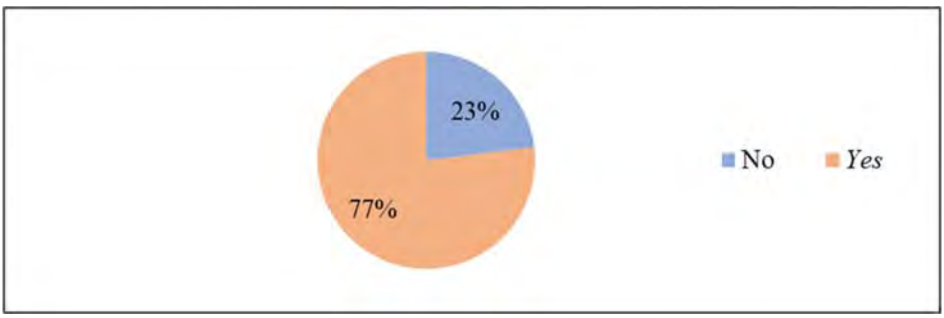
Chart 8: Will easing the regulations by RBI for ARCs may improve the resolution market in India?



Source: Annexure I.

- Total 31 out of 40 experts agreed that the recent easing in FDI norms related to ARCs may expand the capital horizons of ARCs in India. However, prospective foreign investors interested in asset reconstruction business may be further studied (Chart 9).

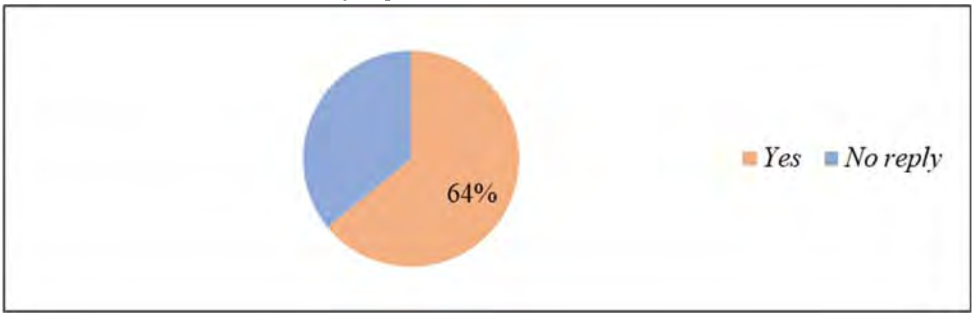
Chart 9: Recent introduction of 100% FDI into ARCs, would be beneficial in the future?



Source: Annexure I.

- Similarly, 26 out of 40 experts were optimistic about the incorporation of Government backed bad bank as a new entrant into existing channels of resolution. Also, remaining 14 experts were in dilemma and raised concern about the future operations of bad banks, on account of certain contingent policy and evolutionary outcomes (Chart 10).

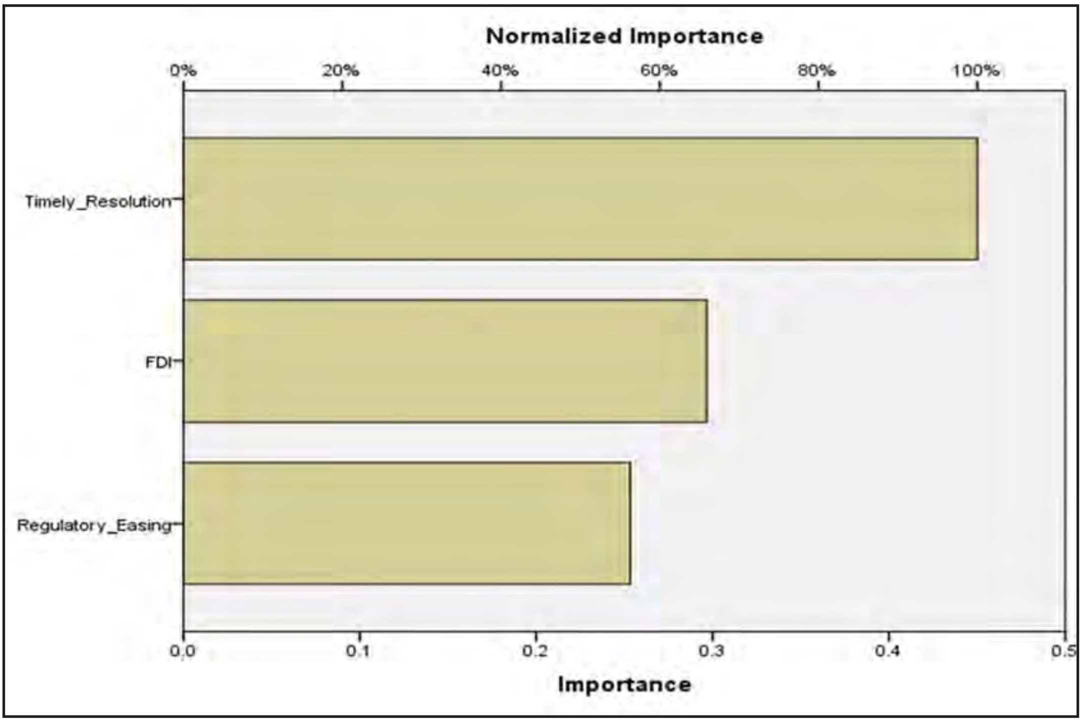
Chart 10: Capital infusion by the Government, backed by Government guarantees, to support the bad bank, may improve the resolution market in the future?



Source: Annexure I.

Accordingly, the viewpoints of the experts have been analysed using multilayer perceptron artificial neural networks for knowing the important factors that may impact the promising supporting role of ARCs in the future. Analysis indicated that timely resolution may be the most important factor, followed by FDI infusion and regulatory easing (Chart 11).

Chart 11: Summary table for the normalised importance of the factors contributing to the DV = supporting role of ARCs in future

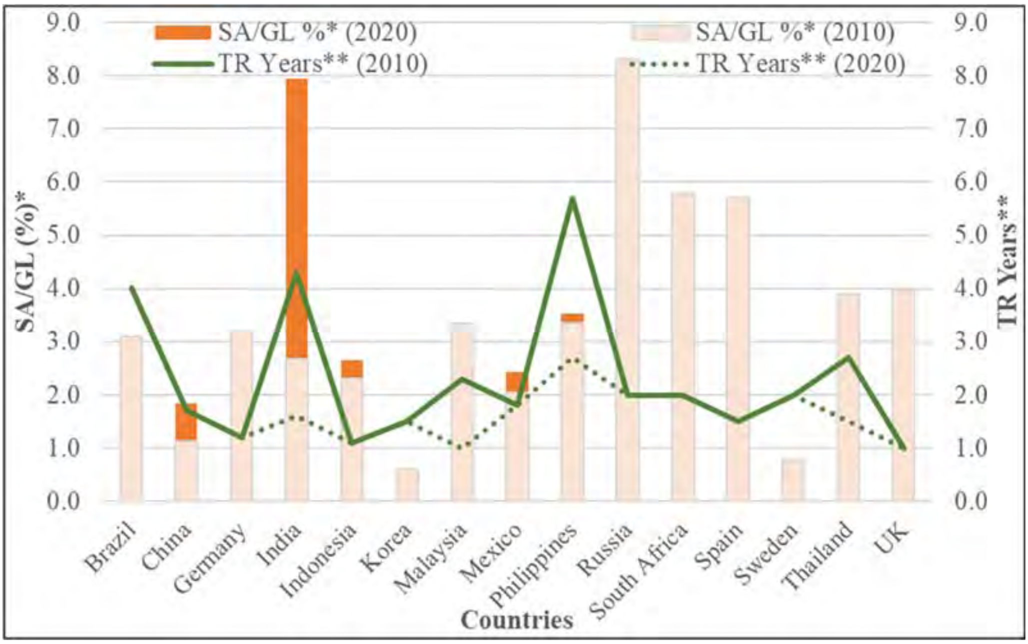


**Bad bank as a factor has been excluded from the analysis, owing to missing values in the data collected.*
Source: Compiled by the author.

INTERNATIONAL EXPERIENCE – PARTICULARLY BAD BANKS

For the analysis of international experiences, select few advanced and emerging economies[12] has been considered initially, anticipating a historical learning curve related to bad banks. Accordingly, for the analysis, 'time taken for resolution' and 'total stressed assets as a percentage of gross loans' have been plotted on a chart for the year 2009-10 and 2019-20, corresponding to selected counties, respectively, for an overview regarding the 10-year evolution in stressed asset quantum w.r.t timely resolution factor (Chart 12).

Chart 12: Comparative country-wise transition of 'time taken for resolution (years)' and 'stressed assets to gross loans ratio (percent)' during 2009-10 and 2019-20



**SA/GL = Stressed assets to gross loans ratio (percent). ** TR = Time taken for resolution (Years)*

Source: Annexure V. Compiled by the author using data sourced from UN Database.

Illustratively, UK, Germany, Indonesia and Spain have been proactive, and providing resolution under 1.5 years. However, comparative gain-quantum of the 'stressed assets as a percentage of gross loans' has been maximum in India, although 'time taken for resolution' decreased marginally, whereas, other countries trends appeared in control. Moreover, as evident in Chart 12, India has similar trends with Malaysia, Philippines and Thailand related to reduction of time taken for resolution. Thus, countries indicating similar experiences and proactive trends have been explored further in this section.

Countries with similar experiences

Philippines transformation of time reduction has been plausible. Presently, bad bank model comprised of five FIST corporations (FISTCs)[13] established in 2021 - fully owned by Government. The procedural highlights related to internal control of FISTs has been:

- The 'barcode' attached to specific stressed asset, clear timeframes and certain tax[14] exemptions.
- Mandatory asset transfer in the nature of true sale – transfer of rights and ownership.

- Strict provisions that prohibit any directors, employees or officers of transferor FIs to be involved in the operations of the transferee FISTCs.

- Proper book-keeping, accounting disclosures and external auditing provisions with an incorporation of an oversight committee.

Thai Asset Management Company (TAMC, 2001-2013) and other private AMCs in Thailand, had supported each other and TAMC acquired around 80% stressed assets from Government-owned institutions. In addition, the board of directors comprised of industry representatives and Government officials, however, TAMC faced problems in staffing of experts and has been dependent on transferor FIs. Furthermore, there has been lack of transparency in disclosure of asset realisation rates and timelines, considering 'rapid and transparent management' has been incorporated in its mission statement. Also, these concerns have been documented in the reports of IMF and World Bank (Dreyer, 2021).

Malaysia's national AMCs, *Danaharta* has been more transparent in its operations with reported overall 58% asset realisation rate with 12.8% losses on total amount invested. Moreover, *Danaharta* has been supported by Danamodal[15] and corporate debt restructuring committee (CDRC), with specific roles. All three agencies worked under the supervision of steering committee set up by the central bank and three-member audit committee for an effective internal control and oversight. Furthermore, KPIs have been enacted in the provisions and results exceeded the expectations in majority of cases. Moreover, majority of the board members comprised of Government officials. Also, funding has been initially sourced from Government, and further through bonds backed by Government guarantees (Dreyer, 2021a). Table 4 presented a brief summary of the analysis.

Table 4: Summary of country-wise features of bad banks/ national AMCs

Country	Philippines*	Malaysia**	Thailand***	India****
Bad Bank	FISTCs	Danaharta	TAMC	NARCL
Year of Establishment	2021	1998	2001	2021
Timeframe for Resolution	5 years after acquisition	KPIs set to resolve by Dec, 2001	10-year for ceasing operations	Conditional 5-year guarantee for SRs
Sunset clause	No	No	Yes (2013)	No
Ownership	Government owned	Government owned	Government owned	Majority Government ownership
Penalties	Monetary and administrative sanctions.	80% value reduction during renegotiation in acquiring stresses assets	Monetary penalties	Charge of guarantee fee – for delay in resolution
Incentives	Tax Exemptions	Profit sharing/Loss amortisation provisions	Profit sharing provisions	-

*Source: *GOP (2021) **Dreyer (2021a) ***Dreyer (2021) ****RBI (2022a)*

Advanced countries indicating declining stressed assets trends

A trend has been observed in advanced economies namely, robust legal framework and proactive efforts towards implementation. As evident in Germany, insolvency laws empowered BaFin[16] (Federal Financial Supervisory Authority), with the required toolkit for resolution process, comprised of tools namely; establishment of a temporary bridge bank/AMC, bail-in[17], replacing management key persons, or transfer of assets to external purchaser. Another key pattern observed has been the early intervention and planning of resolution process.

Furthermore, during the analysis, Spain indicated the reduction in the stressed assets over the selected 10-year timeframe (Annexure V). Besides, this transition may be associated with macro-economic factors considering Spanish band bank (SAREB), has performed just well in the resolution task with around 20% asset realisation rate, followed by consistent losses (Arner et al., 2022). Presently, SAREB is struggling with certain issues such as, lack of transparency and distressed underlying assets in real estate (RBI, 2022a).

Similarly, UK has followed the European pattern, and transparent approach has been visible through presence of KPIs, and availability of financial statements at half-yearly intervals, until 2019. Moreover, UK bad bank remained profitable and, ownership structure of the bad bank, comprised of sharing the board members with transferor FIs. However, the performance of the bad bank has been evaluated by asserting reliance on the auditing reports of the committee. The performance has not been independently analysed in the past, owing to its scale of operations (Lawson, 2021).

Table 5: Summary of features of bad banks/national AMCs – advanced economies

Country	Germany*	UK**	Spain***
Bad Bank/CAMCs#	FMS Wertmanagement	UK Asset Resolution (UKAR)	SAREB
Year of Establishment	2010	2010	2012
Timeframe for Resolution	10-year for wind up operations	10-year for wind up operations	15-year for ceasing operations
Sunset clause	Revised	-	Likely 2027
Ownership	Government owned	Government owned	Majority private owned with 45% Government stake.
Current Status	Active	Sold assets in 2021	Active

#Centralised Asset Management Company

*Source: *IMF (2022) *ECB (2017) ***Arner et al. (2022)*

Accordingly, Indian approach in the establishment of NACRL, has been similar to the successful model followed by Malaysia, limited to following points:

- Establishment of a supporting agency - India Debt Resolution Company Limited (IDRCL) for managing stressed assets.
- Presence of underlying Government guarantee and its time-bound nature.
- Penal provisions.

However, there has been few differences as well, such as;

- Ownership structure.
- Organisation of the Board of Directors.

Likewise, international experience only provides an overview of the situation. Macro-economic determinants for every country may work differently. However, odds of anticipating the future success may be increased through careful navigation of financial and logistical challenges. Also, considering the fact that underlying Government guarantees may be perceived as more attractive proposition than SRs, further proactive efforts, continued commitment of the Government, and transparency may help to achieve the desired results with minimum cost burden on taxpayers.

Apart from the above observations, case of Ireland's and its procedural robustness entailed a special mention, considering the 10-year transition of time taken for resolution has been impressively constant at 0.4 years, whereas corresponding stresses assets to total loans ratio has been transitioned to 3.4 in 2019-2020 from 13.9 during 2009-10 (Annexure V). Furthermore, analysis of Ireland's stressed asset resolution framework indicated the proactive approach of the Central Bank of Ireland, which includes prevention, early intervention before opting for resolution proceedings. The framework of resolution work-in-advance, through continuous monitoring of institutional financial performance. Furthermore, when presence of early warning signals detected, the resolution tools become active within the specified timeframes. Resolution tools includes any of the four procedures, namely, sale of business, asset separation, asset transfer to bridge institution,[18] or bail-in. Annual target levels are set for resolution using the specific fund created for resolution (CBI, 2021). Also, past experiences of National Asset Management Company (NAMA), established in 2009, have been successful (RBI, 2022a).

CONCLUSION

In the times of rising stressed assets, providing an ecosystem of timely and relevant resolution process, may have an immense positive impact on asset quality, ease of doing business, and country's economy overall. IBC has been instrumental and serving as a catalyst in the resolution market, whereas, rising time-delays in providing resolution has surfaced as a cause of concern during the analysis. Moreover, analysis indicated that reducing time-delay rates may significantly prevent further erosion in the asset realisation values. Whereas large gap has been evident in the timeframes of IBC and ARCs in providing resolution.

In addition, ARCs performance over the years has been rather modest, owing to longer resolution durations, procedural delays, and high write-off rates of SRs. Also, the analysis suggested that there has been a significant positive impact of the asset realisation rates on the rate of redemption of SRs, and the resultant reduction in time-delay. Moreover, subject matter experts believe that there must be some ARC in place, as a support system, for sharing the workload of other resolution channels. Also, experts have been in the favour of regulatory easing, timely resolution, increment in the capital base of ARCs and Government's proactive support/control. Further analysis of the experts' opinions indicated 'timely resolution' as the most important factor in the aspirational future of ARCs/bad banks.

Recent establishment of bad bank in India may emerge as a timely step in the right direction by providing an additional channel of resolution. However, experts believe that it will be an evolutionary process and its anticipatory success would be an overstatement. However, the approach of India during establishment of NARCL may be perceived as careful adaptations and success analysis of the international experiences, related to respective bad banks. Furthermore, the rising stressed assets in India, relatively higher than other select economies, may demand a continuous commitment towards resolution. Although, there has been a relative reduction in time-delays, which may be seen as resultant effect of IBC.

In addition, select key recommendations has been summarised below, which may be helpful for improvement of the resolution process of stressed assets in coming years.

RECOMMENDATIONS

- Need of mandatory/voluntary additional disclosure practices related to 'age of stressed asset acquired' and 'time taken for resolution' in the financial statements of ARCs/bad banks – for tracking the life cycle of acquired stressed asset.
- Need of competition amongst existing ARCs for the uniform distribution of AUM.
- Need of accountability and transparency in handling the stressed assets, likewise IBC channel.
- Need of proactive steps to minimise the trade-off between timely resolution and erosion of asset value.
- A blockchain technology-based ecosystem may be implemented to track resolution process, under the regulatory control of RBI/IBBI.
- Need of setting up KPIs for every channel of resolution.
- Establishment of an overseeing agency/committee for bad bank may be explored.
- Training of bank officials for effective in-house resolution may be explored.
- MoUs with international bad banks for technical know-how and staff training.

BIBLIOGRAPHY

(1) Arner D. et al. (2022), "COVID-19, Macroeconomic and Sustainability Shocks, Moral Hazard and Resolution of Systemic Banking Crises: Designing Appropriate Systems of Public Support", European Business Organization Law Review, pp.1-40.

(2) Bhagwati J. et al. (2017), "Can asset reconstruction companies (ARCs) be part solution to the Indian debt problem?" (No. 338), ICRIER Working Paper.

(3) Bhansali U. et al. (2020), "Bad banks in India", Deloitte release.

(4) CBI (2021), The Central Bank of Ireland's Approach to Resolution for Banks and Investment Firms, Second Edition.

(5) CRISIL, ASSOCHAM, & Association of ARCs (2019), Bolstering ARCs-Focus on quicker resolution and co-investor model among imperatives.

(6) Dreyer M. (2021), "The Thai Asset Management Company (TAMC)", Journal of Financial Crises: Vol.3: Issue 2, pp.512-545.

(7) Dreyer M. (2021), "Malaysia: Pengurusan Danaharta Nasional Berhad", The Journal of Financial Crises, 3(2) [Dreyer (2021a)].

(8) ECB (2017), Stocktake of National Supervisory Practices and Legal Frameworks Related to NPLs, European Central Bank.

(9) The Economic Survey 2016-17, GOI (2017).

(10) Budget Speech 2021-22, GOI (2021).

(11) GOI (September, 2021), FAQs regarding Central Government guarantee to back Security Receipts issued by National Asset Reconstruction Company Limited for acquiring of stressed loan assets. Ministry of Finance - PIB release [GoI (2021a)].

(12) GOP (2021), SEC releases draft implementing rules of fist act.

(13) IBBI, & IOV Registered Valuers Foundation (2019), Securities or Financial Assets Valuation, First edition, April 2019.

(14) IBBI Quarterly Newsletter, April-June, 2022.

(15) IMF (2022), Technical Note—Crisis Management and Financial Safety Nets.

(16) Ito T. and Hashimoto Y. (2007), "Bank Restructuring in Asia: Crisis management in the aftermath of the Asian financial crisis and prospects for crisis prevention-Malaysia", RIETI Discussion Paper.

(17) Lawson A. (2021), "United Kingdom Asset Resolution Limited (UKAR)", The Journal of Financial Crises, 3(2), pp.641-664.

(18) Rao M. R. (2022), Resolution of Stressed Assets and IBC - Address delivered by Shri M. Rajeshwar Rao, Deputy Governor, Reserve Bank of India in the International Research Conference on Insolvency and Bankruptcy held at IIM Ahmedabad – April 30, 2022.

(19) RBI, Report of the Working Group on Restructuring Weak Public Sector Banks, 1999.

(20) RBI, Resolution of Stressed Assets – Revised Framework, 2018.

(21) RBI, Report of the Committee to Review the Working of Asset Reconstruction Companies, 2021.

(22) RBI Bulletin, April, 2021 [RBI (2021a)].

(23) Financial Stability Report, June, 2022.

(24) RBI Bulletin, February, 2022 [RBI (2022a)].

(25) Tam D. and Fulmer S. (2021), "Spain: Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria (SAREB)", The Journal of Financial Crises, 3(2), pp.726-756.

(26) UN Report on World economic situation and prospects, 2022.

ANNEXURE I: QUESTIONNAIRE DISCUSSED WITH SUBJECT MATTER EXPERTS

Following is the list of questions discussed with subject matter experts over e-mail/phone and google form (https://forms.gle/LWYWk6PsTVbwiCxUA) has been filled. Details of the experts has been available with the author.

Q1. Asset Reconstruction Companies, as a resolution provider in the stressed assets market in the near future, may be seen as:

a) A parallel support to IBC channel
b) A replacement to IBC channel

Q2. Which channel of resolution will provide timely and appropriate resolutions in the near future:

a) IBC
b) Asset Reconstruction Companies

Q3. Will easing the regulations by RBI for Asset Reconstruction Companies may improve the resolution market in India?

a) Ye
b) No

Q4. Recent introduction of 100% FDI into Asset Reconstruction Companies, would be beneficial in the future?

a) Yes
b) No

Q5. Capital infusion by the Government, backed by Government guarantees, to support the bad bank, may improve the resolution market in the future?

a) Yes
b) No

ANNEXURE II: BINARY LOGISTIC REGRESSION MODEL SUMMARY (DV = TIME - TIME EVENT IN RESOLUTION AND IDV = ARR - ASSET REALISATION RATIO).

Case Processing Summary			
Unweighted Cases[a]		**N**	**Percent**
Selected Cases	Included in Analysis	32	100.0
	Missing Cases	0	0.0
	Total	32	100.0
Unselected Cases		0	0.0
Total		**32**	**100.0**
a. If weight is in effect, see classification table for the total number of cases.			

Dependent Variable Encoding	
Original Value	Internal Value
NO DELAY	0
DELAY	1

Block 0: Beginning Block

Classification Table[a,b]					
Observed			Predicted		
			TIME		Percentage Correct
			NO DELAY	DELAY	
Step 0	TIME	NO DELAY	0	7	0.0
		DELAY	0	25	100.0
	Overall Percentage				78.1
a. Constant is included in the model.					
b. The cut value is .500					

Variables in the Equation						
		B	S.E.	df	Sig.	Exp(B)
Step 0	Constant	0.511	.365	1	.000	1.667

Variables not in the Equation					
			Score	df	Sig.
Step 0	Variables	ARR	19.714	1	.000
	Overall Statistics		19.714	1	.000

Block 1: Method = Enter

Omnibus Tests of Model Coefficients				
		Chi-square	df	Sig.
Step 1	Step	30.210	1	.000
	Block	30.210	1	.000
	Model	30.210	1	.000

Model Summary			
Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	12.130	.611	.833

Hosmer and Lemeshow Test			
Step	Chi-square	df	Sig.
1	1.279	8	.996

Contingency Table for Hosmer and Lemeshow Test						
		TIME = NO DELAY		TIME = DELAY		Total
		Observed	Expected	Observed	Expected	
Step 1	1	3	2.954	0	.046	3
	2	3	2.903	0	.097	3
	3	3	2.701	0	.299	3
	4	1	2.102	2	.898	3
	5	1	1.085	2	1.915	3
	6	1	.239	2	2.761	3
	7	0	.015	3	2.985	3
	8	0	.001	3	2.999	3
	9	0	.000	3	3.000	3
	10	0	.000	5	5.000	5

Classification Table[a]					
Observed			Predicted		
			TIME		Percentage Correct
			NO DELAY	DELAY	
Step 1	TIME	NO DELAY	11	1	91.7
		DELAY	2	18	90.0
	Overall Percentage				90.6
a. The cut value is .500					

Variables in the Equation							
		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1[a]	ARR	-.630	.269	5.493	1	.019	.533
	Constant	29.954	12.956	5.345	1	.021	1.02E+13
a. Variable(s) entered on step 1: ARR							

Correlation Matrix			
		TIME	ARR
Step 1	TIME	1.000	-.998
	ARR	-.998	1.000

ANNEXURE III: BIVARIATE LINEAR REGRESSION MODEL SUMMARY (DV = SRR - SECURITY RECEIPTS REDEMPTION RATIO AND IDV = ARR - ASSET REALISATION RATIO)

Descriptive Statistics			
	Mean	Std. Deviation	N
SRR	53.2941	16.13523	17
ARR	27.6471	4.45731	17

Correlations			
		SRR	ARR
Pearson Correlation	SRR	1.000	.873
	ARR	.873	1.000
Sig. (1-tailed)	SRR		.000
	ARR	.000	
N	SRR	17	17
	ARR	17	17

Model Summary[b]									
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.873[a]	.762	.747	8.12265	.762	48.136	1	15	.000

a. Predictors: (Constant), ARR

b. Dependent Variable: SRR

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3175.867	1	3175.867	48.136	.000[b]
	Residual	989.662	15	65.977		
	Total	**4165.529**	**16**			

a. Dependent Variable: SRR

b. Predictors: (Constant), ARR

Coefficients[a]								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	-34.093	12.749		-2.674	.017	-61.266	-6.920
	ARR	3.161	.456	.873	6.938	.000	2.190	4.132

a. Dependent Variable: SRR

ANNEXURE IV: AMOUNT INVOLVED IN VARIOUS CHANNELS OF RESOLUTION RELATED TO STRESSED ASSETS OF BANKS W.R.T CORRESPONDING FINANCIAL YEAR

(₹ in crore)

Year	Lok Adalat	DRTs	ARCs	IBC
2004	2424	25336	19727	
2005	794	14313	13236	
2006	1109	6123	9824	
2007	759	9163	9050	
2008	2147	5816	7262	
2009	4024	4125	12071	
2010	7226	9791	14264	
2011	5245	14086	30619	
2012	1711	24073	35316	
2013	6553	30970	68071	
2014	23115	55268	95242	
2015	31025	60313	156862	
2016	71955	69298	80147	
2017	36179	100745	141376	
2018	45737	133150	82001	10013
2019	53724	268619	258455	148103
2020	67561	245745	196744	232381

Source: (RBI, 2021a)

ANNEXURE V: COUNTRY-WISE EVOLUTION OF TIME TAKEN (YEARS) TO RESOLVE THE STRESSED ASSETS AND STRESSED ASSETS TO GROSS LOANS RATIO (PERCENT) – 2009-10 TO 2019-20

	Stressed Assets to Gross Loans (percent)*		Time taken for resolution of stressed assets (years)*	
Country Name	**2009-10**	**2019-20**	**2009-10**	**2019-20**
Brazil	3.1	2.2	4.0	4.0
China	1.1	1.8	1.7	1.7
Germany	3.2	1.1	1.2	1.2
India	2.7	7.9	4.3	1.6
Indonesia	2.3	2.6	1.1	1.1
Ireland	13.9	3.4	0.4	0.4
Korea	0.6	0.2	1.5	1.5
Malaysia	3.4	1.6	2.3	1.0
Mexico	2.0	2.4	1.8	1.8
Philippines	3.3	3.5	5.7	2.7
Russia	8.3	8.3	2.0	2.0
South Africa	5.8	5.2	2.0	2.0
Spain	5.7	2.9	1.5	1.5
Sweden	0.8	0.5	2.0	2.0
Thailand	3.9	3.2	2.7	1.5
UK	4.0	1.2	1.0	1.0

**Missing values has been replaced with the nearest values.*

Source: http://data.un.org/Data.aspx?q=insolvency&d=WDI&f=Indicator_Code%3aIC.ISV.DURS, https://data.worldbank.org/indicator/FB.AST.NPER.ZS

ANNEXURE VI: MOVEMENT OF NPAs OF SCHEDULED COMMERCIAL BANKS

(₹ in crore)

Financial Year	Addition during the Year	Reduction during the Year	Write-off during the Year	Closing Balance
2013	119811.60	65457.96	7186.86	165005.70
2014	163911.61	86848.53	13795.07	228273.70
2015	177861.51	75678.45	50979.04	278467.92
2016	385962.04	65028.77	59444.84	539956.35
2017	327594.27	100780.87	81990.78	684732.28
2018	488175.38	82280.21	129503.57	895601.26
2019	210531.87	127835.39	183168.49	739541.00
2020	238464.08	99691.54	178305.31	678316.98
2021	278710.86	74685.13	133999.88	616615.55

Source: https://www.rbi.org.in/upload/Publications/PDFs/50596.pdf

[1] Ratio of investments in security receipts.

[2] List of ARCs registered with RBI as on January 31, 2022.

[3] Money: Capital investment, Haircuts, incentives, and management fees. Time: Appointments in Board of ARC's from PSBs.

[4] Five-year average.

[5] AMC is an interchangeable word with ARC in global context.

[6] Majority of banks were nationalized.

[7] Value of asset realized on resolution as a percentage of total value of assets involved.

[8] 2020-21 onwards, being an abnormal period due to pandemic, has been excluded from the analysis.

[9] https://in.mathworks.com/help/econ/hpfilter.html.

[10] Computed by author based on data presented in Chart 3.

[11] Illustration – PhoenixARC Financial Reports.

[12] Advanced economies – Germany, Spain, Sweden and United Kingdom. Emerging economies – Brazil, China, Indonesia, Malaysia, Mexico, Philippines, Russia, South Africa, and Thailand. Based on country classification list sourced from UN database (UN – WESP, 2022).

[13] Financial Institutions Strategic Transfer Corporations (FISTCs) – bad banks.

[14] Stamp duty, capital gains and value added taxes.

[15] Danaharta responsible for acquisition and Danamodal for restructuring/recapitalisation of stressed assets.

[16] Financial Regulatory Authority under the supervision of Federal Ministry of Finance, Germany.

[17] A term used in advanced economies where financial creditors face a haircut.

[18] Bridge institutions are similar to bad banks model, established specifically for resolution purpose with a sunset clause of maximum two years.

27 EARNINGS MANAGEMENT, STRESS AND AUDITOR CHANGE: THREE STEPS TOWARDS BANKRUPTCY?

-Sumit Banerjee, Rupesh Sharma and Dr. Swechha Chada

EXECUTIVE SUMMARY

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) presents a viable solution for the creditors of firms in distress. However, due to the lag between the admission of a case and its resolution, there is a fall in the value that could be recovered from a firm. Hence, it becomes imperative to understand the factors that separate probable bankrupt firms from those that do not go bankrupt. The authors test if earnings management, financial stress, and auditor change are good indicators of bankruptcy in the Indian context. The authors find that earnings management is a predictor of bankruptcy. However, the significance comes from accrual-based earnings management. Real earnings management has no effect on bankruptcy. The results are inconclusive regarding the relationship between financial stress indicators and bankruptcy. Further, the authors find that auditor change is a predictor of bankruptcy and can also indicate the phenomenon of audit opinion shopping by these firms on the verge of bankruptcy. This study has policy implications for designing early warning signals for firms on the verge of bankruptcy. This would help the creditors to employ timely corrective measures and recover a higher share of value from the proceedings.

Keywords: Bankruptcy, Earnings Management, Financial Stress, Auditor Change, Bankruptcy Prediction

INTRODUCTION

> '...We would expect that lenders do not wait for a default by a borrower to initiate resolution processes. Lenders should combine prudent risk pricing of their exposures with ongoing monitoring of the exposure and maintenance of adequate capital and risk provisions. Additionally, since the point at which a counterparty has become insolvent cannot be pinpointed accurately, the risk management practices of the lenders have to be sophisticated enough to capture the changes in risk factors that may affect the safety of the said credit exposure.'

Shri M. Rajeshwar Rao, Deputy Governor, Reserve Bank of India, highlighted the need for early assessment of risks of credit exposure in his speech at the first International Research Conference on Insolvency and Bankruptcy.[1] Shri Rao also suggested that there is a significant time gap between the default and the eventual filing for resolution under the IBC. There are further delays in the acceptance of the insolvency application after it has been filed. The time gap between filing and admission increased from 468 days in 2020-21 to 650 days in 2021-22, against a stipulated period of 14 days. This time lag results in the depletion of value that must be borne by the creditors eventually. Hence, it becomes imperative to identify critical indicators that can suggest if the credit facility that has been extended is in any danger of default.

Bankruptcy is an essential feature of a frictionless economy. It helps in the quick resolution of the claims of creditors on a firm that is not functioning optimally. However, a company going under bankruptcy exerts costs on the economy. The literature classifies these costs into four broad categories

(Branch 2002): a) real costs borne directly by the bankrupt firms, which include professional fees and internal staff resources; b) real costs borne by the claimants, including professional fees, their staff resources in protecting their interests, reduced marketability of instruments, and widening spreads; c) losses to the bankrupt firms that may be offset by the gains to the competition, like market share loss; and d) real costs borne by parties other than the bankrupt firm or its claimants, like a decline in the market value. The costs related to bankruptcy on the bankrupt firm, its employees, the claimants, investors, and the economy at large, are significant. An event like bankruptcy can have a cascading effect on the financial health of these stakeholders. Hence, examining the event of bankruptcy and its related triggers is a matter of public policy.

The case of *Satyam* had an economy-wide impact regarding the excesses of earnings management and how it can lead to severe consequences. Earnings management is a discretionary decision taken by management to alter the financial reports to suit their objectives. Since the incentives and employment of the managers are directly linked with the firm's earnings, it can be asserted that they are likely to extend their contractual relationship (Fisher, Gavious and Martel, 2019). It may also mean that the financial performance and position of the firm can be glossed over by managing the earnings until they cannot do so anymore. Hence, it is essential to understand if the bankruptcy of a firm is preceded by a significant amount of earnings management by the managers.

While earnings management may be an invisible indicator preceding bankruptcy, financial stress can be used by stakeholders to gauge the financial health of the firm. The authors use McKeown et al. (1991) for classifying firms under financial stress. The indicators that are used are a) negative working capital in the current year, b) operational losses in the three years prior to the bankruptcy filing, c) deficit in retained earnings in the past three years, and d) bottom-line losses in the last three years. Since these indicators of stress are visible only after the managers are unable to manipulate the earnings any further, any indication of financial stress is expected to be of greater importance than any other variable for predicting bankruptcy.

The third variable examined is not a financial variable but a governance variable. In India, where the market institutions are in the developing phase, auditors assume a huge governance responsibility. Higher promoter ownership, inadequate oversight of the board, and a lax judicial environment create opportunities for the manager to engage in activities that may be detrimental to the health of the firm. Management may want to compromise this position of governance by appointing someone who can overlook the managerial actions. Also, audit opinion shopping is a real phenomenon where managers get a favourable opinion by appointing a new auditor to verify the financial reports (Krishnan and Stephens 1995). Since the auditor is a vital governance functionary, the authors test if changing them can provide information about potential bankruptcy.

The authors have used the dataset from the Insolvency and Bankruptcy Board of India (IBBI) on companies opting for voluntary liquidation or companies admitted to the corporate insolvency resolution process (CIRP) and the financial data from the CMIE database to construct the dataset. It is found that accrual earnings management is positively related to bankruptcy. This variable is significant to bankruptcy filing even with a lag of three years. However, the authors do not find any significance in real activity-based earnings management. The results show that bankrupt firms mostly manipulate the accruals to hide the grim financial position of the firm. It is also to be noted that earnings management can give an advanced indication for possible bankruptcy. However, the authors did not find financial stress to be a significant predictor of bankruptcy. Lastly, the authors also find a positive and significant relationship between auditor change and bankruptcy. It can indicate that auditor change may be a last-ditch effort by the management to hide the poor financial position of the firm.

This study sheds light on the indicators of bankruptcy. The three variables are significant in some respects, indicating a possible bankruptcy of the firm. Results are important to policymakers in identifying firms in trouble and employing corrective measures. Further, the results can inform lenders in conducting a better assessment of borrowers' health. Finally, it also supports other stakeholders, like investors, in their decision-making on whether to invest in these companies.

The paper first discusses the literature and develops hypotheses. It then details the data used in the paper and presents the results and discusses their implications. Finally, the paper provides the conclusion for the study.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Earnings management and bankruptcy

Managers engage in earnings management to present a synthetic appearance of consistent profits and to smooth fluctuations in earnings. Earnings management refers to the deliberate actions done by the management in the external financial reporting process to extract private benefits (Schipper, 1989). Managers exploit their discretionary powers to alter the financial reports from showing an inaccurate financial position. The management makes these alterations to largely present a favourable view of the firm. The managers are motivated to indulge in these practices as the incentive structure is primarily based on the reported earnings (Becker et al. 1998).

Managers inflate their earnings to meet or beat market expectations. The target figures set by the analysts and shareholders become a milestone to achieve for these firms (Haw et al. 2005; Rodríguez-Pérez and van Hemmen 2010). If the firms fail to achieve the target, there is a loss in firm value as investors offload their shares. Then, there are also the parameters set by the lenders as debt covenants that require the managers to show a certain level of financial performance. On the other hand, managers deflate their earnings to create 'cookie jar reserves'[2] or take a 'big bath'[3] in a particular year to ensure the performance in the following year looks better in comparison.

It is evident that the act of earnings management helps cover up the bad financial positions of the firm. Financial misrepresentation is not without its downside. It results in enforcement actions by the regulators in the form of penalties and legal actions against the firm. These actions entail enormous costs for firms and deter managers from such practices. However, a higher cost is one that is imposed by the market by reducing the firm value to something that is closer to the 'true' value of the firm, considering the misrepresented financial statements (Karpoff, Lee, and Martin 2008). This highlights that an intangible cost, that of reputation loss, out of such action is also applied to the firm. Since a bad financial position invites a higher level of scrutiny from various stakeholders, earnings management not only polishes over the poor financial position but also deters the stakeholders from understanding the need to employ corrective measures to improve performance. Prior empirical evidence establishes that firms inflate their earnings in the period leading to the filing of bankruptcy and reduce it close to the filing date (Leach & Newsom, 2007). It has also been found that firms having inflated earnings are less likely to recover from bankruptcy procedures (Fisher, Gavious and Martel, 2019).

While not explicitly illegal, a continuous engagement in earnings management projects a distorted position of the firm. The incorrect financials may prevent effective monitoring by the regulators and misinform investors. Continued earnings management could lead to an unmanageable amount of manipulation, resulting in eventual bankruptcy, as seen in *Satyam Computers'* case in 2009. The *Satyam* case in India stands as the model representative of the fallout of earnings management. The Chairman and CEO, Mr. Ramalingam Raju, manipulated the books of accounts to inflate the quarterly profits to meet the analysts' estimates. The highly inflated books of accounts presented *Satyam* as a bright prospect for investing when the company was not performing well enough. The reported quarterly revenues for the second quarter of 2008 were inflated by ₹ 588 crore to ₹ 2,700 crore, and the actual operating margins were less than a tenth of the reported ₹ 649 crore.[4] *Satyam* was eventually sold to Tech Mahindra for approximately one-tenth of its value one year prior to the sale.

Excessive earnings management inflates the firm's position, further increasing market expectations and resulting in the need to report higher earnings. This vicious spiral can have detrimental effects unless stopped by the management or auditors. Overall, these concerns render the extent of earnings management a determining factor in the case of bankruptcy. Hence, the authors hypothesise that:

H_1: Earnings management is related to firm bankruptcy.

Stress and bankruptcy

Financial stress stymies the ability of the management to engage in productive activities and restricts the managers' capacity to take risks. The authors use the McKeown et al. (1991) model to identify stressed companies. They use four financial indicators as symptoms of a company under stress (McKeown, Mutchler, and Hopwood 1991). The indicators used were: a) negative working capital in the current year, b) operational losses in the three years prior to filing for CIRP, c) deficit in retained earnings in the past three years, and d) bottom-line losses in the last three years.

Positive working capital allows the management to make larger allowances for trade credit and have inventory to meet surprise demands (Blinder and Maccini 1991). It reduces the effect of fluctuations in production costs and helps them manage erratic customer demand. A higher working capital can also allow the firm to acquire customers by extending a larger credit period in times of low demand (Brennan, Maksimovic, and Zechner, 2022). Research says that there is an optimum level of working capital that is best for the firm, deviation from which in either direction leads to negative value creation (Baños-Caballero, García-Teruel, and Martínez-Solano 2014). However, having a positive working capital allows room for the managers to make economic decisions to increase revenue. On the other hand, a negative working capital indicates inefficiency. It reduces the capacity of precautionary liquidity that a firm enjoys in controlling the vagaries of the market (Fazzari and Petersen 1993).

Losses erode the wealth of the firm, which restricts its risk-taking ability. For a firm to function ordinarily, it must provide for the eroded wealth through some other source. Two prominent bankruptcy prediction theories suggest the extreme ends of this replenishment (Scott 1981). The Gambler's ruin model suggests that the loss in the business has to be met by selling assets. However, per the perfect-access model, the loss can be met by selling debt or equity in a frictionless market. More efficient models lie in between these extremes. However, the point to note here is that the loss negatively affects either the operational conditions of the firm or the financial conditions of the firm. The loss is registered as either an operational loss, a bottom-line loss, or a deduction in retained earnings. Extant research shows that firms under financial stress have received going-concern modified audit opinions (Geiger, Raghunandan, and Rama 2005; Geiger and Raghunandan 2001). Hence, the authors hypothesise that:

H_2: Stressed financial statements are positively related to bankruptcy.

Auditor change and bankruptcy

Auditor change can be initiated due to a variety of reasons. Some of these reasons indicate a positive change in the firm's outlook. The signalling theory states that firms can change auditors to signal a better operating environment. Firms may get reputed auditors to signal that the firm is open to stricter scrutiny. This would signal that the firm's audited financial statements are of superior quality.

Auditors can also be changed for monetary considerations. Management can change auditors to spend less on auditor fees. Usually, this results in contracting an auditor of lower repute. This can, in some cases, result in reduced audit quality.

An essential reason for auditor change can be managerial entrenchment. As per the agency theory, the manager may not work for the firm value maximisation (Jensen & Meckling, 1976). The information asymmetry between the manager and the other stakeholders creates opportunities for the manager to extract private benefits from this position. The auditor can be in a position to draw attention to these questionable managerial actions, which can adversely affect the managerial position. Hence, the manager would likely appoint an auditor that can overlook their activities (Lin and Liu 2009). An auditor can also be changed due to incompatibility between the auditor and the manager. This change can be initiated to ensure that the objectives of the auditor are aligned with the objectives of the management.

Another reason for auditor change is audit opinion shopping. It is done by the management to obtain a more favourable audit opinion from a new auditor (Krishnan and Stephens 1995; Lennox 2000). The extant literature states that such change happens after receiving modified audit opinions (Archambeault and DeZoort 2001). It has also been found that firms engaging in audit opinion shopping have a weak audit environment. In such cases, the lack of oversight helps the management get a favourable opinion after the auditor change. Empirical evidence suggests that if the current auditor restricts the management's control over unfavourable financial information in the reporting process, the management is more inclined to opt for a new auditor (Kluger and Shields 1989).

The various reasons for auditor change underline the fact that the intended consequence of auditor change can differ from the intentions of management. Some of the firms may want to change to seek better audit quality and signal to the stakeholders about the future growth trajectory of the firm. However, others may change auditors in pursuit of private goals. The management may want to extract benefits or get a favourable opinion from the new auditor. In these cases, the chance of the reported financial results not showing the firm's actual financial performance and position is higher. Previous studies find that auditor switching is more frequent in the case of bankrupt firms (Schwartz and Menon, 2022). A series of such erroneous financial reports can mislead the stakeholders. A compromised audit opinion may also prevent a financial problem from showing on the financial reports. Since the problem cannot be identified on time and corrective measures cannot be employed to adjust the firm's operations, the financial problems may exacerbate and eventually lead to default. Hence, the authors hypothesise that:

H_3: The change of auditor is related to firm bankruptcy.

DATA

Data sample

The historical firm-level financial data for the Indian firms are collected from CMIE Prowess$_{dx}$. The list of firms that filed for bankruptcy is compiled from the IBBI and merged with the firm-level financial data. Bankrupt firms are classified as such, irrespective of the process initiated by themselves or their creditors. The data for such firms is available from January, 2017 to March, 2022. The database publishes the details about the date of commencement of insolvency proceedings, duration of proceedings, parties that triggered the resolution process (financial creditors, operational creditors, or corporate debtors), claims by different lenders, liquidation value and the realisable amount. The authors winsorise all continuous variables at 1% and 99% to mitigate the impact of outliers on our estimations.

Empirical model

The empirical design examines whether earnings management, as hypothesised, influences the firm's decision to file for bankruptcy. The following baseline regression equation shows panel regression for this test:

$$\begin{aligned}\text{Bankrupt}_{it} = {} & \beta_0 + \beta_1 * \text{EM}_{it-1} + \beta_2 * \text{Stress}_{it-1} \\ & + \beta_3 * \text{Auditor Change}_{it-1} \\ & + \beta_4 * \text{EM}_{it-1} * \text{Stress}_{it-1} * \text{Auditor Change}_{it-1} \\ & + \beta_5 * \text{Firm Size}_{it-1} + \beta_6 * \text{Leverage}_{it-1} + \beta_7 * \text{Tobins Q}_{it-1} \\ & + \beta_8 * \text{CapEx}_{it-1} + \beta_9 * \text{CF Volatility}_{it-1} + \beta_{10} * \text{ROA}_{it-1} \\ & + \beta_{11} * \text{IO}_{it-1} + \beta_{12} * \text{Dividend Dummy}_{it-1} + \beta_{13} * \beta\text{G}_{it-1} \\ & + \text{YFE} + \text{IFE} + \varepsilon_{it} \qquad \text{Eq. (1)}\end{aligned}$$

where *i* is the firm and *t* is the year. The dependent variable, bankrupt, is a dummy variable that takes the value 1 if it has filed for bankruptcy or opted for voluntary liquidation. Otherwise, the surviving firms in the sample are coded 0. Therefore, the authors choose the Logit regression model to produce unbiased estimates in the study (Wooldridge 2010). The authors also test our hypothesis by adopting probit analysis. The coefficients of interest are the coefficients of EM $_{it-1}$ (β_1), Stress $_{it-1}$ (β_2), Auditor Change $_{it-1}$ (β_3). The model is controlled for differences in firm size (Firm Size $_{it-1}$), capital structure (Leverage$_{it-1}$), market valuation (Tobins Q $_{it-1}$), investment profile (CapEx $_{it-1}$), cash flow volatility (CF Volatility $_{it-1}$), profitability (ROA $_{it-1}$), institutional ownership (IO $_{it-1}$), dividend payment (Dividend Dummy $_{it-1}$), business group affiliation (βG $_{it-1}$), year fixed effects (YFE) and industry fixed effects (IFE).

Variable construction

The primary independent variable is accruals earnings management. Different measures of earnings management can be employed. Total earnings comprise non-discretionary and discretionary accruals (Dechow et al., 1995). Non-discretionary accruals are normal accruals that reflect a firm's accurate financial position and income. Discretionary accruals or abnormal accruals represent the magnitude of accruals recognised through managers' discretion and are more likely to contain measurement errors (Dechow et al., 2010). Managers manage earnings to reach their desired objectives: they manipulate accruals by delaying expense detection or accelerating revenue recognition (Healy and Wahlen 1999).

According to Dechow & Dichev (2002), accruals quality, a measure of earnings management s quality, is calculated as follows:

$$\begin{aligned}\frac{\text{WCA}_{it}}{\text{Total Assests}_{it}} = {} & \beta_0 + \beta_1 * \frac{\text{CFO}_{it-1}}{\text{Total Assests}_{it}} + \beta_2 * \frac{\text{CFO}_{it}}{\text{Total Assests}_{it}} \\ & + \beta_3 * \frac{\text{CFO}_{it+1}}{\text{Total Assests}_{it}} + \text{Industry Fixed Effects} \\ & + \text{Year Fixed Effects} + \varepsilon_{it}\end{aligned}$$

Eq. (2)

where WCA $_{it}$, working capital accruals of firm *i* in year *t* is calculated as the change in current assets (ΔCA), minus the change in cash and cash equivalents (Δ Cash), minus the change in current liabilities (ΔCL), plus the change in short term bank debt. Cash flow from operations (CFO_{it}) in a year is calculated as net income before extraordinary items (NIBE) minus total accruals (TA). Further, TA is the difference between working capital accruals and depreciation and amortisation expenses (WCA $_{it}$–Dep $_{it}$). Variables are deflated by average total assets, which are calculated as the mean of the firm's assets in the year (t-1) and (t). The regression is controlled for industry and year fixed effects. The industry fixed effect is executed by classifying the firms based on the first two digits of NIC classifications.

The residual of this regression measures the discretionary accruals. The residual is the annual variation in the working capital accruals that remains unexplained by the firm's previous, current, and future cash flow. To evaluate the robustness of the results observed with Dechow & Dichev's (2002) accruals quality measure, the authors repeat the analyses with alternate proxies. Another alternative, widely used in the literature, is estimated following Ball & Shivakumar (2006). This model controls not only for cash flows in consecutive periods but also for changes in cash flows.

For assessing real earnings management, the authors follow the Roychowdhury (2006) method to compute the abnormal cash flow from operations. The authors prepare the data in a similar format as in the case of the calculation of accrual earnings management. The authors conduct cross-sectional regression on our dataset for every year and every industry based on the 2-digit NIC code. The term 'Abnormal Cash Flow' from operations is defined as the residual term in the following regression model:

$$\frac{CFO_{j,t}}{TA_{j,t-1}} = \alpha_0 + \beta_1 . \frac{1}{TA_{j,t-1}} + \beta_2 . \frac{SLS_{j,t}}{TA_{j,t-1}} + \beta_3 . \frac{\Delta SLS_{j,t}}{TA_{j,t-1}} + \varepsilon_{j,t} \qquad \text{Eq. (3)}$$

The authors employ two more measures of calculating real earnings management, named Abnormal Production and Abnormal Expenditures, and run a similar regression for these two variables, which are the residual terms of the following two regression models, regressed for every year and every industry. In equation (4), the dependent variable is the production costs, which have been calculated as the summation of the cost of goods sold and change in inventory (COGS + ΔINV). In equation (5), the authors have considered selling and distribution expenses as discretionary expenses.

$$\frac{Prod_{j,t}}{TA_{j,t-1}} = \alpha_0 + \beta_1 . \frac{1}{TA_{j,t-1}} + \beta_2 . \frac{SLS_{j,t}}{TA_{j,t-1}} + \beta_3 . \frac{\Delta SLS_{j,t}}{TA_{j,t-1}} + \beta_4 . \frac{\Delta SLS_{j,t-1}}{TA_{j,t-1}} + \varepsilon_{j,t} \qquad \text{Eq. (4)}$$

$$\frac{DisExp_{j,t}}{TA_{j,t-1}} = \alpha_0 + \beta_1 . \frac{1}{TA_{j,t-1}} + \beta_2 . \frac{SLS_{j,t}}{TA_{j,t-1}} + \ + \varepsilon_{j,t} \qquad \text{Eq. (5)}$$

Hypothesis 3 examines the effect of changing the auditor years before filing for the bankruptcy process.

RESULTS AND DISCUSSION

Effect of earnings management on bankruptcy

In this section, the authors examine the impact of earnings management on bankruptcy, and estimate a panel fixed effect regression, logit and probit analysis. The dependent variable, Bankruptcy_Status, equals 1 if the creditors of the firm (either operational or financial) filed for bankruptcy, and 0 otherwise, in a given financial year. In addition to the proxies of accruals earnings management, the authors also control for other predictors of bankruptcy, as shown in Eqn. (1) (unreported). The results are reported in Table 1. The independent variable is accruals earnings management, estimated following Dechow & Dichev (2002) in Columns (1), (3) and (5) of Table 1. The authors find that upon controlling for all the other covariates, there is a positive relationship between accruals earnings management and filing for bankruptcy. The measures of accruals earnings management are lagged for 3 years (AEM_DD_1 lagged by 1 year, AEM_DD_2 lagged by 2 years, and AEM_DD_3 lagged by 3 years). The results are consistent when estimated following Logit and Probit in Columns (3) and (5).

To test the robustness of the results, the authors re-estimate accruals earnings management, estimated following Ball & Sivakumar (2006). The results are reported in Columns (2), (4) and (6) of Table 1. The results are consistent in that there is a positive relationship between accruals earnings management and filing for bankruptcy. Our results establish that accruals earnings management remains significant for three financial years prior to bankruptcy.

Table 2 examines the relationship between real earnings management and filing for bankruptcy. The analysis is repeated using panel fixed effects, Logit and Probit, using alternate proxies for real earnings management. Interestingly, the authors find no significant relationship between real earnings management and the probability of filing for bankruptcy. The lagged real earnings management is statistically insignificant for the three preceding financial years prior to bankruptcy.

Effect of financial stress on bankruptcy

Hypothesis 2 tests the effect of the financial stress indicators of a firm on bankruptcy. Following McKeown et al. (1991), authors classify the firms are stressed firms based on the following four symptoms: a) negative working capital in the current year, b) operational losses in the three years prior to filing for CIRP, c) deficit in retained earnings in the past three years and d) bottom line losses in last three years. A firm is said to be stressed if it exhibits any of the above four symptoms in the three years before filing for bankruptcy. Table 3 presents the impact of firm stress on bankruptcy. The authors employ firm stress lagged for the preceding three financial years. Contradictory to the expectations, the authors find that there is no statistically significant relationship between a firm's financial stress and bankruptcy filing. The analysis has to be repeated using the latest and relevant indicators of financial stress in the firm to test its robustness.

Effect of auditor change on bankruptcy

Extant literature suggests that auditor turnover is one of the critical factors that affect earnings management in firms that may file for bankruptcy. In this regard, the authors examine if auditor turnover can be one of the salient features of firms before filing for bankruptcy. The variable Auditor_Change is a dummy variable that takes the value of 1 if there is a change in auditor or audit partner in Indian firms. The results are tabulated in Table 4. The authors find that there is a positive relationship between auditor change and bankruptcy filing. The results suggest that the financially distressed Indian firms switched auditors, probably to impact earnings management.

CONCLUSION AND FUTURE DIRECTIONS

The study investigates the relationship between two financial indicators and one governance indicator in the bankruptcy of a firm. Results indicate that earnings management is significantly related to bankruptcy status. Furthermore, authors find that the relationship is significant for accrual-based earnings management and not for real earnings management. This result is significant for lagged values of earnings management for up to three years. It shows that early identification of earnings management in problematic firms can help in employing corrective measures to prevent bankruptcy. Interestingly, authors do not find significance in our variable of financial stress as a predictor of bankruptcy. Theoretically, financial stress should be a significant indicator of bankruptcy, as a profit-making firm is less likely to file for bankruptcy. However, the analysis does not provide any empirical support for that argument. Financial stress reduces the room for reporting discretion in giving a going-concern modified opinion (Geiger and Raghunandan 2001). It shows that financial stress is an essential indicator of bankruptcy. However, the results do not support these findings. It is found that auditor change is an important predictor of bankruptcy. It supports the audit opinion shopping theory that the auditor may be changed by the firms to get a favourable report when in crisis. The new regulations under the Companies Act, 2013 that limit the board's power to terminate an auditor's contract and provide a fixed tenure can reduce the influence of the management on the auditor's opinion.

The findings have some policy implications. Earnings management is not an illegal practice and, in some cases, may help a firm to reduce information asymmetry. However, it allows firms to embellish their books when in crisis. It is necessary to examine the books of the firms that are managing earnings to understand their actual positions. Also, the auditor's tenure has been fixed under the new regulations. However, auditor change in a firm that is not performing well may indicate possible bankruptcy. Auditor change has to be examined deeply by the stakeholders to get an accurate assessment of the solvency of the firm. As the insolvency and bankruptcy proceedings are still in nascent stages, information about these indicators can help creditors and regulators anticipate possible bankruptcies and aid in protecting creditors' rights.

BIBLIOGRAPHY

1) Archambeault D. and DeZoort F. (2001), "Auditor Opinion Shopping and the Audit Committee: An Analysis of Suspicious Auditor Switches", International Journal of Auditing.

2) Ball R. and Shivakumar L. (2006), "The Role of Accruals in Asymmetrically Timely Gain and Loss Recognition", Journal of Accounting Research, 44(2), pp. 207-242.

3) Baños-Caballero S. et al. (2014), "Working capital management, corporate performance, and financial constraints", Journal of Business Research, 67, pp.332-338.

4) Becker C. et al. (1998), "The Effects of Audit Quality on Earnings Management", Contemporary Accounting Research, 15(1), pp. 1-24.

5) Blinder A. and Maccini L. J. (1991), "The Resurgence of Inventory Research: What have we learned?", Journal of Economic Surveys, 5(4), pp. 291-328.

6) Branch B. (2002), "The costs of bankruptcy: A review", International Review of Financial Analysis, 11, pp. 39-57.

7) Brennan M. et al. (1988), "Vendor Financing", The Journal of Finance, 43(5), pp. 1127-1141.

8) Dechow P. and Dichev I. (2002), "The Quality of Accruals and Earnings: The Role of Accrual Estimation Errors", The Accounting Review, 77, pp. 35-59.

9) Dechow P. et al. (1995), "Detecting Earnings Management", The Accounting Review, 70(2), pp. 193-225.

10) Dechow P. et al. (2010), "Understanding Earnings Quality: A Review of the Proxies, Their Determinants and Their Consequences", Journal of Accounting and Economics, 50(2), pp. 344-401.

11) Fazzari S. and Petersen B. (1993), "Working Capital and Fixed Investment: New Evidence on Financing Constraints", The RAND Journal of Economics, 24(3), pp. 328-342.

12) Fisher T. et al. (2019), "Earnings Management in Chapter 11 Bankruptcy", Abacus, 55(2), pp. 273-305.

13) Geiger M. and Raghunandan K. (2001), "Bankruptcies, Audit Reports, and the Reform Act", Auditing: A

Journal of Practice & Theory, 20(1), pp. 187-195.

14) Geiger M. et al. (2005), "Recent Changes in the Association between Bankruptcies and Prior Audit Opinions", AUDITING: A Journal of Practice & Theory, 24(1), pp. 21-35.

15) Haw I.-M et al. (2005)," Market Consequences of Earnings Management in Response to Security Regulations in China", Contemporary Accounting Research, 22(1), pp.95-140.

16) Healy P. and Wahlen J. (1999), "A Review of the Earnings Management Literature and Its Implications for Standard Setting", Accounting Horizons, 13(4), pp. 365-383.

17) Jensen M. and Meckling, W. (1976), "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", Journal of Financial Economics, pp. 305-360.

18) Karpoff J. et al. (2008), "The Cost to Firms of Cooking the Books", The Journal of Financial and Quantitative Analysis, 43(3), pp. 581-611.

19) Kluger B. and Shields D. (1989), "Auditor Changes, Information Quality and Bankruptcy Prediction", Managerial and Decision Economics, 10(4), pp 275-282.

20) Krishnan J. and Stephens R. (1995), "Evidence on opinion shopping from audit opinion conservatism", Journal of Accounting and Public Policy, 14(3), pp.179-201.

21) Leach R. and Newsom, P. (2007), "Do Firms Manage their Earnings Prior to Filing for Bankruptcy?", Academy of Accounting and Financial Studies Journal, 11(3), pp. 125-137.

22) Lennox C. (2000), "Do companies successfully engage in opinion-shopping? Evidence from the UK", Journal of Accounting and Economics, 29, pp.321-337.

23) Lin Z. and Liu M. (2009), "The impact of corporate governance on auditor choice: Evidence from China", Journal of International Accounting, Auditing and Taxation, 18(1), pp. 44-59.

24) McKeown J. et al. (1991), "Towards an Explanation of Auditor Failureto Modify the Audit Opinions of Bankrupt Companies. Auditing", A Journal of Practice & Theory, 10(Supplementary), pp. 1-13.

25) Rodríguez-Pérez G. and van Hemmen S. (2010), "Debt, Diversification and Earnings Management. Journal of Accounting and Public Policy", 29(2), pp.138-159.

26) Schipper K. (1989), "Earnings Management. Accounting Horizons", 3(4), pp. 91-102.

27) Schwartz K. B. and Menon K. (1985), "Auditor Switches by Failing Firms. The Accounting Review", 60(2), pp. 248-261.

28) Scott J. (1981), "The Probability of Bankruptcy", Journal of Banking & Finance, 5(3), pp. 317-344.

29) Woolridge J. M. (2010), "Econometric Analysis of Cross Section and Panel Data (2nd ed.)", Cambridge: MIT Press.

Table 1: Effect of Accruals EM on bankruptcy

	Dependent variable:					
	Bankruptcy_Status					
	Panel		**Logit**		**Probit**	
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
AEM_DD_1	0.072**		2.216***		1.016***	
	t = 2.756		t = 3.277		t = 3.294	
AEM_DD_2	0.054***		1.953***		0.923***	
	t = 3.068		t = 2.965		t = 3.079	
AEM_DD_3	0.056***		2.147***		0.983***	
	t = 3.286		t = 3.305		t = 3.336	
AEM_BS_1		0.074**		2.342***		1.062***
		t = 2.732		t = 3.510		t = 3.498
AEM_BS_2		0.046**		1.728***		0.837***
		t = 2.295		t = 2.699		t = 2.871
AEM_BS_3		0.049***		1.785***		0.813***
		t = 3.653		t = 2.804		t = 2.818
Constant			-2.790***	-2.743***	-1.495***	-1.460***
			t = -5.751	t = -5.670	t = -6.783	t = -6.643
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Ind FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	9,265	9,265	9,265	9,265	9,265	9,265
R^2	0.112	0.112				
Adjusted R^2	0.105	0.105				
Note:						*p<0.1; **p<0.05; ***p<0.01

Table 2: Effect of Real EM on bankruptcy

	Dependent variable:					
	Bankruptcy_Status					
	Panel		Logit		Probit	
	(1)	(2)	(3)	(4)	(5)	(6)
REM1_1	-0.005		-0.226		-0.126	
	t = -0.437		t = -0.590		t = -0.728	
REM1_2	0.006		0.105		0.049	
	t = 0.687		t = 0.247		t = 0.251	
REM1_3	0.007		0.330		0.174	
	t = 0.704		t = 0.896		t = 1.045	
REM2_1		0.025		-0.020		0.003
		t = 0.580		t = -0.015		t = 0.006
REM2_2		0.018		0.083		0.043
		t = 0.681		t = 0.062		t = 0.071
REM2_3		0.014		0.433		0.213
		t = 0.463		t = 0.349		t = 0.385
Constant			-2.423***	-2.390***	-1.245***	-1.236***
			t = -4.675	t = -4.633	t = -5.365	t = -5.362
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Ind FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	8,713	8,713	8,713	8,713	8,713	8,713
R^2	0.091	0.091				
Adjusted R^2	0.083	0.083				
Note:						*p<0.1; **p<0.05; ***p<0.01

Table 3: Effect of Firm Stress on bankruptcy

	Dependent variable:		
	Bankruptcy_Status		
	Panel	**Logit**	**Probit**
	(1)	**(2)**	**(3)**
Firm_Stress_1	-0.002	-0.204	-0.075
	t = -0.265	t = -0.943	t = -0.749
Firm_Stress_2	0.007	0.022	-0.007
	t = 0.975	t = 0.097	t = -0.063
Firm_Stress_3	0.003	-0.092	-0.033
	t = 0.363	t = -0.399	t = -0.309
Constant		-1.762***	-0.966***
		t = -2.879	t = -3.512
Ind FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	7,232	7,232	7,232
R^2	0.133		
Adjusted R^2	0.125		
Note:			*p<0.1; **p<0.05; ***p<0.01

Table 4: Effect of Auditor Change on bankruptcy

	Dependent variable:		
	Bankruptcy_Status		
	Panel	**Logit**	**Probit**
	(1)	**(2)**	**(3)**
Auditor_Change	0.011	0.292*	0.143*
	t = 1.452	t = 1.741	t = 1.906
Constant		-3.580***	-1.836***
		t = -6.226	t = -7.243
Control Variables	Yes	Yes	Yes
Ind FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	8,049	8,049	8,049
R^2	0.088		
Adjusted R^2	0.079		
Note:			*p<0.1; **p<0.05; ***p<0.01

[1] Address delivered by Shri M. Rajeshwar Rao, Deputy Governor, Reserve Bank of India – April 30, 2022 – in the First International Research Conference on Insolvency and Bankruptcy held at IIM Ahmedabad.

[2] It refers to the creation of hidden reserves by company in good years that can used during bad years in future to increase earnings.

[3] It refers to the act of management where they deliberately make the income results look worse in a poor year so that future results may look better.

[4] Scandal at Satyam: Truth, Lies and Corporate Governance, Knowledge at Wharton, Wharton School of the University of Pennsylvania.

28 RESOLUTION APPLICANTS: STAKEHOLDERS IN THE SUCCESSFUL RESOLUTION OF CORPORATE DEBTORS

- Vijaykumar V Iyer, Ankur Bhargava and Asman Avinav Joshi

EXECUTIVE SUMMARY

The resolution applicants play a vital role as stakeholders in any corporate insolvency resolution process (CIRP) and in the revival of a corporate debtor (CD) under the Insolvency and Bankruptcy Code, 2016 (IBC/Code). Despite the growth in the market for resolution applicants since 2016, challenges still exist for participation of resolution applicants in CIRP, including the delays and difficulties faced in obtaining approvals for resolution plans. The research paper, in the first part of the study uses available data to analyze participation of resolution applicants in successful resolutions under CIRP by industry, investment trends of resolution applicants by major industry sectors, and the impact on realization by financial and operational creditors of CD. The second part of the study, conducted through a survey of 50 Resolution Professionals (RPs), identifies the challenges faced by resolution applicants and the tools available for identifying stressed assets in CIRP. Lastly, the authors provide recommendations to address the identified issues to make CIRP more efficient.

Keywords: Insolvency, Bankruptcy, Corporate Insolvency Resolution Process, Corporate Debtor, Resolution Applicant, Industry Sectors, Challenges, Delay, Financial Creditors, Operational Creditors, Tools, Survey

INTRODUCTION

'You don't run a business hoping you don't have a recession'

- Jamie Dimon

'The only good loan is one that gets paid back'

- Robert Wilmers

The IBC was enacted to provide a framework for the resolution of stress in insolvent corporates, partnership firms and individuals. It also provides a framework for creditors to resolve the issue of non-performing assets (NPAs) in their books and thus aims to improve the credit availability in the economy. The objectives of the Code include the rehabilitation and revival of the companies under stress in a court monitored time-bound and effective manner for maximization of value of assets of such companies, 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 (IBBI/Board), and for matters connected therewith or incidental thereto.

Thus, the Code as a legislation not only deals with the recovery of debts but also with the economy of the whole country.[1]

The Code gives a platform for the CD to revive, recover, and compete in the market, post a successful resolution plan submitted by the resolution applicant under the CIRP. As a result, the resolution applicants play a major role as a stakeholder in the CIRP for the revival of a CD.

Section 25 of the Code prescribes the duties of a RP, which includes the duty to invite prospective resolution applicants[2] to submit resolution plans for the CD. Further, section 5(25) of the Code defines a resolution applicant as any person who submits a resolution plan individually or jointly with any other person.

A resolution applicant under the Code can be any person and the criteria describing the ineligibility of the resolution applicants to submit a resolution plan is provided under section 29A of the Code. Therefore, notwithstanding any provisions of any other acts, the Code allows a resolution applicant, which may include corporate firms, financial institutions (including creditors of the CD), and asset reconstruction companies (ARCs) to submit a resolution plan in the CIRP of a CD.

The CIRPs under the Code have seen active interest and participation from a wide array of potential resolution applicants belonging to various industries, which is evident from the fact that successful resolution has been achieved in as many as 517 CIRP cases as on June 30, 2022.[3]

PROBLEM STATEMENT AND OBJECTIVE

This research paper aims to identify and analyze the role of resolution applicants as a stakeholder in the CIRP. As part of the research, different kinds of resolution applicants including corporate entities, financial institutions, and ARCs who have submitted resolution plans for the CDs have been analyzed. For ease of analysis, the data set considered is limited to cases where the resolution plan has been approved by the Hon'ble Adjudicating Authorities (AAs).

The research paper attempts to further analyze the issues faced by the resolution applicants in achieving closure of the process before and after the approval of the plan by the AAs.

The research paper aims to address the research questions as laid down below:

a) Who are successful resolution applicants/participants in the resolution of CDs and which sector of the industry do such successful resolution applicants belong?

b) Whether the successful resolution applicants and CDs belong to the same industry sector?

c) What is the realizable amount offered by the resolution applicants of a specific industry to the financial creditors (FCs) and operational creditors (OCs)?

d) What are the challenges faced by the successful resolution applicants before and after the approval of the resolution plan by the AAs?

e) What are the enablers, tools, and means available to the resolution applicants to identify a stressed asset under CIRP?

This research paper also aims to analyze the findings of the research, to identify any grey areas or gaps in the current framework for the CIRP under the Code, and to make recommendations to fill such gaps, thereby assisting in the development of a more effective framework for participation of resolution applicants under the Code.

SAMPLE SIZE OF THE DATA ANALYZED AND SURVEY CONDUCTED

a) The authors have gathered data of CDs achieving successful resolution from the IBBI website and the IBBI quarterly newsletters.[4]

   The authors referred to orders of Hon'ble National Company Law Tribunal (NCLT) approving the resolution plan for CDs undergoing CIRP and identified the resolution applicant as well as the industry to which such resolution applicants belong.

Out of 517 CDs achieving resolution, the authors could identify the resolution applicants of 478 CDs. The remaining resolution applicants of CDs in 39 cases could not be identified due to the non-availability of the relevant information on the IBBI portal or their reference in the NCLT orders.

The authors have then plotted the industry of the successful resolution applicant based on public sources of data.

b) The authors also conducted a survey in the form of a detailed questionnaire, which was sent to 1007 Insolvency Professionals (IPs), of which 50 IPs with a cumulative experience of over 160 assignments as RPs in CIRP participated and submitted their responses.

RESEARCH LIMITATIONS

The authors have identified the following limitations of the proposed research:

a) The data analysis is contingent on the availability and accuracy of data extracted from the IBBI portal and IBBI newsletters. The extracted data sets of some CDs were incomplete.

b) The survey relies on the responses of the 50 IPs and does not reflect the opinions of the authors. The variance in sample size and responses may impact the observations of the survey.

WHO CAN BECOME A RESOLUTION APPLICANT UNDER THE CODE?

Section 25(2)(h) of the Code requires the RP to invite resolution plans from prospective resolution applicants who fulfill criteria as laid down by the RP with the approval of the CoC, having regard to the complexity and scale of operations of the business of the CD and such other conditions as may be specified by the Board.

Before the Insolvency and Bankruptcy Code (Amendment) Act, 2017,[5] there was no set of criteria prescribed under the Code prohibiting a resolution applicant to submit a resolution plan. As observed in a few cases, there was no restriction on the promoters to participate in the CIRP and submit a resolution plan for the CD. There was an apprehension and belief that the people responsible for taking the CD into financial stress and insolvency could gain back control of the CD, which in turn may not fulfill the objective of revival and rehabilitation of the CD.

The Code envisaged that the resolution plans of businesses should increase the value of the CD over the years in a sustained way, which requires strategies for going beyond the mere restructuring of liabilities. Thereafter, the 2018 amendment was brought into force and section 29A was introduced in the Code, prescribing the ineligibility criteria for the resolution applicants.

Section 29A of the Code

The Code doesn't limit any person to act as a resolution applicant except the category of applicants mentioned under section 29A of the Code. This section has become the yardstick to determine the eligibility of potential resolution applicants. It was brought into force vide the 2018 Amendment Act[6] and was modified twice by way of amendments.[7] It was enacted to protect the CD from resolution applicants who could have a negative impact on the CD, thereby affecting the objectives of the Code, i.e. to maximize the value of assets of the CD, and to ensure a feasible and viable turnaround of the CD.

Section 29A does not specifically exclude the promoters and the incumbent management of the CD, but it contains enabling provisions that result in the majority of promoters being covered under its ambit, making them ineligible to submit a resolution plan.[8]

To be eligible to submit a resolution plan, a person must meet the criteria laid down by the RP with the approval of the committee of creditors (CoC) and must not be ineligible to submit a resolution plan under section 29A.

A person who suffers from the disqualifications listed below is not eligible to submit a resolution plan, according to section 29A. Furthermore, any other person acting jointly or in concert with the prospective resolution applicant is subject to the disqualifications listed below –

a) the person is an undischarged insolvent;

b) the person is a willful defaulter in terms of the Reserve Bank of India (RBI) Guidelines issued under the Banking Regulation Act, 1949;

c) the person has an account, or an account of a CD under the management or control of such person or of whom such person is a promoter, classified as NPA in accordance with RBI Guidelines issued under the Banking Regulation Act, 1949 and at least a period of one year has lapsed from the date of such classification till the date of commencement of the CIRP of the CD:

   Provided that the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to NPA accounts before submission of resolution plan;

d) the person has been convicted for any offence punishable with imprisonment for two years or more;

e) the person is disqualified to act as a director under the Companies Act, 2013;

f) the person is prohibited by Securities and Exchange Board of India (SEBI) from trading in securities or accessing the securities markets;

g) the person has been a promoter or has been in the management or control of a CD in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and an order has been made by the AA under the provisions of the Code;

h) a person who has executed an enforceable guarantee in favour of a creditor, in respect of a CD against which an application for insolvency resolution made by such creditor has been admitted under the Code;

i) a person who has been subject to the above listed disabilities under any law in a jurisdiction outside India;

j) connected persons, i.e. persons connected to the person disqualified under any of the aforementioned points, such as those who are promoters or in management of control of the resolution applicant, or will be promoters or in management of control of the business of the CD during the implementation of the resolution plan, the holding company, subsidiary company, associate company or related party of the above referred persons – exception has been carved out for scheduled banks, ARCs registered with RBI under section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest

Act, 2002, and alternative investment funds registered with the SEBI.

Section 29A makes a person ineligible to act as a resolution applicant if the person is the promoter, management, or in control of a CD and has an account classified as NPA (by RBI guidelines under the Banking Regulation Act, 1949, or as per guidelines of the financial sector regulator), and at least one year has elapsed from the date of such classification until the date of the commencement of the CIRP of the CD.[9] It is provided further, that the aforementioned provisions do not apply to a financial entity that is not a related party of the CD.

Lastly, section 240A of the Code provides an exemption in terms of eligibility of section 29A of the Code, which allows the promoters/management to submit resolution plans. The provisions of clauses (c) and (h) of section 29A do not apply to the resolution applicant in respect of the CIRP or pre-packaged insolvency resolution process of any micro, small and medium enterprises (MSME).

DATA ANALYSIS

To conduct a sector-wise comparison of the resolution applicants and the research on the impact of resolution plans submitted by these resolution applicants on the CD, the authors have collected the following data:

a) the list of CDs achieving successful resolution, along with the industry sector of the CDs;

b) the list of successful resolution applicants, along with the industry of the resolution applicants,

c) the admitted claims and the realizable amount by the FCs and OCs respectively in each case *vis-à-vis* the liquidation value of the CD.

Participation of resolution applicants in CIRP

As per the data available in IBBI's newsletter as of June 30, 2022, the total number of CDs admitted into CIRP is 5636:[10]

a) 1999 cases are currently ongoing, and

b) 3637 cases have been closed.

Of the CIRPs closed:

a) 1703 cases have ended in orders for liquidation;

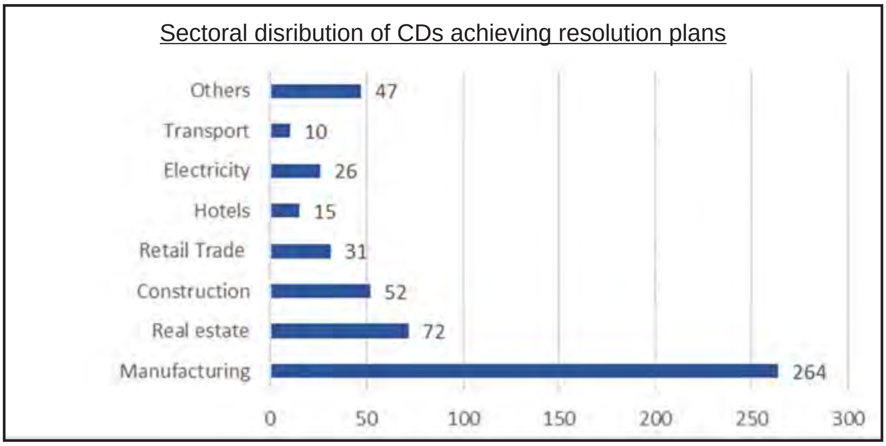
b) 774 cases have been closed on appeal or review or settled;

c) 663 cases have been withdrawn; and

d) 517 cases have ended by approval of resolution plans.

Therefore, as per available data, 14.2% of cases (out of a total of 3637 cases) have reached conclusion by approval of resolution plans.

The authors plotted the CDs and successful resolution applicant's industry against each of these CDs (478 cases where data was available) in order to find a correlation between the resolution applicant's industry and the CD's industry.



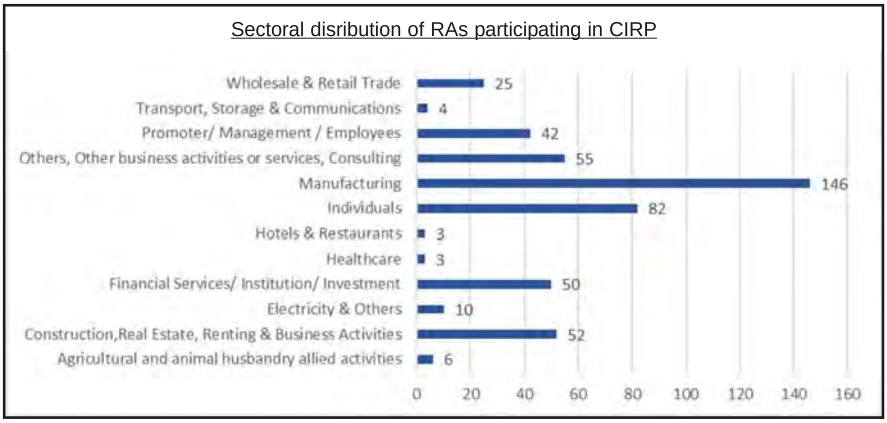


Fig.1: Industry wise breakup of CDs and SRAs

The authors have observed that out of the total CDs achieving successful resolution, 51% belong to manufacturing, 14% to real-estate, and 10% to construction sector.

Further, in respect of these successful cases, 31% of successful resolution applicants belonged to manufacturing sector while 10% belonged to financial services sector.

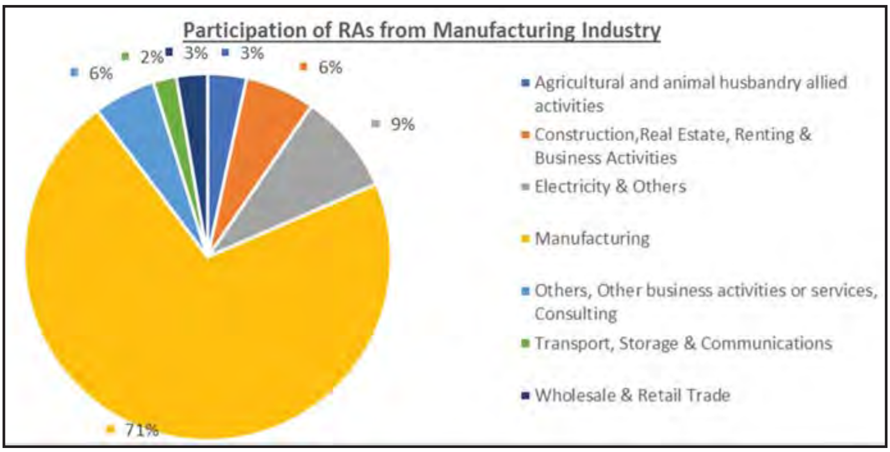


Fig.2: Manufacturing Industry

The authors have further analysed the participation of resolution applicants from the manufacturing industry in CIRP of CDs from various industries. It was observed that 71% of the resolution applicants belonging to the manufacturing industry have submitted resolution plans for CDs belonging to the manufacturing industry (Fig.2).

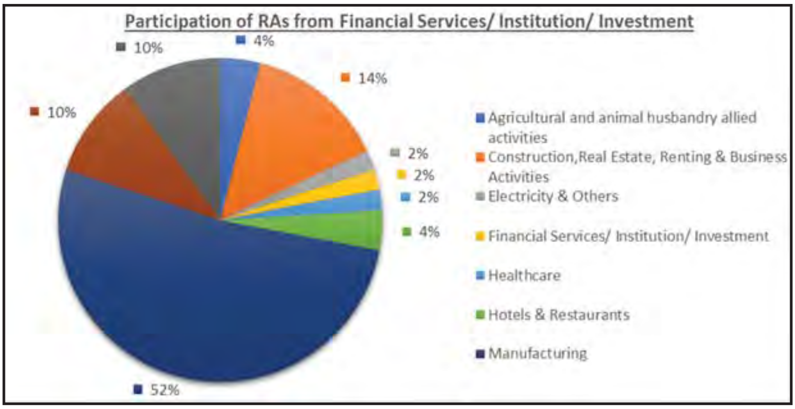


Fig. 3: Financial services/Institution/ Investment

The data shows that the financial services / institution / investment funds have been actively involved in CIRPs as resolution applicants. The objective of obtaining favorable returns on investment acts as an incentive for these entities to acquire companies under the Code and therefore stressed companies, which still have underlying value appeal to such companies. The participation of such financial services entities in the CIRP also indicates success of the Code in unlocking value from stressed companies.

Of the total number of cases where entities from financial services sector were successful resolution applicants, 52% of the CDs belonged to the manufacturing sector (Fig.3). The other industries where such entities remain interested are:

a) 14% in construction, real estate, renting & other business activities;

b) 10% in wholesale and retail trade; and

c) 10% in others, other business activities or services, consulting.

Furthermore, the authors have observed that in 44% of the cases (22 out of 50), the resolution plans submitted by resolution applicants from the financial industry included other partners from the CD's industry, implying that while financial sector entities are interested, they do seek partnership with industry experts.

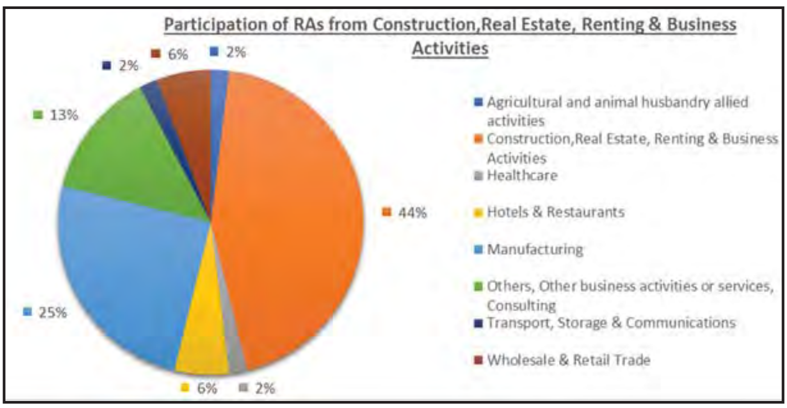


Fig.4: Construction/ Real Estate/ Renting and Business activities

The resolution applicants from construction/ real estate industry have majorly participated in the CIRP of the CDs in the same industry. Furthermore, some diversification can also be seen from the data wherein they have become a resolution applicant of manufacturing and other industries (Fig.4).

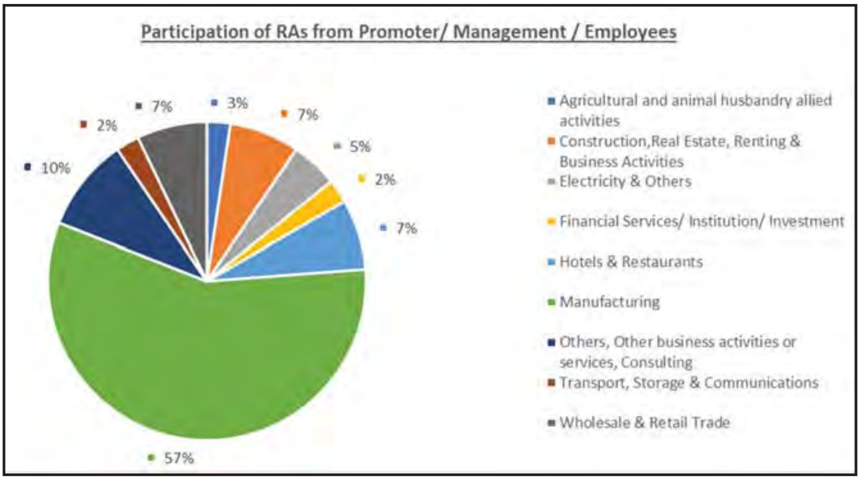


Fig.5.1: Promoter/ Management / Employees

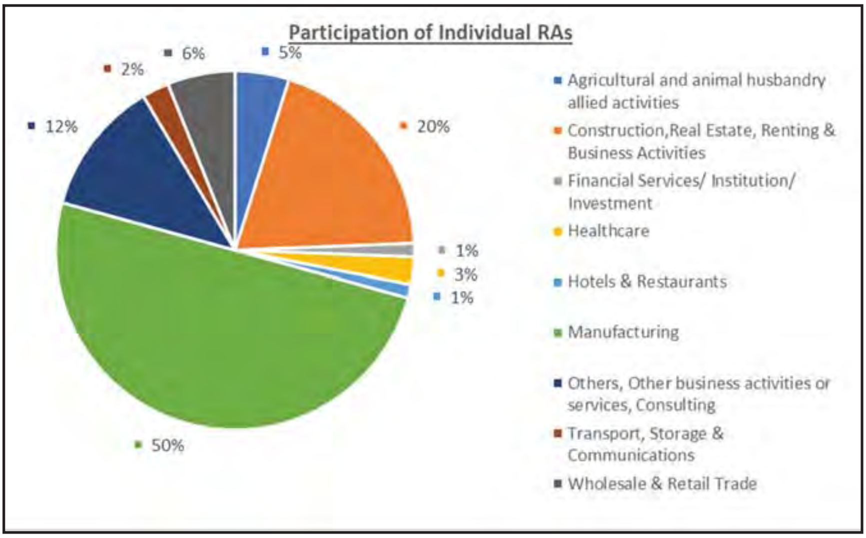


Fig.5.2: Individuals

It was noted from the analyzed data that the participation of promoters, management, employees (Fig.5.1), or individuals (Fig.5.2) as successful resolution applicants is also substantial in number at 124 cases out 478 cases analyzed.

The authors have observed that out of a total of 124 cases where individuals / promoters/ management have participated as resolution applicants, 52 % of CDs belonged to manufacturing sector.

It may be noted that such resolution applicants include the erstwhile promoters, directors of the CDs, association of homebuyers, and individuals or consortium of individuals who are not related to the CD. It is not clear whether these are high-net-worth individuals or sole proprietorship concerns/ individual investors with investment/expansion plans.

It was also observed in cases of promoters submitting resolution plan that in the case of MSMEs (which were identified from the orders of the Hon'ble NCLT), the resolution plans submitted by the promoters/management were eventually approved by the AA once the same were held to be compliant with section 29A.

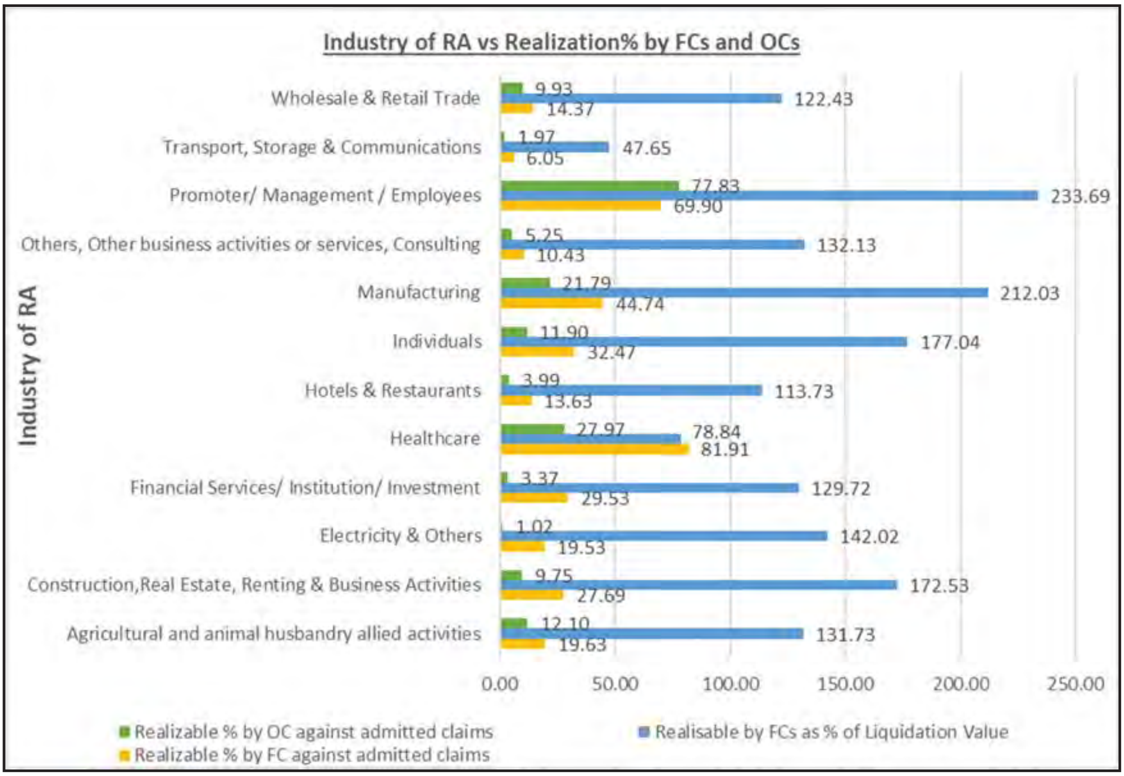


Fig.6: Percentage of realization by FCs and OCs from resolution applicants of various Industries

The authors analyzed the amount of realization that each resolution applicant brought to the FCs who approve the resolution plans for such CDs and have observed the following:

a) The resolution applicants of the following sectors have given a recovery of at least 50% more than the liquidation value of the CD for the FCs against their admitted claims:

(i) Individuals and Promoters/ management/employees;

(ii) Manufacturing;

(iii) Construction, real estate, renting & business activities.

Furthermore, except for the healthcare and transportation industries (due to the small sample size), all other industries of resolution applicants have provided a higher realizable amount to FCs under the resolution plans in comparison to the CD's liquidation value (as shown in Fig.6).

b) The authors have observed that the realization for FCs against their admitted claims has been among the highest in cases where the promoters/management/employees have proposed a resolution plan, at 69.9% in 42 cases. Furthermore, such resolution plans have the highest realizable value for FCs, i.e., 233% of the liquidation value of CDs receiving resolution plans.

The observation of realizations under the CIRP can also be seen to be true in the case of:

(i) resolution applicants from the manufacturing industry where the FCs have realized 44.7% of the admitted claims and 212% of the liquidation value of the CDs.

(ii) individuals acting as resolution applicants of CDs where the FCs have realized 32.4% of the admitted claims and 177% of the liquidation value of CDs.

c) In cases where the promoters/management/employees proposed a resolution plan, the total realization of OCs against their admitted claims was the highest at 77.83%. Following that, the resolution applicants from the manufacturing industry gave OCs a total realization of 21.79% against their admitted claims.

SURVEY

Resolution applicants are one of the most important stakeholders in a CD's resolution under the CIRP. Even though the participation of corporates as resolution applicants has increased since the Code's inception, there are still certain impediments and issues that affect resolution applicants' participation in the CIRP, including but not limited to delays in approval of the resolution plan by AA, the inability of the resolution applicant to withdraw/modify the plan after filing the plan approval application before the AA, etc.

The authors through the survey conducted with IPs have attempted to identify the major issues faced by the resolution applicants which act as an impediment for them to participate in the CIRP.

As per the survey results, the following are the major issues voiced by IPs, as being faced by RAs:

Delay in approval of resolution plan by the AA

The timely resolution of the CD is one of the primary objectives of the Code. Section 12 of the Code requires the CoC to approve the resolution plan within 165 days of the insolvency commencement date, with the AA having 15 days to approve the resolution plan in order to complete the CIRP within the prescribed period of 180 days. The proviso to section 12 requires the completion of the CIRP within 330 days, including any extensions granted under section 12 of the Code.

In practice, such timelines under the Code are directory rather than mandatory. The average time taken by a CD to achieve a successful resolution (after excluding the time excluded by the AA) is 437 days on average (till September 30, 2022).[11]

The summary of the data as compiled from the IBBI quarterly newsletter and the NCLT website for FY 21-22 is mentioned in the table below:[12]

Year	No. of resolution plans approved	The average time taken by NCLT to approve a plan after CoC approval (No. of days)
FY 2021-22	139	296

It has been observed that an average of 296 days is taken by the AA for approval of the resolution plan after approval of the resolution plan by the CoC. This is a major challenge for the completion of the CIRP within the prescribed timelines of the Code.

As per survey results, in their experience, 29 of 50 respondents have faced a delay of at least six months or more in receiving approval from the AA following approval by the CoC (Fig.7).

Further, it is of note that 16 out of 50 of the respondents to the survey have had to wait for more than a year for approval of the resolution plan from the AA.

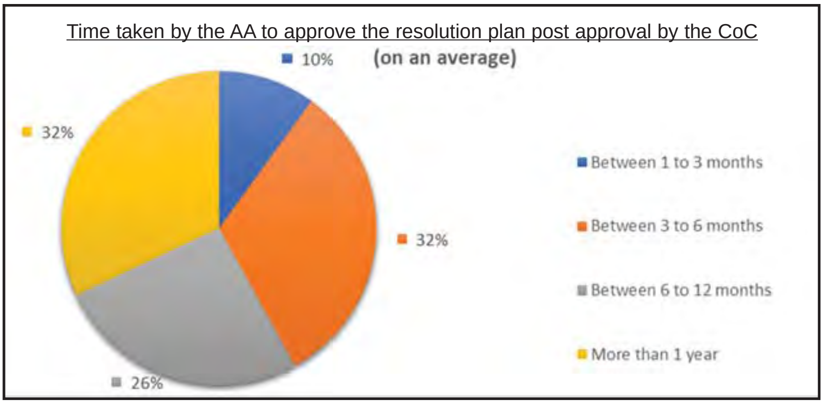


Fig.7: Survey responses on time taken by the AA for approval of resolution plans

The available data and survey results reveal a considerable gap between the intention of the legislature which stipulates the timeline for approval of the resolution plan by the AA within 15 days of approval of the resolution plan by the CoC.

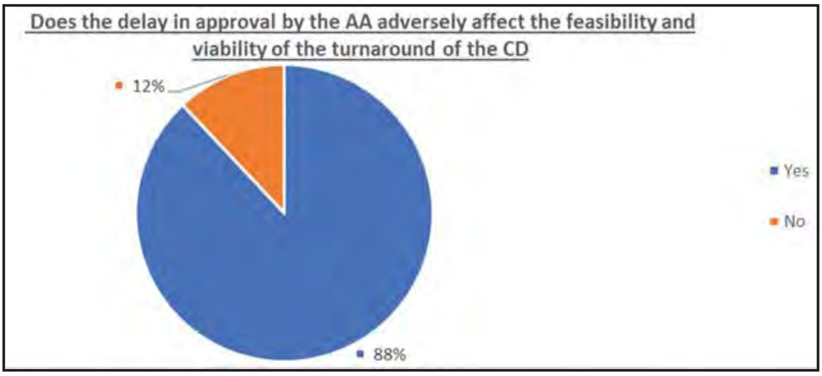


Fig.8: Survey responses on effect of delay (in approval of plan by the AA) on feasibility and viability of the turnaround of the CD

Further, the survey also shows that 44 out of 50 respondents believe that the delay caused by the AA adversely impacts the feasibility and viability of the turnaround of the CD (Fig.8).

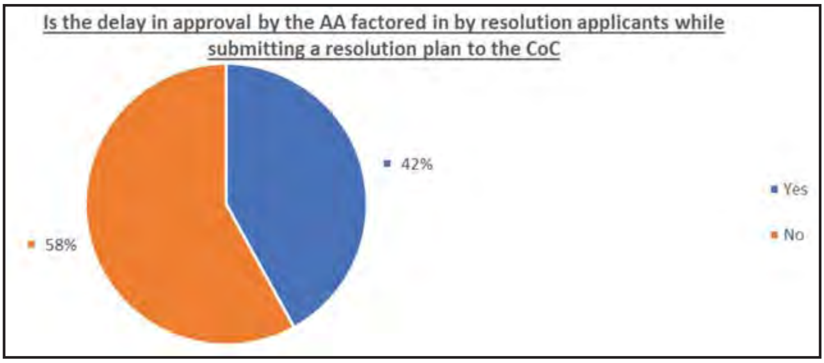


Fig.9: Survey responses on factoring of delay (in approval of plan by the AA) by resolution applicants while submitting a resolution plan to the CoC

It may also be noted that in the experience of 29 of the 50 respondents, the resolution applicants do not take the delay in approval by the AA into account when submitting the final resolution plan.

As part of suggestions from the respondents, additional challenges arising out of delay by the AA were identified, some of which are as follows:

- **Increase in the insolvency resolution process costs after approval of the plan by the CoC:** It directly contributes to the lower recovery for FCs, since most resolution plans put a cap on the insolvency resolution process costs, and anything incurred over and above the same is proposed to be deducted from the share of FCs. Further, the RP is bound to continue the process and maintain the CD as a going concern until the approval of the resolution plan by the AA. Therefore, the longer the time taken by the AA in approving the resolution plan, the higher would be the insolvency resolution process costs incurred in completing the CIRP of the CD.

  The delay leads to an increase in insolvency resolution process costs, which is one of the factors for lower recovery percentage to the creditors under the Code when looked at on a standalone basis.
- Loss of interest by the CoC to keep the CD as a going concern.
- Scarcity of funds with the CD and difficulty in raising interim finance.
- Failure of fund flow planning by the successful resolution applicant where he is stuck with idle funds while awaiting approval of the resolution plan by the AA.
- Deterioration in the value of assets of the CD.
- Migration of critical/ trained manpower to other organizations.
- Possibility of change in business conditions of the CD due to delay may pose a challenge to the successful resolution applicant for implementation of the plan.

Withdrawal of resolution plan

The landmark judgment of the Hon'ble Supreme Court in *Ebix Singapore Pvt. Ltd. v. Committee of Creditors of Educomp Solutions Ltd. and Ors*.[13] brought forth a considerable issue faced by the resolution applicant due to the inefficiency in the system. i.e., delay caused due to time taken by the AA for approval or rejection of the resolution plan. In *Ebix Singapore* case, the Hon'ble Supreme Court considered three cases simultaneously, wherein the resolution applicants prayed for the withdrawal of their resolution plans after approval from the CoC on the ground that the same was pending adjudication before the AA for over a year. The Hon'ble Supreme Court held that the Code does not provide for any procedure for withdrawal of the resolution plan after it is brought before the AA for consideration and the NCLTs have a limited power of judicial intervention to consider any such withdrawals after approval of resolution plan by the CoC.

The Case has raised challenges for resolution applicants whose plan could become commercially unviable due to delay caused in approval of the plan by the AA, considering the inability of such resolution applicants to exit the process despite the delay due to approval by AA.

Successful resolution applicants are forced to reconsider their decision of continuing with the implementation of the plan and because of the absence of any exit mechanism, the uncertainty in the timeline for approval of the plan by the AA hampers the Code as an effective tool to acquire stressed assets under the Code, which is sold as an attractive feature of the Code in that it ensures speedy and time-bound resolution of the CD. Delay in the process leads to various challenges, such as:

a) a complete uncertainty in the minds of the resolution applicants about the assets/ business that will be handed over to the successful resolution applicant on approval of the plan.

b) Successful resolution applicants are trapped in the process without any say or contribution.

c) It becomes difficult for the RPs to raise finance during the period when the resolution plan is pending before the AA, as the plan value remains the same and any such finance raised would increase the insolvency resolution process cost which would be taken from the kitty of the creditors. Therefore, the CoC has reservations about providing interim finance to the CD.

Therefore, the non-availability of any such exit mechanisms contributes to the reluctance of resolution applicants to consider IBC as an alternative tool to acquire stressed assets and they may prefer to deal outside the purview of the present insolvency regime or look for other alternatives.

Lastly, the authors through their survey have gathered the opinion of experienced RPs on the abovementioned issue brought forth by the judgment of the Supreme Court in *Ebix Singapore Pvt Ltd v. Committee of Creditors of Educomp Solutions Ltd. and Ors*.

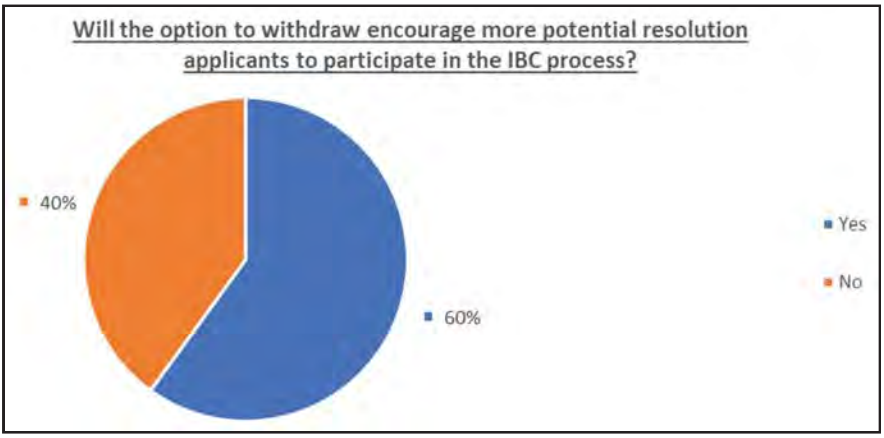


Fig.10: Survey responses on whether an option to withdraw will encourage more potential resolution applicants to participate in the IBC process

It is observed by the authors that 60% of respondents (Fig.10) believe that an option for the withdrawal of the resolution plan would encourage more resolution applicants to participate in the process in specific circumstances such as delay on part of the AA for approval of resolution plan.

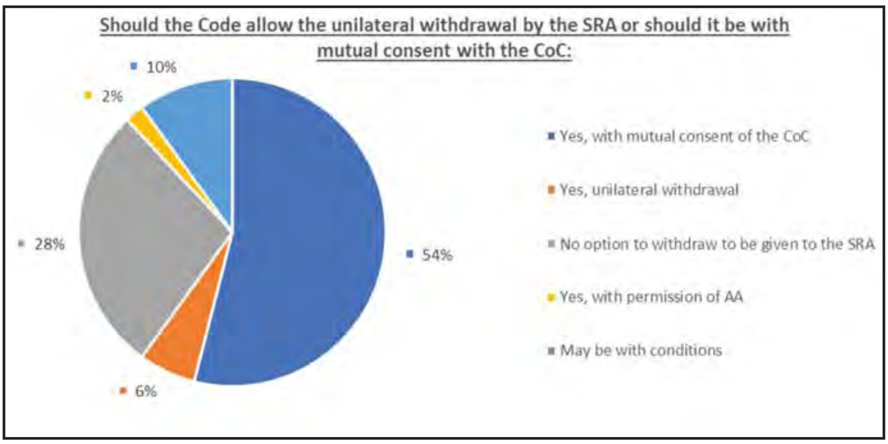


Fig.11: Survey responses on withdrawal of resolution plan unilaterally or with the consent of CoC in specific circumstances

More than a majority of the respondents (54%) voiced that the Code should allow for withdrawal of the resolution plan in specific circumstances with the mutual consent of the CoC.

Some interesting suggestions were also gathered by the authors through follow-up question in the survey. The consensus of the IPs was on the suggestion that the AA may allow for modification in the plan which must be determined by specific benchmarks such as a delay in the approval of the resolution plan by AA by six months etc.

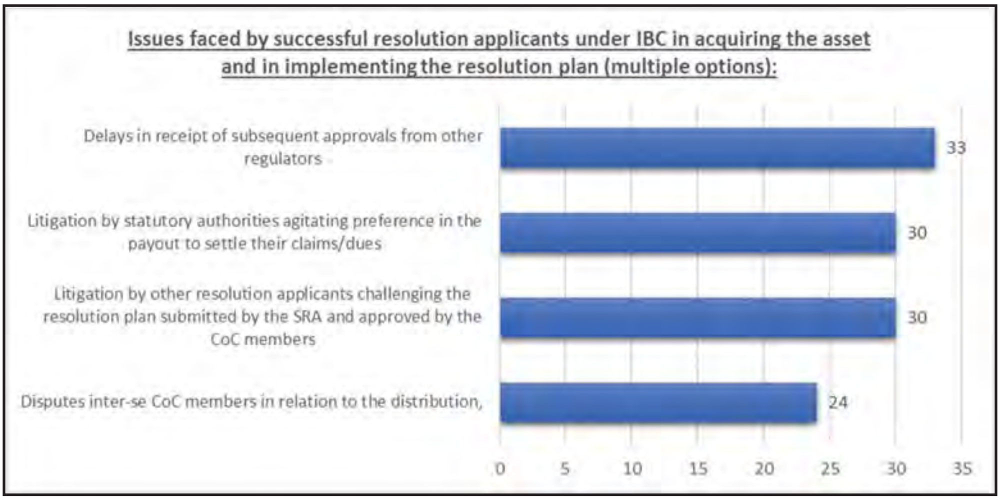


Fig.12: Survey responses on issues faced by successful resolution applicants under the Code

As part of the survey, the authors tried to identify the major issues faced by the successful resolution applicants in acquiring the assets and in the implementation of the resolution plan.

a) **Disputes amongst the members of the CoC about the inter se distribution under the resolution plan**: Firstly, the AA is required under section 31 of the Code to determine that the resolution plan is compliant with the Code and the stakeholders are given the requisite minimum value as mandated under the Code. Even after the protection given under the Code, the members including classes of creditors challenge the resolution plan for uneven distribution of the resolution plan proceeds under the Code.

48% of the respondents indicated that this issue was observed by them in their cases.

b) **Litigation**: Litigation is one of the major challenges to the resolution applicants, which includes disputes by other resolution applicants, and statutory authorities challenging the resolution plan submitted by the successful resolution applicant. Even though there is no vested right or fundamental right of the resolution applicant to have its resolution plan approved,[14] the unsuccessful resolution applicants tend to challenge the successful resolution plan and delay the approval and implementation of the plan.

60% of the respondents indicated that this issue was observed by them in their cases.

c) **Delays in receipt of subsequent approvals from authorities and regulators:** A resolution applicant under section 31 of the Code is required to take the requisite approvals from respective regulators for the implementation of the resolution plan. Furthermore, there is non-cooperation or delay caused by the local authorities or regulators in various circumstances including approvals for electricity, power, water supply, the release of charge on assets, statutory clearances, licenses, etc. Obtaining the timely grant of approvals to the resolution plans also poses a challenge for the successful resolution applicant for proper implementation of the plan.

66% of the respondents indicated that this issue was observed by them in their cases.

d) **Non modification of charges by FCs:** The FCs in some cases refuse to vacate or modify the charge of properties or the banks do not remove the CD from the list of willful defaulters and fraud category, thus, making it impossible for the CD to obtain fresh credit facilities for the revival of the CD.

e) **Non-cooperation by the government agencies**: In some cases, the government agencies have initiated actions for payment of dues outside the resolution plan or have conducted investigations or have attached the assets of the CD during the process including the Central Bureau of Investigation, Enforcement Directorate, Registrar of Companies, Income Tax Department, etc.

Such circumstances become a major roadblock for the resolution applicants. Thus, it becomes important and necessary to have the support of the government authorities or agencies in the resolution process under the Code. Even after the introduction of section 32A in respect of past liabilities of the CD, it was voiced that the authorities continue to investigate and prosecute the CD and proceed with the attachment of properties which acts as a major impediment for the successful resolution applicant to proceed with the implementation of the resolution plan. The inconsistency in the judicial position has impacted matters wherein conflicting judgments passed by various courts have led to a change in the position of law on the subject.

IDENTIFYING THE DIFFERENT ENABLERS, TOOLS, AND MEANS AVAILABLE TO RESOLUTION APPLICANTS TO IDENTIFY A STRESSED ASSET UNDER CIRP

'Competition commoditizes competency' - Jay Baer

In terms of section 25(2(h)[15] of the Code, the RP shall invite prospective resolution applicants, who fulfill such criteria as may be laid down by him with the approval of the CoC, having regard to the complexity and scale of operations of the business of the CD and such other conditions as may be specified by the Board, to submit a resolution plan or plans.

Further, in terms of newly amended regulation 36A(1) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations), the RP shall publish brief particulars of the invitation for expression of interest in Form G of the Schedule-I at the earliest, not later than sixtieth day from the insolvency commencement date, from interested and eligible prospective resolution applicants to submit resolution plans.

It is pertinent to mention herein that the RP may give the invitation for expression of interest (EoI) even earlier than the mandated 60 days as specified in the regulations. Any RP needs to engage with the market to generate interest in the market for the potential acquisition of a CD. There are a set of enablers and means available to the RPs to generate interest in a particular CD or vice versa. There are a set of means available for potential resolution applicants to identify a stressed asset under the CIRP and to participate in the resolution process of the CD. Some of the means are mandated under the Code.

In terms of regulation 36A(2) of the CIRP Regulations, the RP shall publish Form G-

(a) in one english and one regional language newspaper with wide circulation at the location of the registered office and principal office, if any, of the CD and any other location where in the opinion of the RP, the CD conducts material business operations;

(b) on the website, if any, of the CD;

(c) on the website, if any, designated by the Board for the purpose; and

(d) in any other manner as may be decided by the committee.

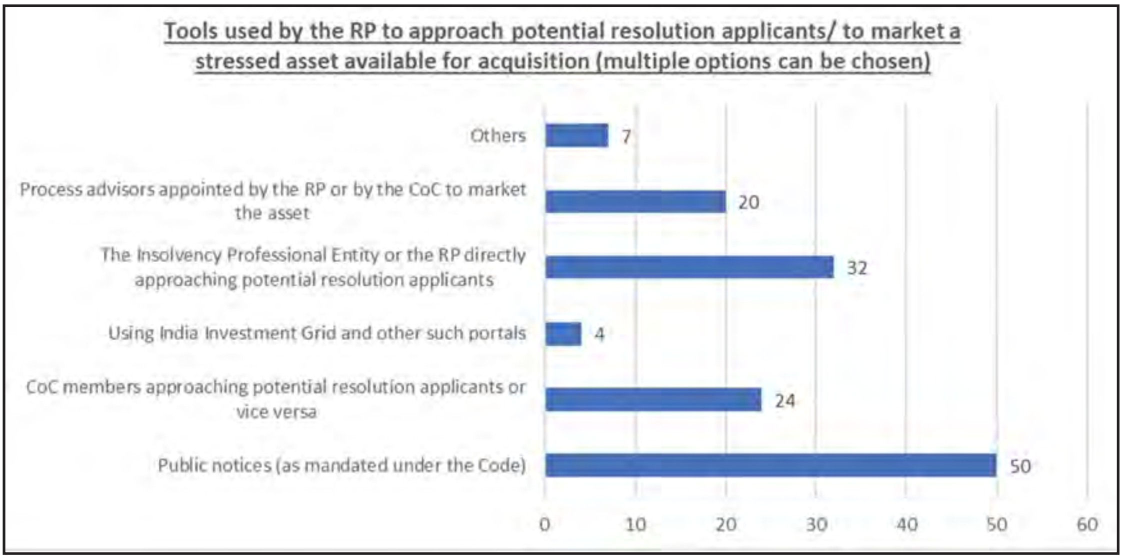


Fig.13: Survey responses on tools used by the RP to approach potential resolution applicants

As per the survey results, all the respondents followed the mandated procedure under the Code and published Form G in the manner provided under the Code.

The respondents also indicated use of other tools or methods to market the CD and find prospective resolution applicants which include:

a) The CoC members directly approach the potential resolution applicants. The CoC members, in the majority of cases, involve the participation of banks. Such banks have a better outreach compared to various investors, and such outreach of banks may help in the marketing of the CD;

b) The RP or Insolvency Professional Entities (IPEs) directly approaching potential resolution applicants;

c) Process advisors appointed by the RP or the CoC to market assets of the CD.

d) India Investment Grid (IIG) which was incorporated to enhance the Ease of Doing Business in India, serves as a platform to connect potential investors to project promoters. Further, the portal has a designated option of inviting interest from the market for the acquisition of stressed assets. The IIG boasts of 3573 stressed assets ranging across manufacturing, textiles, retail, materials, energy, automotive, and information technology sectors seeking investments for potential acquisition.

The IBBI vide its amendment dated September 14, 2022 has also introduced regulation 36C in the CIRP Regulations enabling marketing of assets of the CD.

> 36C. Strategy for marketing of assets of the corporate debtor
>
> (1) The resolution professional shall prepare a strategy for marketing of the assets of the corporate debtor in consultation with the committee, where the total assets as per

> the last available financial statements exceed one hundred crore rupees and may prepare such strategy in other cases.
>
> (2) Decision of implementing such strategy along with its cost shall be subject to the approval of the committee.
>
> (3) The member(s) of committee may also take measures for marketing of the assets of the corporate debtor.

The IBBI has limited the regulation to mandatorily cover only those CDs where the total assets as per the last available financial statements exceed one hundred crore rupees and may prepare such strategy in other cases.

As per the survey (Fig.13), it is observed that in 24 out of 50 i.e. 48% of the IPs take the assistance of the CoC and 20 out of 50 i.e. 40% of IPs take the assistance of the IPEs as a tool to reach out to the resolution applicants.

It was noted that the news about a CD going insolvent generates interest amongst the competitors or potential acquirers, even when the public announcement is made in Form-A inviting claims from the creditors of the CD. The CoC and the IPE supporting the RP could reach out to such resolution applicants/potential competitors of the CD that express interest in the acquisition of the CD. For example, in the data analysis section above, it was observed that in 32.6% of the cases, the resolution applicants belong to the same industry sector.

In the present IBC ecosystem, interest in acquiring a CD is generated when Form-A is published as this tool is used by all the RPs as mandated under the Code. As a result, only those players who already have a fair knowledge about the CD show interest and submit a resolution plan for the CD.

In situations wherein the competitors of the CD belonging to the same industry, wish to acquire a CD or in the past have tried to acquire a CD would, apart from leveraging their already existing understanding of the market and the CD, commence their due diligence of the asset with the information available right when the public announcement declaring insolvency itself and inviting claims is made in Form-A.

Lastly, the authors also came across various issues through a follow-up question in the survey, that are faced by them to approach prospective resolution applicants:

a) **Compensation for Marketing efforts**: The recent amendment requires the RPs to prepare a strategy for the marketing of assets in consultation with the CoC for CDs where assets (as per the last available balance sheet) exceed ₹ 100 crore.[16]

   Such requirement possesses the challenge of the CoC approving costs towards marketing activity. Such allocation of funds by the CoC on specific marketing activities by the RP may incentivize the RPs to explore new avenues to find potential resolution applicants. Reaching out to potential investors through teasers, developing a marketing strategy, and participating in investment forums could incur significant costs and therefore requires the support of CoC members.

   The RP may also need to reach out to technical experts and experienced individuals to assist in the marketing of the CD, which is dependent on the strategy and capability of the RP.

b) **Awareness of the Code:** Companies or small businesses having the ability to participate as a resolution applicant lacks awareness of the Code and the process which makes it difficult for the RPs to approach such resolution applicants. This leads to a handful of companies participating in the CIRP for acquiring stressed assets more than once under the Code.

The aforementioned challenges bring forth the question of the effectiveness of the IBC ecosystem and confidence in the IBC ecosystem of the resolution applicants while considering participation in the CIRP as a resolution applicant.

During the research of different tools used by RPs, the authors came across some interesting methods (through a follow-up option given in the question of the survey) used by RPs to approach resolution applicants:

a) Identifying resolution applicants from members directory of Industry associations and sending emails to companies in the same trade for forward or backward integration;

b) Approaching resolution applicants from fellow professional circles such as IPs, CA, CMA, CS, Lawyers, etc.;

c) Video marketing on the website of CD or other websites.

Furthermore, it was noted that even though IIG has been started by the Government which aims to attract investments across all economic and social infrastructure sub-sectors on a best-effort basis, it was not being used extensively for marketing CDs under CIRP. The authors observed through checking the investment grid portal that CDs are listed in the IIG but the details of the majority of the CDs are either not available or not updated.

IBBI Portal for listing of CDs

As part of the survey, the authors sought the views of IPs to determine if setting up a single dedicated portal by the IBBI for a mandatory listing of CDs and documents such as the information memorandum (IM), detailed invitation for EoI, and request for resolution plan (RFRP) will help in reaching out to more potential resolution applicants.

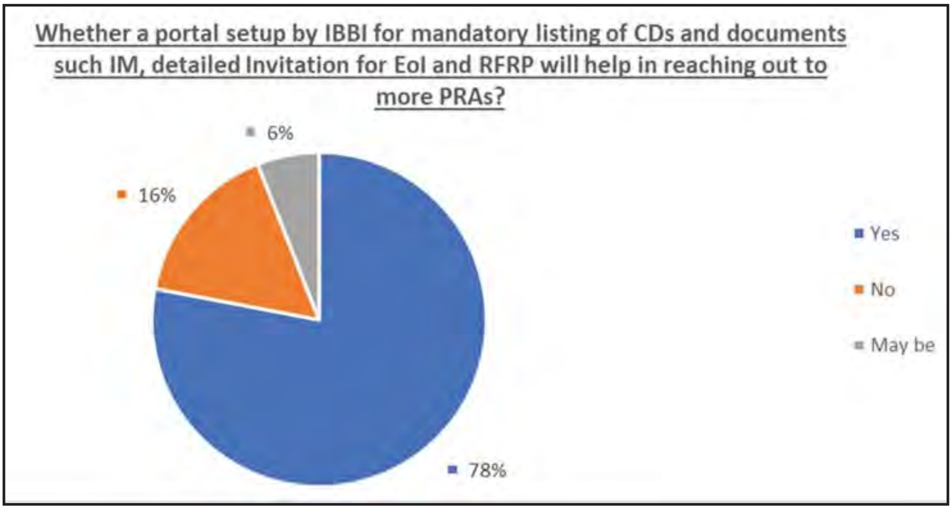


Fig.14: Survey responses on mandatory listing of CDs in IBBI Portal

78% of respondents voiced that a single dedicated portal would assist in reaching out to potential resolution applicants. A potential stressed asset buyer would know that all such assets are listed on the IBBI website (with the requisite details) and this will encourage the potential resolution applicant to visit the IBBI website to search for their target assets. However, it may be noted that the portal will only act as a source of information and the potential resolution applicants would have to fulfill the process requirements as applicable in each CIRP.

CONCLUSION AND SUGGESTIONS

From the data analysed the authors observed that almost a third (32.6%) of the CDs receive resolution plans from resolution applicants belonging to the same industry. Furthermore, the data collated has shown that the erstwhile promoters/ management and individual investors have, relatively, provided the highest realisable value to the FCs against the admitted claims or a higher percentage of return against the liquidation value of the CD.

It is pertinent to note that the IBC ecosystem is still at a rudimentary and growing phase wherein the Government is still considering bringing in more changes to the Code. Even though the present ecosystem has gone through various changes, certain challenges remain for the resolution applicants to participate in the CIRP:

Issues faced by the resolution applicants to participate in the CIRP

a) Delay in approval of resolution plan by the AA

This is one of the most important impediments in the system wherein the Code envisages a period of 15 days for the AA to approve a resolution plan, but the reality is different from the texts of the Code with the AA taking an average period of 296 days in the FY 21-22 for approving a resolution plan after the approval of CoC. Such delays possess a major concern for all the stakeholders in the process.

Potential solutions to challenges faced by resolution applicants:

The following suggestions may be considered for the efficient workings of the NCLTs in the short term:

(i) Applications such as CoC constitution, monthly progress reports, confirmation of IRP to RP, etc. (for which there is no requirement of adjudication and the same may be directly taken on record) be listed together on one specific day of the week and they can then be taken on record.

(ii) Similarly, admission applications may be similarly taken on one specific day of the week.

(iii) Clubbing of applications of similar nature would also result in better case management.

A long-term solution to such problems would be increasing the strength of NCLT and developing adequate infrastructure for adjudication under the Code. Furthermore, the legislature may consider instituting special Insolvency Courts as present in foreign jurisdictions such as the USA which have special Insolvency Courts to deal with insolvency cases.

Further, the Insolvency Law Committee (ILC) in its Report has also noted the delays in the disposal of resolutions plans submitted to the NCLT which can be attributed to (a) high number of objections to the proposed resolution plan; or (b) due to a high degree of pendency of cases. The ILC has recommended that amendments should be made to section 31 of the Code to provide that the NCLT should dispose of applications for approval of resolution plan/s within 30 days of receiving such applications, and record reasons in writing if it fails to dispose of the plan within this timeline.[17]

b) Withdrawal of resolution plan in specific circumstances

As voiced in the survey, this option needs to be brought to the table. Such withdrawal should not be without defined cause such as:

(i) delay in the approval of the resolution plan by the AA with the consent and approval of the CoC so as to decrease the chances of default by the successful resolution applicant;

(ii) Non-acceptance of conditions precedent in the resolution plan

(iii) Enforcement of a new law which causes significant hindrance in conducting the business.

(iv) Emergence of new facts which may cause materially significant financial loss to the resolution applicant

It must be noted that delays in approval of the resolution plan by the AA can affect and erode the value of the asset of the CD as well as delay the deployment of funds that were to be used for the resolution of the CD by the resolution applicant.

It is suggested that for timely disposal of cases the CIRP may be divided into two phases, wherein:

(i) In the first phase a new buyer can be identified and handed over to the management after the AA is satisfied that the plan is compliant with the provisions of the Code.

(ii) In the second phase, the distribution of proceeds wherein undisputed proceeds among creditors would be distributed and the other proceeds will be distributed once the AA decides on the inter-creditor disputed.

Such a step would give an initial boost to the stakeholders and the value of assets of the CD may be protected wherein the resolution applicant injects funds into the CD and initiates the rehabilitation of the CD.

Marketing of stressed assets to potential resolution applicants

It is suggested that:

a) The timeline for submission of EoIs may be extended to 30 days from the currently prescribed period of 15 days. Another option is to consider giving new players a chance (For instance, 15 days after listing of potential resolution applicants) to be motivated to come forward and show their interest to become a resolution applicant and give such players a chance to participate in the process. It will not only help the process to get more resolution applicants if given such time but also could attract a more viable resolution plan.

b) The RPs may consider publishing the Form G immediately after the first meeting of the CoC (i.e., within 45 days considering the delays in approvals from CoC members) and provide at least 30-45 days for submission of EoIs. In such a case the CD can be marketed extensively during these days with a strong marketing strategy in place.

FINAL TAKEAWAYS

The authors' humble attempt in this research paper is to understand the role of resolution applicants as a stakeholder in the successful resolution of CDs under the CIRP. Furthermore, the authors have reviewed the trend of acquisitions by the resolution applicants' in respect of successful resolutions of CDs under the Code, the variance in the realization of the FCs observed *vis-a-vis* the industry of the resolution applicants and the CD, and the prevailing challenges faced by successful resolution applicants after approval of resolution plan by the AAs.

The involvement of resolution applicants in the CIRP is critical for the resolution of CDs under the CIRP. The IBBI has played a vital role to address the concerns of the industry and have taken steps to improve the resolution process under IBC in an efficient manner.

Through this survey, the authors have identified and collated certain challenges faced by resolution applicants and IPs in achieving successful resolution and timely closure of the process. These challenges have led to people questioning the efficacy of the CIRP and in a way questioning whether the Code has been able to achieve the desired objectives. The other big call-out of the research paper is the delay faced by the resolution applicants in obtaining the approval of the AA for their resolution plan. Strengthening the capacity of the AA, increasing the number of benches for IBC matters, and fixing a timeline for hearing the resolution plan application are some of the suggestions highlighted in the paper.

'It's always something, to know you have done the most you could. But don't leave of hoping, or it's of no use doing anything. Hope, hope to the last!'- Charles Dickens

The authors believe that the timely redressal of the issues identified and elaborated in the research paper would help increase the confidence of the resolution applicants in the process and encourage more participation from the industry-leading to swifter and more efficient corporate insolvency resolutions.

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

[2] Section 25(2)(h), IBC.

[3] IBBI Quarterly newsletter for the quarter April - June, 2022.

[4] *Ibid.*

[5] The Insolvency and Bankruptcy Code (Amendment) Act, 2018, w.e.f. November 23, 2017.

[6] *Ibid.*

[7] The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 , w.e.f. June 6, 2018 and The Insolvency and Bankruptcy Code (Amendment) Act, 2020, w.e.f. December 28, 2019.

[8] Srinivas I. (2020), "The Story Behind Section 29A of IBC", IBBI's Annual Publication 2020: Insolvency and Bankruptcy Regime in India: A Narrative.

[9] Section 29A(c), IBC.

[10] Supra Note 3.

[11] IBBI Quarterly newsletter for the quarter July- September, 2022.

[12] Sharma A. (2022), "Colossal Delay of 296 Days by NCLT in Approving Resolution Plan after Approval of Resolution Plan by committee of creditors in FY 2021-22", Live Law, September 27, 2022.

[13] *Ebix Singapore Private Limited v. Committee of Creditors of Educomp Solutions Limited & Anr.,* Civil Appeal No. 3224 of 2020.

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

[15] Section 25, IBC.

[16] IBBI (Insolvency Resolution Process for Corporate Persons) (Fourth Amendment) Regulations, 2016.

[17] Report of the Insolvency Law Committee, May, 2022.

29 FAIRNESS AND EQUITY IN CORPORATE PROCESSES UNDER THE CODE

- Virendra Kumar Gupta, Farzeen Cyrus Pardiwalla and Vidit Divya Kumat

EXECUTIVE SUMMARY

Globally, there have been different paradigms regarding structure of bankruptcy laws based upon traditionalist and proceduralist views. Three aspects, on which both the camps differ, can be summarized as under:

> In short, the traditional bankruptcy experts believe that: (1) the preservation of firms (and therefore jobs) is an important and independent goal of bankruptcy; (2) contemplation of the rights and needs of the parties before the court matters more than the effects on incentives before the fact; and (3) bankruptcy judges should enjoy broad discretion to implement bankruptcy's substantive policies. The proceduralists, on the other hand, believe that: (1) the preservation of firms is not an independent good in itself; (2) ex ante effects are important; and (3) the judge, after controlling for the biases and weaknesses of the parties and resolving the legal disputes, must allow the parties to make their own decisions and thereby choose their own destinies.[1]

Based upon the proceduralist approach, the Insolvency and Bankruptcy Code, 2016 (IBC/Code) has been enacted to overcome the deficiencies and weaknesses of the then existing legal framework which had failed to resolve the insolvency and re-organization of sick entities in a timely manner. The Bankruptcy Law Reforms Committee (BLRC) submitted its Report in November, 2015 wherein it adopted a 'creditors in control approach' as against 'debtors in possession approach' for the new legal framework whereby the commercial process is controlled by the creditors and market dynamics play a key role in resolution of insolvency. Another distinguishing feature of new legal framework is that triggering event is 'default in payment of debt' as against 'inability to pay the debt' in earlier legal framework. The Preamble to the Code prescribes the guidelines to be followed by the creditors collectively for resolution of insolvency in a time bound manner by maximizing the value of the assets of the corporate debtor (CD) for the benefit of all the stakeholders. The decisions of the creditors cannot be interfered with under normal circumstances. The role of Adjudicating Authority (AA) is mainly designed to oversee the integrity of the processes under the Code. The institution of the Insolvency and Bankruptcy Board of India (IBBI/Board) has been created to regulate the role and conduct of various professionals involved in corporate processes under the Code and to frame the regulations for effective implementation of the Code.

Keywords: Fairness, Equity, Natural Justice, The Insolvency and Bankruptcy Code, 2016, Corporate Insolvency Resolution Process, Liquidation Process, Resolution Professional, Operational Creditor, Financial Creditor, Constitutional Validity.

GENESIS, MEANING AND EVOLUTION OF THE PRINCIPLES OF NATURAL JUSTICE: FAIRNESS AND EQUITY

Idea of principles of natural justice

Fairness and equity are integral part of principles of natural justice which aim to ensure distributive justice in economic activities of people and society for inclusive growth and availability of opportunities to all. The other object is to advance the cause of justice and to prohibit arbitrary and capricious exercise of powers in arriving at a decision. Fairness and equity have been aptly explained as –

'No doubt, in the absence of special provisions as to how the person who is to decide is to proceed, law will imply no more than that the substantial requirements of justice shall not be violated.'

-Lord Chancellor[2]

The idea of natural justice is deeply rooted in '*Dharma*' as manifested in the scripts of Indian heritage, as well, as it forms part of *Kautilya's Arthashastra*.[3] Further, the early Roman[4] and Greek empires entail the concept of natural justice and were in fact, instrumental in deriving the meaning of natural justice, natural law, and equity. The Babylonian Monarch Hammurabi believed an improper decision passed by any judge would be penalised and removed from the bench. According to Aristotle (384–322 BCE), the terms 'just by nature' and 'just by law', did not always mean the same, and that, there was natural justice valid everywhere with the same force and its non-abidance could be appealed from positive law.[5]

The concept of natural justice can be described as a term that enshrines fair adjudication as its fundamental element. The principles of natural justice are considered as uncodified law which are incorporated in statutes in various formats. The concept envisages mainly four principles being – (a) *Nemo debet esse judex in propria causa* (nobody shall be a judge in his own cause or in a cause in which he is interested), (b) *Audi alteram partem* (to hear the other side), (c) Speaking and reasoned decisions and (d) Making available a copy of decision.[6] From the last century or so, doctrine of legitimate expectation and promissory estoppel, being new phenomena of principles of natural justice, have been applied in administrative and judicial proceedings. Thus, the integral concept of natural justice that assures reasonableness, fairness, equity, a good conscience, and equality, as laid down by multiple philosophers, rul ers, and jurists over multiple decades, has since then developed exponentially and is still developing.

Idea of fairness

Fairness is a behavioural aspect essentially based on humanity, morality, and ethics. It can simply be defined as treating a person in a manner which one expects for himself or herself. Fairness is a pre-requisite in all our interactions and dealings not only with humans but with nature also. Another way of defining 'fair' or 'fairness' is *'the process of treating a person in a manner that is right or reasonable, or treating a group of people equally and not allowing any personal bias, influence, or opinion to influence one's own judgment'*.[7] When it comes to law, it is expected that, principles of fairness are adopted in the process of policymaking, investigation, and adjudicatory functions, making the same to be transparent and accessible.

Idea of equity

Equity means reasonable or impartial or just decision / treatment based upon the legitimate human considerations in the absence of a statutory or legal provisions. As such, equity is a process to treat everyone equitably according to their circumstances so that equality is achieved. Equity is that principle of natural justice that can be described as a way of reasoning, involving a moral insight into a unique constellation of both a characteristically unique detail of a practical situation and peculiar structure of the hole to which the details belong.[8] Equity is an aid to the exercise of judicial wisdom or conscience based on fairness and not legal technicalities. Equity is applied in judicial proceedings to supplement the law and it does not supplant the law.

Judicial precedents have held that fairness and equity are integral part of fundamental policy of Indian law which imbibes, within itself, the adherence to the principles of natural justice, and the manner in which respect ought to be showed to the judgements of a superior court. In this regard, a useful reference can be made to the decision of the Hon'ble Supreme Court in the case of *ONGC Ltd. v. Western Geco International Ltd.*,[9] wherein it was held as under:

> 38. Equally important and indeed fundamental to the policy of Indian law is the principle that a court and so also a quasi-judicial authority must, while determining the rights and obligations of parties before it, do so in accordance with the principles of natural justice. Besides the celebrated audi alteram partem rule one of the facets of the principles of natural justice is that the court/authority deciding the matter must apply its mind to the attendant facts and circumstances while taking a view one way or the other. Non-application of mind is a defect that is fatal to any adjudication. Application of mind is best demonstrated by disclosure of the mind and disclosure of mind is best done by recording reasons in support of the decision which the court or authority is taking. The requirement that an adjudicatory authority must apply its mind is, in that view, so deeply embedded in our jurisprudence that it can be described as a fundamental policy of Indian law. (Emphasis supplied)
>
> 39. No less important is the principle now recognised as a salutary juristic fundamental in administrative law that a decision which is perverse or so irrational that no reasonable person would have arrived at the same will not be sustained in a court of law. Perversity or irrationality of decisions is tested on the touchstone of Wednesbury principle [Associated Provincial Picture Houses Ltd. v. Wednesbury Corpn., (1948) 1 KB 223: (1947) 2 All ER 680 (CA)] of reasonableness. Decisions that fall short of the standards of reasonableness are open to challenge in a court of law often in writ jurisdiction of the superior courts but no less in statutory processes wherever the same are available.

The Apex Court of India, in the matter of *Canara Bank & Ors v. Shri Debasis Das & Ors.*[10] has also discussed the meaning, scope, evolution, and the enforcements of these principles. This decision highlights the safeguards that these principles provide to every human before the law and observes thus:

> 13. Natural justice is another name for common sense justice. Rules of natural justice are not codified canons. But they are principles ingrained into the conscience of man. Natural justice is the administration of justice in a common-sense liberal way. Justice is based substantially on natural ideals and human values. The administration of justice is to be freed from the narrow and restricted considerations which are usually associated with a formulated law involving linguistic technicalities and grammatical niceties. It is the substance of justice which has to determine its form.
>
> 14. The expressions "natural justice" and "legal justice" do not present a water-tight classification. It is the substance of justice, which is to be secured by both, and whenever legal justice fails to achieve this solemn purpose, natural justice is called in aid of legal justice. Natural justice relieves legal justice from unnecessary technicality, grammatical pedantry, or logical prevarication. It supplies the omissions of a formulated law. As Lord Buckmaster said, no form or procedure should ever be permitted to exclude the presentation of a litigants' defence.
>
> 15. The adherence to principles of natural justice as recognized by all civilized States is of supreme importance when a quasi-judicial body embarks on determining disputes between the parties, or any administrative action involving civil consequences is in issue. These principles are well settled. The first and foremost principle is what is commonly known as audi alteram partem rule. It says that no one should be condemned unheard. Notice is the first limb of this principle. It must be precise and unambiguous. It should appraise the party determinatively the case he has to meet. Time given for the purpose should be adequate so as to enable him to make his representation. In the absence of a notice of the kind and such reasonable opportunity, the order passed becomes wholly vitiated. Thus, it is but essential that a party should be put on notice of the case before any adverse order is passed against him. This is

one of the most important principles of natural justice. It is after all an approved rule of fair play. The concept has gained significance and shades with time. When the historic document was made at Runnymede in 1215, the first statutory recognition of this principle found its way into the "Magna Carta". The classic exposition of Sir Edward Coke of natural justice requires to "vocate interrogate and adjudicate". In the celebrated case of Cooper v. Wandsworth Board of Works[11], the principle was thus stated:

"Even God did not pass a sentence upon Adam before he was called upon to make his defence. "Adam" says God, "where art thou have, thou not eaten of the tree whereof I commanded thee that though should not eat". Since then, the principle has been chiselled, honed, and refined, enriching its content. Judicial treatment has added light and luminosity to the concept, like polishing of a diamond

16. Principles of natural justice are those rules which have been laid down by the Courts as being the minimum protection of the rights of the individual against the arbitrary procedure that may be adopted by a judicial, quasi-judicial and administrative authority while making an order affecting those rights. These rules are intended to prevent such authority from doing injustice.

……

19. Concept of natural justice has undergone a great deal of change in recent years. Rules of natural justice are not rules embodied always expressly in a statute or in rules framed thereunder. They may be implied from the nature of the duty to be performed under a statute. What particular rule of natural justice should be implied and what its context should be in a given case must depend to a great extent on the fact and circumstances of that case, the framework of the statute under which the enquiry is held. The old distinction between a judicial act and an administrative act has withered away. Even an administrative order which involves civil consequences must be consistent with the rules of natural justice. Expression 'civil consequences' encompasses infraction of not merely property or personal rights but of civil liberties, material deprivations, and non-pecuniary damages. In its wide umbrella comes everything that affects a citizen in his civil life..[12]

The legal position which emerges is that, in the absence of provisions in any statute, specifically or by necessary implication, dispensing with the requirement of compliance to the principles of natural justice, fairness and equity shall be observed in all judicial, quasi-judicial and administrative proceedings. In such situations, the court would follow the requirement of giving a reasonable opportunity of being heard before an order is made, as the same is to be read into the provisions of a statute, particularly when the order has adverse civil consequences for the party affected.[13]

In the Code, there are two situations, where principles of natural justice have not been followed. First exception is of the non-applicability of principle of *nemo judex in causa sua* in the design and constitution of committee of creditors (CoC). The second exception is treating the distribution to operational creditors (OCs) and dissenting financial creditors (FCs) in accordance with the provisions of section 30(2)(b) as fair and equitable. In this regard, observations of the Allahabad Bench of National Company Law Tribunal (NCLT), in the case of *Rathi Graphics Technologies Ltd. Through Anshul Gupta (Resolution Professional) v. Raj Kumar Rathi & Ors.,*[14] are as follows:

50. Firstly, we would look at exclusions of certain principles of natural justice from IBC, 2016. For this purpose, we have to take into consideration the fact that IBC, 2016 has been modelled on *'Creditors in control"* regime after giving a go by to earlier regime, wherein promoters remained in possession of their business. To take this process further, look at the institution of 'CoC' which has been created by IBC, 2016, and it is a statutory mechanism/ authority to take all decisions as far as commercial results are concerned. This committee, as the name itself suggests, comprises of

financial creditors who have lent money to the corporate debtor. Such financial creditors are generally secured creditors. Thus, there is an apparent conflict of interests of such financial creditors with that of other stakeholders because their primary focus is realization of their dues although one of the objectives of IBC, 2016 is to balance the interests of all stakeholders. Their decisions as regard to the commercial evaluation i.e., approval of resolution plan is nonjusticiable. Thus, one of the most significant principles of natural justice i.e., ***Nemo judex in causa sua (No one can be a Judge in his own case)*** has been specifically excluded by this design/composition of CoC.

51. Even when we look at the amendment made to Section 30(2) (b) of IBC, 2016 by Insolvency and Bankruptcy Code (amendment) Act, 2019 with retrospective effect from 06.06.2018 whereby **Explanation 1** has been incorporated which provides that "for the removal of doubts, it is hereby clarified that a distribution in accordance with the provisions of this clause shall be **fair and equitable to such creditors**", irrespective of the impact of such explanation on the amount to be distributed to the operational creditors, the incorporation of these words, in our view, by itself indicates that the legislature is conscious of the fact of applicability of principles of natural justice to the proceedings under IBC, 2016 and, thus the legislature has recognized this position by bringing such amendment. Even if one looks at this provision in other way i.e., the principle of fairness and equity has been given away in designing the mode and manner of distribution of money to the operational creditors and to dissenting financial creditors then also, it will be an instance of an exception only.

52. Except the above two situations, we have not found any other exclusion or exception either explicitly or by necessary implication. Even in case of powers of CoC with respect to approval of resolution plan, both RP/CoC are required to follow certain process as prescribed under IBC, 2016 and CIRP Regulations, 2016 although the commercial wisdom of CoC as regard to finding a best solution for resolution of Insolvency is Supreme. Thus, we cannot accept the plea made on behalf of the CoC that because of these two situations, principles of natural justice including the principles of fairness and equity are not applicable by necessary implication to the processes conducted under the supervision of CoC which is statutory authority and discharges public functions. As against this claim, it is a settled judicial position that compliance to principles of natural justice is implied/ necessary when any statute/ code under which an action is being taken by any administrative or statutory authority, is silent as to its application. We may also state here itself that consequence of violation of principles of natural justice is that the action taken in violation thereof may be declared void or may become voidable at the instance of aggrieved party, hence, the opportunity to remedy its grievance must be provided.

SCOPE AND APPLICABILITY OF FAIRNESS AND EQUITY TO THE CORPORATE PROCESSES UNDER THE CODE

The next task is to list out the corporate processes which are undertaken under the Code, the actors controlling such processes and statutory mechanism provided for discharge of their duties. Another related aspect is judicial view on the scope and extent of powers of each institution. Broadly speaking, corporate processes under the Code can be summarized as under:

a) Corporate insolvency resolution process (CIRP) including fast track CIRP
b) Pre-packaged insolvency resolution process
c) Liquidation process including voluntary liquidation
d) Insolvency resolution process of personal guarantors

The actors are common in respect of all these processes. Their duties and applicable regulations are also almost similar. Thus, it would suffice to discuss the concept of fairness and equity as applicable to CIRP and liquidation process under the Code. Before doing so, it is equally important to acknowledge the fact that the proceedings under the Code affect various stakeholders, concerned with the resolution / liquidation of a corporate entity, directly or indirectly. Hence, the Code is a public law dealing with the relationship between the instrumentalities of the state and various stakeholders. The CoC, Interim Resolution Professional (IRP) / Resolution Professional (RP), Liquidator, AA, National Company Law Appellate Tribunal (NCLAT), IBBI, Information Utilities, Insolvency Professional Entities are the statutory authorities created by the Code, those of which discharge statutory functions as assigned to them. A detailed discussion on these aspects has been made in the order of the Allahabad Bench, NCLT in the case of *Rathi Graphics*[15] and the conclusions of the bench are as follows:

> 37. Considering the above objects and the impact of proceedings under IBC, 2016 on the national economy and its growth, corporate world. MSMES, small traders' workmen and employees, Central / State Government, Public Financial institutions etc., we have no hesitation to hold that functions of these institutions are of public importance and their functions closely resemble to governmental functions and that too in the sphere of public economic activities. Further, these institutions also pass the tests prescribed by judicial decisions to classify them as public/statutory authority for there is a deep and pervasive Government control by making necessary regulations as regard to their powers and conduct. Thus, in our view, these institutions can certainly be termed as an agency or instrumentality of State who carry out executive, administrative, commercial and in some situations, quasi-judicial functions as well.
>
> 38. Once institutions of CoC, IRP, RP, Liquidator, IBBI, Insolvency Professional agencies, and Information utilities are found to be an agency or instrumentality of State, it is logical to say that they are bound to follow the **rule of law** which necessarily embodies within itself principles of natural justice subject to specific exclusions of these principles in a statute.[16]

Since Code's design is creditor centric, there is a view that CoC has complete freedom in the conduct of CIRP, and its commercial wisdom cannot be interfered with. This perception is largely valid subject to the legal position that CoC must function within the parameters / guidelines of the Code and regulations made thereunder. The Hon'ble Supreme Court, in the case of *Swiss Ribbons (P) Ltd. v. Union of India*[17] held that in case of arbitrary exercise of its powers by CoC, the AA can intervene. Similar view has been expressed by the Hon'ble Supreme Court, again in the case of *Vallal RCK v. M/s Siva Industries and Holdings Limited & Ors.*[18] Further, the IBBI in its discussion paper floated in the month of August, 2021, following the 32nd Report of Standing Committee of Finance, inserted regulation 17(1A) of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) which states that *'The committee and members of the committee shall discharge functions and exercise powers under the Code and these regulations in respect of corporate insolvency resolution process in compliance with the guidelines as may be issued by the Board'*. In the discussion paper, it has been specifically mentioned that *'The CoC has a statutory role, and it discharges a sort of public function. The pain and gain emanating from the resolution of the CD are to be shared by all stakeholders with fairness and equity. It must, therefore, apply the highest standard, duty of care, follow due process, be fair to all stakeholders and act in a transparent manner in discharge of its responsibilities.'* Even otherwise, the CoC, being a statutory authority, is bound to act in a fair and equitable manner and in accordance with the objects as enshrined in the Preamble to the Code and any violation thereof, in specific circumstances, may invite judicial interference.

The scope and extent of jurisdiction of AA is governed by section 60 of the Code. Further, NCLT being the AA, is bound to follow principles of natural justice in terms of the provision envisaged under section 424 of the Companies Act, 2013 read with the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 (NCLT Rules). In *Sree Metaliks Ltd. & Ors. v. The Union of India & Ors.*,[19] the court reiterated this position. Further, Supreme Court in the case of *K. Sashidhar v.*

Indian Overseas Bank & Ors.,[20] *Swiss Ribbons,*[21] *Embassy Property Developments Pvt. Ltd. v. State of Karnataka & Ors.,*[22] *CoC of Essar Steel India Limited v. Satish Kumar Gupta & Ors.,*[23] and *Gujarat Urja Vikas Nigam Limited v. Amit Gupta,*[24] has defined the extent and manner of exercise of jurisdiction by AA under the Code. Thus, considering the statutory scheme in line with the above judicial decisions, the AA is also bound to follow the principles of fairness and equity, subject to the specific exceptions made in the Code or regulations made thereunder. The jurisdiction of AA under section 31 of the Code is circumscribed by the provisions of section 30(2) of the Code. However, the issue of withdrawal of a resolution plan after approval by CoC does not fall under section 31 of the Code which deals with either approval or rejection of the resolution plan approved by CoC. This aspect, however, did not fall for consideration of the Hon'ble Supreme Court in the case of *Ebix Singapore Pvt. Ltd. v. CoC of Educomp Solutions Ltd. & Anr.*[25]

The following charts show the provisions of the Code, CIRP Regulations and IBBI (Liquidation Process) Regulations, 2016 (Liquidation Regulations) incorporating fairness and equity therein. In some situations, fairness and equity may overlap with each other.

A. CIRP

Under the Code			
Sl.	**Section of the Code**	**Content**	**Observations**
1.	7	Initiation of CIRP by an FC	No notice of hearing is required. However, as per NCLT Rules and judicial decisions, notice of hearing is to be given to the CD before admission of the application.
2.	8	Notice of dispute by OC	Before filing of an application u/s 9 it is a pre-requisite.
3.	12A Rule 8 of NCLT Rules	Withdrawal of an application admitted u/s 7, 9 or 10 Permission to withdraw its application before admission	Opportunity to existing owners to remain in control and management of the CD by settling the dues amicably. Section 12A was not originally in the statute. It is an instance of equitable consideration though no provision to this effect is contained in the Code.
4.	13 r/w 15	Making of a public announcement and calling for submission for claims	The party likely to be affected needs to be informed. Further, IBBI has recently inserted regulation 6A in CIRP Regulations to reduce litigation and possibility of claim not being considered.
5.	21 proviso to 21(2)	No rights of representation, participation or voting in a meeting of CoC to the related parties of the CD.	Persons of specified category disabled to vote in CoC meetings to protect the integrity of CIRP.
6.	27	Replacement of RP by CoC	Opinion is necessary.

7.	29A	Persons not eligible to be resolution applicant	Certain categories of persons / entities are prohibited to submit the resolution plan.
8.	31(2)	Discretion to AA to reject the resolution plan	The deployment of the word 'may' give discretion to the AA to send the plan for reconsideration by CoC to avoid liquidation.
9.	43, 45, 49, 50 & 66	Nullifying preferential transactions, undervalued transactions, transactions defrauding creditors, extortionate credit transactions, fraudulent trading, or wrongful trading.	Jurisdiction given to AA to recover the assets / money, siphoned off during the relevant period so that interests of all stakeholders can be protected.
10.	60(5) applicable to both CIRP and liquidation process	Jurisdiction of AA	This provision r/w NCLT Rules vests the AA with equitable jurisdiction in situations not specifically covered by any provision of the Code or regulation subject to the same being in line with objects and purposes of the Code. Further, AA, being quasi-judicial institutions is bound to act with fairness.
11.	61(3)(ii) applicable to both CIRP and liquidation process	Appeal against the orderapproving the resolution plan u/s 31 on ground of material irregularity committed by RP during CIRP	This ground is additional protection to an aggrieved party though the resolution plan may have passed the test of section 30(2) of the Code.
12.	64 applicable to both CIRP and liquidation process	Expeditious disposal of applications	Equity demands expeditious disposal of cases. Fairness demands recording of reasons for not disposing of any application within the prescribed time. Hence, speed is the essence of the Code, and the same being maintained through this provision.
13.	65 applicable to both CIRP and liquidation process	Fraudulent or malicious initiation of proceedings.	This provision is of crucial importance to prevent abuse of the process of law as wrongful initiation has severe consequences not only for CD but to several other parties as well.
14.	208(2) applicable to both CIRP and liquidation process	Functions and obligations of IPs	Every IP is to abide by the code of conduct in discharge of its functions and which incorporates both fairness and equitable considerations.
		CIRP Regulations	
1.	3(2)	IRP/RP to make disclosures in accordance with the code of conduct.	This regulation ensures fairness in the decisions of IRP/RP.

Sl.	Section of the Code	Content	Observations
2.	3(3)	Relinquishment of assignment in case of conflict of interest.	This is also an example of fairness being applied.
3.	8, 8A, 9, 9A, 10, 11, 12, 12A, 13, 14.	Submission, verification, admission / rejection, and determination of claims of creditors.	This is an elaborate arrangement as regard to the claims of creditors. Further u/s 60(5)(b)/(c), the AA can adjudicate upon the decision of RP.
4.	20(4) / (5)	The RP to ensure that email regarding notice of CoC meeting has been delivered to each participant.	Keeping record is a part of concept of fairness.
5.	23(3)	Responsibilities of RP	This regulation prescribes recording the proceedings and preparation of minutes of meeting.
6.	24(6) / (7)	Minutes of meetings are to be prepared and circulated amongst all members.	Minutes of meetings to be circulated to all participants which may include related party members of CoC.
7.	24(5)	Circulate the minutes of meetings concerning decisions of CoC within 48 hours of the conclusion of the meeting.	Circulation of decisions of CoC promptly provides an opportunity to an aggrieved party to raise its grievance.
8.	29(3)	Rights of bona fide purchaser	The title of any assets purchased in bona fide manner will belong to such purchaser.
9.	30A	Settlement before constitution of CoC	This regulation extends the scope of amicable settlement beyond section 12A of the Code by providing for the settlement before constitution of CoC.
10.	36, 36A (10), 36A (11), 36B (1)	Information memorandum and invitation for expression of interest	These regulations provides for information to be provided to prospective resolution applicant and right of certain prospective resolution applicant to raise objection and receive request for resolution plan.
11.	38(1)A	Mandatory contents of the resolution plan	This regulation provides for statement as regard to mode and manner of taking care of interest of all stakeholders in line with the Preamble to the Code.
12.	39(1)(c)	Undertaking by the prospective resolution applicant	This regulation provides for undertaking that information records provided in connection with the resolution plan disclose true and fair information failing which deposit may be forfeited and penal action can be taken.

Sl.	Section of the Code	Content	Observations
13.	39A	Preservation of records	Fairness includes recording of reasons and maintenance of records thereof.

B. Liquidation process

Under the Code			
Sl.	**Section of the Code**	**Content**	**Observations**
1.	35(1)	Powers & duties of the Liquidator	The powers of Liquidator are subject to the directions of AA meaning thereby that any party aggrieved by the decision of the Liquidator can approach AA.
2.	36(2)	Fiduciary capacity of the Liquidator	The Liquidator is to hold liquidation estate in a fiduciary capacity for the benefit of all the creditors.
3.	38, 39, 40, 41 & 42	Claims	These sections define the process of quantifying the claims. The Liquidator has adjudication power which can be appealed u/s 42 before AA by an aggrieved person.
Liquidation Regulations			
1.	2A	Contributions to liquidation cost	In proportion to the financial debts owed by the CD.
2.	2B	Compromise or arrangement	Brought on statute to fill the gaps.
3.	5, 6	Reporting, maintenance of registers and books of accounts	These regulations prescribe for preparation and maintenance of records.
4.	7(3)	Appointment of professionals	Disclosure of pecuniary and personal relationship by such professionals.
5.	16, 17, 18, 19, 20, 21, 21A, 22, 23, 24, 25, 29, 30	Claims	Submission and admission of claims and various aspects related thereto.
6.	28	Debt payable at future time	A person may be entitled for distribution of a claim whose payment was not due on liquidation commencement date.
7.	32	Treatment of asset subject to security interest	Such asset cannot be sold under this regulation unless security interest has been relinquished.

Sl.	Section of the Code	Content	Observations
8.	33(1)	Mode of sale of assets	Prior permission of AA to sale the assets by way of a private sale or to a related party of the CD or other interested persons.
9.	35(2)	Valuation of assets / business	Certain category of persons not to be appointed as registered valuers.

Considering the above, the Code and regulations made thereunder have incorporated provisions based upon the principles of fairness and equity which need to be followed by all the institutions. Still several gaps exist and thus, there is a compelling need to carry out appropriate reforms. However, till such gaps are filled by the legislature, the question is 'What should be the judicial approach to fill such gaps?' This issue has been succinctly examined by the Hon'ble Supreme Court in the case of *Gujarat Urja Vikas Nigam*,[26] wherein the Court propounded that:

> Equally, when presented with a novel question on which the legislature has not yet made up its mind, we do not think this Court can sit with folded hands and simply pass the buck onto the Legislature. In such an event, the Court can adopt an interpretation – a workable formula – that furthers the broad goals of the concerned legislation, while leaving it up to the legislature to formulate a comprehensive and well-considered solution to the underlying problem. To aid the legislature in this exercise, this Court can put forth its best thinking as to the relevant considerations at play, the position of law obtaining in other relevant jurisdictions and the possible pitfalls that may have to be avoided. It is through the instrumentality of an inter-institutional dialogue that the doctrine of separation of powers can be operationalized in a nuanced fashion. It is in this way that the Court can tread the middle path between abdication and usurpation.[27]

The Supreme Court in *Arun Kumar Jagatramka v. Jindal Steel & Power Ltd. & Anr.*[28] while deciding the question of applicability of section 29A to a scheme of compromise or arrangement in liquidation process under the Code, in the absence of any specific provision making section 29A applicable to such proceedings, and considering the object and purpose of the Code and section 29A, held that the section 29A was applicable to a scheme of compromise or arrangement in liquidation process under the Code. The Supreme Court in *CoC of Essar Steel*[29] upheld the validity of section 30(2)(b) of the Code after taking into consideration the fact that OCs were to get more money after the amendment and explanation thereto also prescribed that such distribution made between OCs and FCs was fair and equitable. The Hon'ble NCLAT, however, in several cases, has expressed its opinion that the OCs should be given more than the liquidation value and has advised the IBBI to look into this aspect. In a recent order passed in the matter of *Excel Engineering & Ors. v. Mr. Vivek Murlidhar Dabhade & Ors.*,[30] this aspect has been reiterated. Thus, equity regarding such mechanism, according to judicial wisdom, is still elusive. Although, the Central Government and IBBI have been quite proactive in making changes, however, there is a strong case for structural reforms and filling up of the gaps in the conduct of corporate processes under the Code. Some of the gaps are indicated as follows:

a) The CoC has no binding legal obligation to allocate a bigger amount to OCs in the resolution plan, despite the duty cast upon it by the Preamble and regulation 38(1A) of CIRP Regulations because of section 30(2)(b) r/w section 30(4) of the Code.

b) Not all parties impacted by the resolution process have a right to participate/vote in the conduct of CIRP. The benefit of section 60(6) of the Code, though available to the CD under new management after resolution, even on genuine grounds, is not available to such parties/creditors of the CD in view of clean slate theory, considering the statutory scheme of section 31 of the Code, propounded by the Supreme Court in the case of *CoC of Essar Steel*.[31]

c) Closure of CIRP / liquidation process in the situation of no funds being available to meet the cost of conducting such proceedings.

d) Recording of reasons for replacement of the RP by CoC is necessary. Regulations ought to be made to that effect for compliance by CoC before replacing the RP. After lapse of certain period of CIRP, such change can be made only with the prior approval of IBBI / AA.

e) The RP is required to run the CD as a going concern, hence, some qualitative factors such as experience of running of that type of business, experience of managing sick businesses or professional qualification like MBA, etc. must be made compulsory.

f) The scope for advisory role of owners / existing management may be explored as this may help in running of the business and getting a better value of the assets of CD particularly when such persons have given personal guarantee and are not of tainted character / integrity. Further, their assistance can also be taken in structuring the evaluation matrix. Needless to mention that their views may not be binding. This will also help in reducing litigation pertaining to section 19(2) of the Code. On the other side, in case of intentional non-cooperation by such persons, their passport or driving licence can be impounded.

g) Section 29A of the Code should apply even after the implementation of resolution plan or transfer of business of the CD in liquidation proceedings.

h) In case of more than one resolution applicant, challenge mechanism should be the only option to finalise the bid as this would not only reduce the litigation and delay but also maximise the value of the assets of the CD.

i) Instead of conducting the proceedings under the Code, in accordance with NCLT Rules, separate rules need to be enacted in line with the object and purposes of the Code. Since, timelines are to be maintained, adjournments after certain occasions, must come at heavy costs. Filing fee should be based upon the amount of claim and number of pages attached with the application to avoid filing of frivolous applications and documents.

j) Dedicated benches need to be formed for disposal of the matters under the Code. Separate benches for company law matters should also be formed as in last six years, matters relating to reorganisation or restructuring and oppression and mismanagement under the Companies Act, 2013 have become non-priority which also need to be disposed of with equal urgency to boost the economy, for saving of employment and removing the pain of litigants.

k) Apart from, fair value and liquidation value, being the criteria for evaluation of resolution plan or sale of business of the CD, other modes of the valuation of assets/business should be explored for maximization of value of assets of the CD.

l) Consolidation of insolvency resolution process of parent and its subsidiary (ies) must be ensured particularly when there is inescapable interlinking of operational facilities / assets between them.

m) Timelines for decision making on the part of CoC members must be prescribed. In case of deviation, suitable cost must be imposed. Further, discretionary situations must be covered by specific regulations.

n) Amendment in the Income Tax Act, 1961 is required to allow the benefit of carry forward of loss and credit/ non-applicability of minimum alternate tax in the situation of sale of CD or its undertaking as going concern under liquidation process.

o) In the period between the approval of resolution plan by AA after approval of resolution plan by CoC, RP continues to manage the operations of CD as per proviso to section 23(1). The stakes for successful resolution applicant are very high as any delay in approval may have adverse impacts on his economic interests such as erosion in value of assets, increased CIRP costs and non-viability of resolution plan due to change in business dynamics, hence, statutory mechanism be framed to allow successful resolution applicant to have control on the affairs of CD during such period.

CAN THE CONSTITUTIONAL VALIDITY OF THE CODE BE CHALLENGED ON VARIOUS GROUNDS?

One critical issue is whether constitutional validity of the Code can be challenged on the ground that it violates some of the fundamental rights contained in the Part III of Constitution of India which are inherently based on the principles of fairness, equity, and equality, being the very essence of principles of natural justice. Articles 14, 19 and 21 of Part III of the Constitution of India ensure that fairness, equity, and equality must be followed in administrative and quasi-judicial functions subject to just exceptions carved out in these articles. Article 300A envisages the entitlement to own property as a constitutional right. Article 311 stipulates fair opportunity in specific proceedings. Further, Preamble to the Constitution of India aims at securing justice, social, economic and political and promises equality of status and opportunity. Directive Principles of State Policy, though not justiciable, are fundamental guidelines for the governance of the country. Article 37 mandates the state to apply these principles in making of laws.

In the earlier part of this paper, the various facets of fairness and equity were discussed. The Code has adopted these principles in the conduct of corporate processes under the Code to pass the muster of constitutionality of the Code. In this background, one can take note of the fact that in the past two years, major challenges have been made as regards to the constitutional validity of certain provisions of the Code mainly on the ground of violation of Article 14. However, the constitutional validity of certain provisions has not been challenged on the grounds of violation of principles of fairness and equity and specially for violation of Article 19(1)(g), 21 and other provisions of the constitution as plenary legislative power is subject to supremacy of the Constitution of India. Before enumerating situations involving such violation, it is pertinent to take note of the case of *Swiss Ribbons*,[32] wherein the constitutional validity of the Code was challenged before the Supreme Court on following grounds:

a) The appointment of members of NCLT and NCLAT was contrary to the decision of the Supreme Court in the case of *Madras Bar Association v. Union of India*,[33] hence, orders passed by such members were to be set aside and such members be barred from passing orders in future.

b) The classification between two types of creditors i.e., FCs and OCs was not only discriminatory but also manifestly arbitrary.

c) Section 12A of the Code was contrary to the directions of Hon'ble Supreme Court and the requirement of 90% of voting share completely derailed the process of settlement.

d) Section 29A of the Code was also contrary to the objects sought by the Code.

The Supreme Court examined the legal framework dealing with insolvency and bankruptcy as it existed prior to enactment of the Code. In this process, the Hon'ble Supreme Court referred to BLRC Report of 2015, judicial approach in general towards economic legislation, both globally and in the country, and statement of objects and reasons for enacting the Code. Before the Court, data of 80 cases resolved under IBC till then was presented in which OCs were given amount similar to FCs. The relevant observations of the Hon'ble Supreme Court are as under:

> 11. As is discernible, the Preamble gives an insight into what is sought to be achieved by the Code. The Code is first and foremost, a Code for reorganisation and insolvency resolution of corporate debtors. Unless such reorganisation is affected in a time-bound manner, the value of the assets of such persons will deplete. Therefore, maximization of value of the assets of such persons so that they are efficiently run as going concerns is another very important objective of the Code. This, in turn, will promote entrepreneurship as the persons in management of the corporate debtor are removed and replaced by entrepreneurs. When, therefore, a resolution plan takes off and the corporate debtor is brought back into the economic mainstream, it is able to repay its debts, which, in turn, enhances the viability of credit in the hands of banks and financial institutions. Above all, ultimately, the interests of all stakeholders are looked after as the corporate debtor itself becomes a beneficiary of the resolution scheme – workers are paid, the creditors in the long run will be repaid in full, and shareholders/investors are able to maximize their investment. Timely resolution of a corporate debtor who is in the red, by an effective legal framework, would go a long way to support the development of credit markets. Since more investment can be made with funds that have come back into the economy, business then eases up, which leads, overall, to higher economic growth and development of the Indian economy. What is interesting to note is that the Preamble does not, in any manner, refer to liquidation, which is only availed of as a last resort if there is either no resolution plan or the resolution plans submitted are not up to the mark. Even in liquidation, the liquidator can sell the business of the corporate debtor as a going concern. [*See* **ArcelorMittal** (supra) at paragraph 83, footnote 3].
>
> 12. It can thus be seen that the primary focus of the legislation is to ensure revival and continuation of the corporate debtor by protecting the corporate debtor from its own management and from a corporate death by liquidation. The Code is thus a beneficial legislation which puts the corporate debtor back on its feet, not being a mere recovery legislation for creditors. The interests of the corporate debtor have, therefore, been bifurcated and separated from that of its promoters / those who are in management. Thus, the resolution process is not adversarial to the corporate debtor but, in fact, protective of its interests. The moratorium imposed by Section 14 is in the interest of the corporate debtor itself, thereby preserving the assets of the corporate debtor during the resolution process. The timelines within which the resolution process is to take place again protects the corporate debtor's assets from further dilution, and also protects all its creditors and workers by seeing that the resolution process goes through as fast as possible so that another management can, through its entrepreneurial skills, resuscitate the corporate debtor to achieve all these ends.[34]

Thus, in the background of the above understanding of the objects, likely outcome and empirical data, the Hon'ble Supreme Court upheld the validity of provisions of the Code under challenge. However, considering the fact of more liquidations than resolutions, staggering level of haircuts borne by secured creditors, insignificant or nil payments to OCs, non-adherence to timelines due to frivolous litigation making corporate processes under the Code as adversarial litigation, lackadaisical conduct of CoC and judicial delays, it is apparent that considerations which prevailed over the judicial mind, while upholding the constitutional validity in the first major challenge, have remained a pipe dream only.

The second challenge was made as regards to the constitutional validity of sections 4 and 6 of the Insolvency and Bankruptcy Code (Amendment) Act, 2019 whereby amendments were made to section 30(2), 30(4) and 12 of the Code. The Hon'ble Supreme Court upheld the validity of such amendments subject to deletion of the word 'mandatorily' in second proviso to section 12 of the Code terming it excessive, unreasonable and arbitrary, thus, being violative of Article 19(1)(g). The relevant portion of the findings of the Hon'ble Supreme Court in *CoC of Essar Steel*[35] is as under:

> …Given the fact that the time taken in legal proceedings cannot possibly harm a litigant if the Tribunal itself cannot take up the litigant's case within the requisite period for no fault of the litigant, a provision which mandatorily requires the CIRP to end by a certain date - without any exception thereto - may well be an excessive interference with a litigant's fundamental right to non-arbitrary treatment under Article 14 and an excessive, arbitrary and therefore unreasonable restriction on a litigant's fundamental right to carry on business under Article 19(1)(g) of the Constitution of India. This being the case, we would ordinarily have struck down the provision in its entirety. However, that would then throw the baby out with the bath water, inasmuch as the time taken in legal proceedings is certainly an important factor which causes delay, and which has made previous statutory experiments fail as we have seen from **Madras Petrochem** (supra). Thus, while leaving the provision otherwise intact, we strike down the word "mandatorily" as being manifestly arbitrary under Article 14 of the Constitution of India and as being an excessive and unreasonable restriction on the litigant's right to carry on business under Article 19(1)(g) of the Constitution. The effect of this declaration is that ordinarily the time taken in relation to the corporate resolution process of the corporate debtor must be completed within the outer limit of 330 days from the insolvency commencement date, including extensions and the time taken in legal proceedings…..

Thus, the constitutional validity of other provisions/ overall structure of the Code, being violative of principles of fairness, equity and other grounds contained in Articles 14, 19 and 21 of the Constitution of India, has not been challenged. Further, the supreme court has upheld the constitutional validity of various challenges on the premise that CoC /RP would act in a fair and equitable manner considering the objects of the Code and in case of arbitrary or capricious exercise NCLT/NCLAT could intervene. It is also noted that the Supreme Court has referred to report of BLRC, United Nations Commission on International Trade Law (UNCITRAL) Guidelines and Reports of Insolvency Law Committee formed by the Government. The fact that the Code was an economic legislation which came into existence after failure of earlier legal regimes, the Supreme Court formed a view that experimentation was to be allowed and changes were to be made by legislature, based upon the experience gained over a period. Thus, the Hon'ble Supreme Court, though aware of pitfalls, based upon certain assumptions as indicated in the decision of *Swiss Ribbons*, consciously adopted a hands-off approach. From the very beginning of year 2021, instances of arbitrary exercise of powers by RP, CoC, and Liquidator came to the fore. NCLTs were blamed for large haircuts even though it had no role to play in commercial decisions. The Standing Committee of Parliament on Finance also took note of this situation in its 32nd Report of August 2021. The Finance Minister also expressed that the Code was being gamed. Even the IBBI published a draft discussion paper in August 2021 on the issues relating to proprietary of certain decisions of CoC and published draft code of conduct to be observed by the CoC. The NCLT, Allahabad Bench in the case of *Rathi Graphic*[36] while faced with a situation of allegations of arbitrary exercise of powers by CoC and RP, expressed its views on this very subject, in the closing para of the said order titled as 'Our Experience and Expectations' which reads as under:

> 153. This matter made us to ponder as regard to the relevancy to creditor driven process which has replaced the earlier regime of debtors in control. In our view, we have travelled from one extreme to another extreme i.e., where in earlier situation there was no timely resolution and no threat to the errant promotors to act in a disciplined manner following business ethics and moralities. Now, the time taken for resolution of Insolvency/Liquidation is around 450 days as per published statistics as against 330 days prescribed in the IBC, 2016 but still it is much lesser than the time consumed in earlier regimes. However, it is at what cost? The present structure of IBC, 2016 has given unbridled power to the creditors. They have taken large haircuts which was a great controversy in recent past. IBBI in its discussion paper for bringing a code of conduct for CoC has also brought out several other instances wherein the functioning of the CoC was found to be below par. It may not be wrong to say that the present case

> would add one more matter to that list. Further, the CoC is very much responsible for delays in completion of CIRP. The under valuation of the assets of the corporate debtor is also an issue which needs a serious re-look and methodology prescribed in the present Code/Regulations needs to be changed. The plight of operational creditors including statutory authorities as a consequence of approval of resolution plan or liquidation proceedings in terms of provisions of Section 53 has made the case worst. Thus, it may not be a theoretical statement to state that in this process we have departed from socialistic approach to capitalistic approach. Even the judiciary has adopted a hands-off approach based upon foreign jurisprudence qua economic legislation. In our view, there is urgent necessity to adopt a middle path i.e., somewhere between the creditors driven process and debtors in control process to really take care of interests of all stakeholders which include society at large. From the recent developments which have been taken note of in our order, we hope that it will happen sooner.[37]

Thus, the Code remains a work in progress, and it requires immediate attention to address various issues emanating from its functioning.

At the first instance, specific provisions without any reference to the Preamble to the Code must pass the test of constitutional validity. Further, the statement of objects and reasons of the Code state that achievement of objects outlined in the Preamble to the Code was the purpose of the Code. As the Preamble to the Code inherently incorporates principles of fairness, equity, and equality, hence, any provision of the Code, being in contravention of Preamble to the Code may be construed as violative of Article 14, 19 and 21 of the Constitution of India. The Preamble is a guiding factor and has force of law as held by the Supreme Court in the case of *CoC of Essar Steel*[38] in para 46 which reads as:

> 46. This is the reason why Regulation 38(1A) speaks of a resolution plan including a statement as to how it has dealt with the interests of all stakeholders, including operational creditors of the corporate debtor. Regulation 38(1) also states that the amount due to operational creditors under a resolution plan shall be given priority in payment over financial creditors. If nothing is to be paid to operational creditors, the minimum, being liquidation value - which in most cases would amount to nil after secured creditors have been paid - would certainly not balance the interest of all stakeholders or maximise the value of assets of a corporate debtor if it becomes impossible to continue running its business as a going concern. Thus, it is clear that when the Committee of Creditors exercises its commercial wisdom to arrive at a business decision to revive the corporate debtor, it must necessarily take into account these key features of the Code before it arrives at a commercial decision to pay off the dues of financial and operational creditors. There is no doubt whatsoever that the ultimate discretion of what to pay and how much to pay each class or subclass of creditors is with the Committee of Creditors, but the decision of such Committee must reflect the fact that it has taken into account maximising the value of the assets of the corporate debtor and the fact that it has adequately balanced the interests of all stakeholders including operational creditors. This being the case, judicial review of the Adjudicating Authority that the resolution plan as approved by the Committee of Creditors has met the requirements referred to in Section 30(2) would include judicial review that is mentioned in Section 30(2)(e), as the provisions of the Code are also provisions of law for the time being in force. Thus, while the Adjudicating Authority cannot interfere on merits with the commercial decision taken by the Committee of Creditors, the limited judicial review available is to see that the Committee of Creditors has taken into account the fact that the corporate debtor 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 operational creditors has been taken care of. If the Adjudicating Authority finds, on a given set of facts, that the aforesaid parameters have not been kept in view, it may send a resolution plan back to the Committee of Creditors to re-submit such plan after satisfying the

> aforesaid parameters. The reasons given by the Committee of Creditors while approving a resolution plan may thus be looked at by the Adjudicating Authority only from this point of view, and once it is satisfied that the Committee of Creditors has paid attention to these key features, it must then pass the resolution plan, other things being equal.[39]

In this context, one must take into consideration, the provisions of the Code which are in direct conflict with the object of balancing the interests of all stakeholders and to promote credit as contained in the Preamble to the Code and the fundamental rights, in particular Articles 19(1) (g), 21 and 300A of the Constitution of India, such situations are:

a. **Unfair treatment to OCs and existing public shareholders:** Insignificant or nil payment to the OCs, unsecured FCs in the resolution plan, in spite of the observations and expectations of the Hon'ble Supreme Court that CoC will be fair in its approach while upholding the validity of section 30(2)(b) and interlinking of section 53 with section 30(2)(b) and section 30(4) of the Code. Such conduct of CoC is also in violation of regulation 38(1A) of CIRP Regulations. The value of security held by an FC is given weightage in the resolution process in quantifying the amount to be distributed which is against the principle of collective welfare. Lastly, such treatment to OC is also against the stated object regarding availability of credit as OCs, in this situation, would provide services / goods against advance. It is argued that supply of goods or services on credit involves business risk and the supplier can always stop supplies to mitigate the risk. Theoretically, it may sound good but in practical business situations, the OC cannot stop supplies as his money is already stuck. Further, the commercial risk cannot justify the mandatory write of a legal claim through legislation in an arbitrary and unreasonable manner.

b. **Non-inclusion of OCs in CoC** except as prescribed in regulation 16 of CIRP Regulations although on aggregate basis, the operational credit in the economy / business is much more than the financial credit / loans. Further, in the jurisdictions like USA, UK and Singapore mechanism for effective participation/ consent of OCs in the resolution process exist. Even under the Companies Act, 2013 and earlier Companies Acts provision for consent of each class creditors have been kept. Thus, IBC lacks this basic requirement.

c. **Extinguishment of existing share capital** held by public in case of listed companies going under insolvency resolution. However, now a minimum of 5% public shareholding is required to be maintained and SEBI has floated a discussion paper whereby it is proposed that public shareholders can participate in the resolution process.

EXCESSIVE DELEGATION OF LEGISLATIVE POWER TO IBBI

The IBBI derives its power to make regulations in terms of provisions of section 196(1)(t) read with section 240 of the Code. As per section 240(1), IBBI may make regulations consistent with the Code and rules made thereunder, to carry out the provisions of this Code although section 188 of IBC provides for establishment of IBBI for the purposes of the Code. However, it is a settled position of law that delegated legislative power has to be seen from the enabling provisions specifically made by the legislature to that effect. Thus, the legislature has delegated the power to IBBI only to carry out the provisions of the Code and 'not the purposes' of the Code. Further, such power of IBBI is also subject to compliance of regulations made by IBBI and rules framed by Central Government. In this background, following situations show that IBBI is making regulations which are not envisaged or beyond the scope of the provisions of the Code:

a) According to regulation 39(9) of CIRP Regulations, any creditor, aggrieved by non-implementation of a resolution plan approved under sub-section (1) of section 31, may apply to the AA for directions, whereas section 33(3) provides that any person whose interest are prejudicially affected by contravention of provisions of resolution plan may apply for liquidation of the CD.[40] The creditor also comes within the definition of 'any person' as mentioned in section 33(3) of the Code. Hence, this regulation and main provision stand at variance.

b) Section 12A provides for withdrawal of an application filed under section 7 or section 9 or section 10 with the approval of 90% voting share of CoC whereas, regulation 30A of CIRP Regulations provides for withdrawal of application even before the constitution of CoC.

c) Section 21 of the Code prescribes that CoC shall comprise all FCs of the CD. Whereas regulation 16 of CIRP Regulations prescribes for constitution of CoC with only OCs where CD has no FCs, or all FCs are related party of the CD.

d) Recently enacted, regulation 6A of CIRP Regulations, is also an instance of fostering a duty on IRP / RP beyond the provisions of sections 13, 18 and 25 of the Code.

e) Section 30(2)(a) provides for payment of insolvency resolution process cost in a manner specified by the Board in priority to the payment of other debts of the CD. Originally regulation 38 of CIRP Regulations specified as to in what manner quantum of insolvency resolution process cost shall be determined and paid. Several amendments were made thereto. Now, there exists no regulation in this regard though the substantive provision still requires so. Thus, in some situations, litigation arises because of this gap.

f) In case of sale of business of the CD as a going concern or its business under regulation 32 and 32A of Liquidation Regulations read with regulation 39C of CIRP Regulations implies taking over of assets and liabilities together, hence, such regulations are in direct conflict with section 53 of Code. Section 53 needs to be modified to give correct and complete effect to sale of business or CD as going concern.

g) Regulation 28 of Liquidation Regulations provides of mutual set off of claims and counter claims. However, the same cannot be given effect in view of section 53(1) which provides for waterfall mechanism overriding contrary provisions of any law which would obviously include Liquidation Regulations as well.

The above are a few examples but there can be so many other issues of a similar nature. The only reason for adopting such modus operandi is to avoid the cumbersome legislative process which needs to be adopted to make change in the substantive law as compared to making of regulations. However, it is fraught with grave consequences and sets a dangerous trend.

COMMERCIAL WISDOM OF CoC

Except the Preamble and certain regulations such as regulation 38(1A) of CIRP Regulations, no other guidelines or code of conduct exist which needs to be adhered to by the CoC in controlling and conducting the commercial corporate process as envisaged under the Code. In fact, regulation 38(1A) of CIRP Regulations is a nugatory in view of the provisions of section 30(2)(b) and section 30(4) of the Code. Regulation 39(3) of CIRP Regulations originally prescribed that '*the committee shall evaluate the resolution plans received under sub-regulation (1) strictly as per the evaluation matrix to identify the best resolution plan and may approve it with such modifications as it deems fit..*'. However, now the CoC is required only to evaluate the resolution plans as per evaluation matrix. Hence, there is a significant dilution in the responsibilities of CoC.

The appointment of IRP / RP, in substance, is in the hands of CoC. The CoC can replace IRP / RP in terms of provisions of sections 22 and 27 of the Code, respectively. As far as change of IRP is concerned, section 22(2) simply prescribes for majority vote, hence, in cases where application has been admitted on behalf of a creditor other than the members of CoC, this is routinely done by appointing a person of CoC's choice. In case of replacement of RP under section 27, primarily point to be noted is that such replacement can be done at any stage of CIRP. Second point is that it is solely based on the opinion of CoC. There is no explicit requirement of recording of reasons in this regard. In most cases, such decision of the CoC has been upheld by AA or NCLAT being an instance of exercise of commercial wisdom of CoC. It is also worthwhile to note that under section 28 of the Code, IRP/RP is bound to take significant decisions with the prior approval of CoC and in spite of this, power to replace is exercised, in most of the cases where originally name of IRP/RP was proposed by the applicant creditor.

SPECIFIC INSTANCES OF VIOLATION OF ARTICLE 19(1)(G) OF THE CONSTITUTION OF INDIA

a. Successful resolution applicant cannot be allowed to withdraw after the resolution plan is approved by CoC, although as per regulation 38(2)(a) of CIRP Regulations, a resolution plan is required to provide the term of the plan and its implementation schedule. Further, regulation 38(2)(b) of CIRP Regulations prescribes that resolution plan shall provide for the management and control of the business of CD during its term. A combined reading of these regulations indicates that after submission of resolution plan till approval of the same by CoC, the RP continues to manage and control the business of the CD. After the approval of resolution plan by CoC, the RP in terms of proviso to section 23(1) will continue to manage the operations of the CD till an order approving a resolution plan is passed by the AA under section 31(1) of the Code. In the case of *Ebix Singapore*,[41] the attention of the Supreme Court was not drawn to this regulation. Hence, this does not find mention in the above order at any place. Hopefully, this situation will be cured sooner than later as no resolution plans may come which would lead to liquidation, a situation not even being mentioned in the Preamble to the Code. Even otherwise, there are more liquidations than resolutions so far.

b. **Complete displacement of the existing owners of the CD from the corporate process and still making them liable to honor personal guarantees without having any recourse to right of subrogation:** In terms of provisions of the Code, the management of affairs of the CD gets vested in IRP/RP and all the powers of Board of Directors stand suspended. The IRP/RP functions under the supervision and control of CoC. This is done in all cases based upon the creditors in controls paradigm of the Code and on the assumption that existing promoters are solely responsible for this situation of the CD. There should be some criteria for inclusion of existing promoters other than willful default or fraudulent promoters to remain in the management of affairs of the CD so that the CD can be run as a going concern and value of the assets of the CD can be maximized. This should be so when such promoters have given a personal guarantee. Further, by virtue of section 31(1) read with section 238, there is a waiver of right of subrogation. Hence, the personal guarantor stands to lose at all ends particularly when CoC functions to protect its interest only to the extent to realize the value of the assets of the CD to meet the requirement of the Code provisions and thereafter members of COC go after personal guarantors.

c. **Qualitative criteria for appointment of IRP/RP:** At present, qualifications to become IRP or RP do not require any business experience in general or of the relevant sector. Hence, the going concern status with profitable operations is not maintained which ultimately results into lesser valuation of the CD or unfortunate corporate death due to liquidation. Interestingly, it is the RP who with the approval of CoC, in terms of provisions of section 25(2)(h) of the Code lays down the criteria for inviting resolution plans having regard to the complexity and scale of operations of the business of the CD.[42] In essence, the RP functions as Chief Executive Officer under the supervision of CoC who is akin to Board of Directors of a company. Hence, business qualification / experience for an effective IRP / RP is a pre-requisite.

d. The invocation of personal guarantee without any right of recourse given to the personal guarantor of the CD is also against the objective of promotion of entrepreneurship as no person will come forward to give personal guarantee and take entrepreneurial initiatives. Alternatively, lending mechanism needs to change.

At present, no provision exists to check the re-entry of the willful/fraudulent promoters after the implementation of resolution plan or sale of the business of the CD under liquidation. Thus, in the absence of provision like section 29A in the Code, the very purpose of the Code is defeated as in reality, such practice is a distinct possibility.

Proceedings under the Code are proceedings *in rem*, hence, rights of creditors of OCs of the CD suppliers / service providers of CD are also adversely impacted causing chain of insolvencies and gross economic slowdown which is also against the stated objectives of making availability of credit and entrepreneurship development.

CONCLUSION

The Code has incorporated principles of fairness and equity in corporate processes under the Code from its very inception and thereafter, filled the gaps, wherever necessary. The Code, as such, is largely successful, considering the infrastructural constraints, pandemic situation, in inculcating discipline in corporate lending and borrowing apart from resolution of big matters. The real success of the Code lies in recovery of the debts in pre-admission stage though the recovery is not the stated object of the Code. The judiciary has upheld the constitutional validity of various provisions of the Code giving liberty of experimentation to the legislature and on the premise that all involved institutions will act in a fair and equitable manner. However, now it is imperative that the legislature must bring carry out the changes in the structure of the Code by incorporating principles of fairness and equity in its all dimensions in all corporate processes under the Code to prevent abuse of present structure for unjust enrichment of select few and to achieve the objects enshrined in the Preamble of the Code. Until then it is incumbent upon the higher judiciary to ensure that Code meets the criteria and / tests as enshrined in Articles 14, 19(1)(g), 21, 37, 38 and 39 and Preamble of the Constitution of India as experimentation in this way cannot be allowed to continue infinitely. It is pertinent to point out that subsequent to submission of this paper, the Ministry of Corporate Affairs published a discussion paper on January 18, 2023 wherein various points raised in the paper have been considered for implementation through proposed legislative changes.

[1] Baird D. (1998), "Bankruptcy's Uncontested Axioms", The Yale Law Journal, Vol. 108, p. 579.

[2] *Earl of Selbourne, LO in Spackman v. Plumstead District Board of Works*, 1985 (10) AC 229:54 LJMC 81.

[3] Shikhar Shrivastava, "Concept, Evolution and Importance of Natural Justice", Law Times Journal, December 7, 2019.

[4] The word natural justice is derived from the Roman word '*jus-naturale*' and '*lex-naturale*'.

[5] Topic – Natural Law, Britannica, February 24, 2023.

[6] The Roman law put forth the first two principles, as for the third one, it is a principle that has been incorporated as a result of the developments in constitutional and administrative law.

[7] Cambridge Dictionary.

[8] Padjen I. (1996), "Fairness as an Essential Element of Law", Vol. XXXIII, No. 5, pp. 108-119.

[9] 2014 (9) SCC 263.
[10] (2003) 4 SCC 557.
[11] *Cooper v. Wandsworth Board of Works*, 1963 (143) ER 414.
[12] *Ibid*.
[13] *Sahara India (Firm) v. CIT*, (2008) 169 Taxman 328 (SC).
[14] IA No.31/2021 in CP(IB) No.325/ALD/2019, June 13, 2022.
[15] *Ibid.*
[16] *Ibid.*
[17] (2019) 4 SCC 17.
[18] Civil Appeal Nos. 1811-1812 of 2022.
[19] (2017) ibclaw.in 03 HC.
[20] Civil Appeal No.10673 of 2018, CA No. 10719 -2018, SLP (C) No. 29181 of 2018.
[21] Supra Note 17.
[22] Civil Appeal No.9170 of 2019, SLP(C) No.22596 of 2019.
[23] Civil Appeal No. 8766-67/2019.
[24] (2021) 7 SCC 209.
[25] Civil Appeal No.3224 of 2020.
[26] Supra Note 24.
[27] *Ibid.*
[28] Civil Appeal No.9664 of 2019.
[29] Supra Note 23.
[30] Comp. Apps. (AT) (Ins.) No.85-86 of 2020.
[31] Supra Note 23.
[32] Supra Note 17.
[33] (2015) 8 SCC 583.
[34] Supra Note 17.
[35] Supra Note 23.
[36] Supra Note 14.
[37] *Ibid.*
[38] Supra Note 23.
[39] *Ibid.*
[40] Regulation 39(9), CIRP Regulations and Section 33(3), IBC.
[41] Supra Note 25.
[42] Section 25(2)(h), IBC.

30 RERA Vs. IBC: LANDOWNER, DEVELOPER, BUILDER, ALLOTTEE AT CROSSROADS

-Vishal J Dave, Mayur Jugtawat and Sejal Palan

EXECUTIVE SUMMARY

The corporate insolvency resolution process (CIRP) vis-a-vis Real Estate (Regulation and Development) Act, 2016 (RERA) is undergoing tremendous changes under law which require certain amount of consistency due to involvement of homebuyers. The research paper deals with such ambiguities brought in thereby creating direct conflict with RERA and difficulty in participating in the CIRP. There exists greater difficulty in the verification of claims by Resolution Professional (RP) due to uncertainty of situations to define scope of homebuyers under the Insolvency & Bankruptcy Code, 2016 (IBC/Code). In addition to such problems, there exists inevitable partnership between landowners and developers who are generally required to go hand in hand to complete any project. The ongoing multiple projects of the same corporate debtor (CD) is another concern for RP, resolution applicant and other stakeholders to achieve objectives of Code i.e., to maximise the value of assets in time bound manner.

Keywords: IBC, Real Estate, Homebuyers, RERA, CIRP, CD, Allottee, Landowners, Developers

INTRODUCTION

Our country, in the last couple of years has witnessed a lot of enactments in the laws to consolidate economic system in India. Recent amendments in the Goods and Service Tax Act, 2016, the IBC, and the RERA are a few examples of the recent development in the economic laws and regulations. The real estate sector has been subjected to various challenges in the past couple of years. From demonetization to the implementation of new GST rules, developers and homebuyers have taken major blows. Earlier homebuyers used to approach consumer courts to redress their grievances. Then came the RERA which has become a resourceful platform to address the grievances of homebuyers in a more channelized way.

The two important legislations were brought in by the legislatures to improvise economic and social structure of society. RERA and IBC are economic centric legislations for the betterment of the society. The objective behind the RERA is to enhance accountability and transparency in the real estate sector while it also aims to provides speedy adjudication of disputes. The aim of the RERA is to bring more opportunity in the real estate sector by attracting domestic as well as foreign investors in more organized manner.

The Ministry of Finance, Government of India had subsequently brought an amendment in the IBC, in August, 2018 to allow an individual homebuyer to initiate CIRP before the Hon'ble National Company Law Tribunal (NCLT). The amendment has given the homebuyers the status of 'financial creditors' (FCs).

The objectives of the IBC are to revive the CD in distress. The Code provides for a time-bound process, including any litigation, which must be completed within 330 days.[1] The focus of IBC is to maximise value of assets of the CD.

The IBC and RERA appear to have hollowed against each other with regards to settling of the interest of homebuyers. Both IBC and RERA have the provisions where the probability for the conflict in their operations is very high. In this paper, the authors shall compare these two major legal mechanisms in terms of their effectiveness and subjective approach.

RERA INTO IBC

Discourse on the overlapping of both these laws came into the highlight when the 2018 amendment of IBC was brought. The amendment had included allottee into the code under section 5(8) which provided that *'any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing'.* The term 'allottee' and 'real estate project' had their meaning assigned through the RERA. The first instance of homebuyers was reflected in the matter of *Nikhil Mehta v. AMR Infrastructure*[2] wherein appellate tribunal held that the homebuyers are to be considered as the FCs due to assured return scheme in contract where the seller had to pay the assured return till the home buyer gets the actual possession of the property which is why the transaction will constitute as a loan and hence, the financial debt under the Code. Therefore, the allottees who have assured return clause in their contract will have the recourse to initiate the insolvency process. This has been followed by the NCLT in many cases including *Neelam Singh v. Megasoft Infrastructure*,[3] *Anubhuti Aggarwal v. DPL Builders Pvt. Ltd.*,[4] *Pawan Dubey v. J.B.K. Developers*.[5]

The Insolvency Law Committee (ILC), while pondering upon the issue of homebuyers in the real estate projects, recommended that the non-completion of the real estate projects is common and the amount which is raised is also very significant raised against 'time value of money' thereby making IBC proper forum to resolve the disputes as the Code provides for the definition of financial debt and allottees would perfectly fall under the definition. Considering the Report of the ILC, the three-judge bench in *Pioneer Urban Land and Infrastructure Limited & Anr. v. Union of India & Ors*.[6] (Pioneer Urban) upheld constitutional validity to the amendment of 2018 and section 5(8)(f) of IBC which gives allottees the status of FC. The IBC define allottees meaning as assigned under RERA however, the difficulty arises is that RERA is a central law to be followed by states, but some states did not adopt RERA, in such situation judiciary has to take active role and has to define/interpret allottees as per IBC.

The harmonious construction of both the legislations was taken into consideration so that objectives of both the legislations are intact and are not affected. However, if there is a conflict between RERA and IBC then, RERA should give way to IBC so RERA should not be considered as special statue which in conflict could override the general statue that is the IBC.

IBC INTO RERA

The objective of the RERA is to ensure transparency and efficiency in the real estate sector, protecting the interest of the stakeholders and establishing an adjudicating mechanism for speedy redressal of disputes.[7] It consists of preventive and penal provisions to safeguard the interest of the homebuyers by imposing duties on the promoters or errant builders. As per the law, it is essential for every promoter to register his project with RERA and 70% of the realized amount shall be deposited in a separate escrow account;[8] withdrawal of the amount from the account shall be in proportion to the degree of project completion, failure in compliance of which entails penalty.

Some of the rights of the homebuyers as provided under section 19 of the RERA includes the right to obtain project information, right to know completion schedule, right to claim possession, right to claim refund of the amount paid along with the interest and compensation in case the builder failed to comply or unable to give possession of the property, right to have documents and right in case of any defects or problems in the quality of the property within five years of possession.[9]

However, to strike a balance between the interest of homebuyers and the builders, RERA also provides with certain duties of the homebuyers which includes duty to research, duty to make payment, duty to pay interest, duty to participate in the registration, duty to form association of buyers and duty to take possession within the period of two months after the issuance of the occupancy certificate.[10]

Pursuant to the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 (Second Amendment), whereby the 'allottees' were deemed as 'FCs' under section 5(8)(f) of the Code. In the case of *Pioneer Urban*[11] before Supreme Court of India, more than 150 developers/real estate companies challenged the Second Amendment which inserted two explanations in clause (8)(f) of section 5 of the Code. Pursuant to the first explanation, any amount raised from an 'allottee' of a 'real estate project' (i.e., a homebuyer) shall be deemed to be an amount having the commercial effect of borrowing, and hence would be considered as a FC under the section 7 of the IBC. The amendment had further allowed the homebuyers being FCs to have representation in the committee of creditors (CoC) through an authorized representative and have voting rights.

The Apex Court in the judgment has categorically distinguished that the constitutional validity of the amendment will be decided on the background of the fact that the legislature must be given free play in the joints when it comes to economic legislation. For clear understanding, the Supreme Court then went ahead to examine the recommendations made by the ILC wherein it was stated that the delay in completion of under-construction apartments has become a common phenomenon. The Committee further agreed that amounts raised under home buyer contracts is a significant amount, which contributes to the financing of the construction of an asset in the future. Finally, the Committee concluded that the current definition of 'financial debt' is sufficient to include the amounts raised from homebuyers/allottees under a real estate project, and hence, they are to be treated as FCs under the IBC. Thus, the Supreme Court has observed that the judgments in respect of the economic choices must be given a certain degree of deference by the courts.

The Court then examined the RERA and concluded that, even by the doctrine of harmonious construction, RERA and the IBC must be held to co-exist, and, in the event of a clash, RERA must give way to the IBC. The RERA, therefore, cannot be held to be a special statute which, in the case of a conflict, would override the general statute, viz. the IBC.[12]

The Apex Court further made it clear that it is impossible to say that classifying the homebuyers is not founded upon an intelligible differentia, nor is it possible to say that such classification is substantially arbitrary having no rational relation to the objects of the IBC.

Further, interpreting the explanation added to section 5(8)(f) of the IBC, the Court further held that allottees/homebuyers were included in the main provision, i.e., section 5(8)(f) with effect from the inception of the Code. The explanation which was added in 2018 merely clarifies the doubts that had arisen. This judgment shall prove to be a huge deterrent against the fraudulent/unscrupulous real estate developers. While on the other hand the constitutional bench of the Supreme Court by upholding the constitutional validity of the amendment in the IBC, has given a huge sigh of relief to the aggrieved homebuyers who can now approach under the IBC without any hassle.

Allottees in a real estate project, including a home buyer having attained the status of a FC under the code, has the following rights in a CIRP:

a) Allottee shall be at par with the banks and the financial institutions as FC.
b) Allottee shall have a right of representation in the CoC on its own or through an authorized representative in a class of creditors.
c) By becoming an FC, a allottee would have priority over government and operational creditors (OCs).[13]

Allottee can also initiate a CIRP proceeding against defaulting promoters by filing an application with the NCLT under section 7 of Code on the occurrence of a default, as an FC. However, if there is delay of possession of their homes then the allottees can have recourse by filing complaint under section 31 of the RERA (the details of filing document may change according to the state regulations), where they can get compensation from the developers along with the interest under section 18 of the RERA.[14]

The two laws while developing has collided and brought need for harmonious way to work together to achieve objectives of both the legislations. The clash of two laws is settled by Hon'ble Supreme Court in the matter of *Pioneer Urban*[15] by stating that he Supreme Court after referring to the various provisions of RERA has stated that section 88 of RERA were in addition to and not in derogation of the provisions of any other law for time being in force and as per section 89, RERA is to have effect notwithstanding anything inconsistent contained in any other law for the time being in force.

IBC AMENDMENTS WITH RESPECT TO HOMEBUYERS

Initially under IBC the homebuyers were not treated as FCs, as position of homebuyer under the IBC was a moot point. Hon'ble NCLAT in *Nikhil Mehta and Sons (HUF) v. AMR Infrastructure*[16] tried to settled the chaos to some extent by upholding that homebuyers are to be considered as the FCs due to assured return scheme in contract where the seller had to pay the assured return till the home buyer gets the actual possession of the property which is why the transaction will constitute as a loan and hence, the financial debt under the Code. Thereafter, Hon'ble Supreme Court of India in the case of *Chitra Sharma v. Union of India*,[17] upheld the right of representation of the homebuyers; to participate in meetings of the CoC of Jaypee Infratech Ltd. Thereafter, to bring clarity on status of home buyer, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 (Ordinance) was promulgated on June 6, 2018 and the following explanation was incorporated in section 5(8)(f):

> Explanation.- For the purpose of this sub-clause-
>
> any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and
>
> the expressions, "allottees" and "real estate projects" shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (6 of 2016);

Simultaneously with the above stated ordinance, on July 3, 2018 an amendment was carried out in the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, introducing a separate category for the homebuyers i.e, 'creditors in a class' and prescribing form FA for submission of their claims. Finally, the said Ordinance received the approval of the Parliament and thereafter, the Second Amendment was passed on August 17, 2018.

Facing rampant use of IBC by the homebuyers the builders approached the Hon'ble Supreme Court challenged the constitutional validity of Second Amendment in the case of *Pioneer Urban.*[18] Hon'ble Supreme Court upheld the validity of the amendment and held that the money raised by developers from the homebuyers is done with a profit-making motive and therefore it was held that it has the commercial effect of a borrowing and hence, is included within the definition of 'financial debt' under section 5(8)(f) of the IBC.

On December 12, 2019, the Insolvency and Bankruptcy Code (Second Amendment) Bill, 2019 was introduced in Lok Sabha which prescribed the threshold in filing application under section 7 by the homebuyers jointly by not less than:

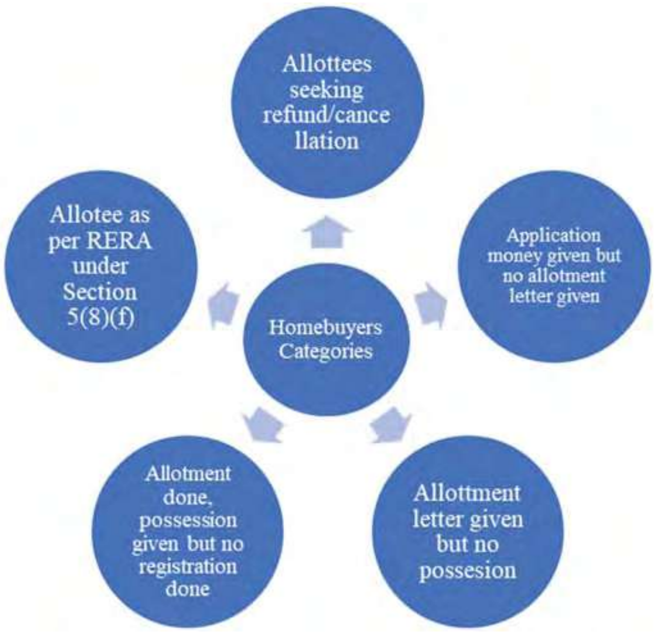
a) 10% of the total number of such creditors in the same class, or

b) 100 of such creditors in the same class.

The Insolvency and Bankruptcy Code (Second Amendment) Bill, 2019 received the assent of the president on March 13, 2020 and was notified as the Insolvency and Bankruptcy Code (Amendment) Act, 2020.

There were only two amendments that have happened in respect of homebuyers. In the IBC Amendment Act of 2020 in which section 7 was amended because the Apex Court observed that in a real estate project there can be hundreds or even thousands of allottees and if a single allottee as a FC is allowed to make an application under section 7, the interests of other allottees may be put in peril.[19] Another amendment was wherein section 5 was amended which gives the effect of FCs to the allottees, it says that the amount raised from the allottees in the real estate project have the commercial borrowing effect which gives the homebuyers the status of FC.[20]

CATEGORIES OF ALLOTTEES UNDER IBC



Can landowners be termed as FC under IBC?

With the introduction of allottees under IBC, the parties falling under the ambit of allottees has opened the gates of interpretation as to understand the scope and limits of allottees under IBC. One such issue arose in the matter of *Namdeo Ramchandra Patil v. Vishal Ghisulal Jain RP of Corporate Debtor*[21] wherein Hon'ble NCLAT decided on the issue whether sharing the constructed area and allotment of flats and commercial units in lieu of entitlement to landowners under the development agreement would make the transaction of allotment a financial debt within the meaning of section 5(8)(f) of IBC.

As settled by Supreme Court in the case of *Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited v. Axis Bank Ltd. & Ors.*[22] that the essential element under section 7 is disbursement against the time value of money. In the above case, the landowners were entitled to share the constructed area in the ratio of 45:55 and allotment of flats and commercial units in lieu of their entitlement under the development agreement does not make the transaction of allotment a financial debt within the meaning of section 5(8)(f). The similar view is taken by Hon'ble NCLT, Indore bench in the matter of *L & T Finance Ltd v. Sanjay Kumar Singh, IRP of JSM Devcons Pvt Ltd & Anr*[23] wherein the Adjudicating Authority (AA) examined the transaction entered into between landowner and developer and held that the transaction is more or less is in the nature of joint venture and therefore the status of allottee will not be applicable on Ashoka Hitech Builders Pvt. Ltd.

The landowners cannot seek place in CoC based on allotment of some units to them when there is already a joint development agreement (JDA) between parties sharing the profits. The transaction shall be purely commercial between the two parties and the onus shall lie upon the landowners to prove that the transaction entered is independent to fall under the definition of allottee.

Terms and conditions of agreement between buyer and seller defines allotee

Buyback clause

An agreement for sale of whatsoever nature is vital in deciding status of allottee under IBC. *Prima facie*, the onus is upon the homebuyer to prove that he is an allottee. Allottees of real estate projects can come armed with information provided by promoter or real estate developer itself, based on which a default relating to amounts due and payable to the allottee is made out in an application under section 7 of the IBC. Once this happens, the burden shifts on the promoter/real estate developer to point out in their reply and in the hearing before the NCLT, that the allottee is himself a defaulter and would, therefore, on a reading of the agreement and the applicable RERA rules and regulations, not be entitled to any relief including payment of compensation and/or refund, entailing a dismissal of the application.

Hon'ble NCLT, principle bench, Delhi in the matter of *HT Media Limited v. Imperia Structures Limited*[24] has dealt with the issue of clause in the agreement which offered buyback of the apartments along with compound interest at the end of 24 months and the agreement also made a clarification that the intending allottee will have the right, but not any obligation to sell the apartment back to the developer.

Hon'ble NCLT while determining the locus of HT Media Limited held that an agreement with respect to buyback shall not alter the basic nature of transaction and therefore even if buyback clause is not triggered, HT Media being purchaser of apartments shall be considered as allottee under the IBC.

However, Hon'ble NCLAT in the matter of *Shubha Sharma, Suspended Board of Director v. Mansi Brar Fernandes*[25] after examining the memorandum of understanding between parties held that FC was a speculative investor and not a person who is genuinely interested in purchasing the apartments. Therefore, the two contradictory views with respect to buy back clause indicate that definition of allotees is dependent on terms and conditions.

Assured return

Assured return scheme is an investment plan, wherein a builder gives interest, or return on money invested by an investor at an agreed rate of interest. However, such schemes are sometimes risky as builder may misappropriate the amount to other projects defrauding the allottee who are promised assured return. In the matter of *Nikhil Mehta and Sons v. AMR Infrastructure Ltd.,*[26] the Hon'ble NCLAT, recognized that assured returns from real estate projects, act as 'time value of money', for the investment made by the investor. It also held that assured returns by builders is a method of raising or mobilising funds from open market or public at a lower rate of interest without any security and any regulatory body, thereby making investors 'FCs'. Accordingly, it became easier for the investors of a real estate project to initiate CIRP against the said project under the IBC.

Also, the assured returns are well recognised by RERA authorities as well. Haryana RERA in the cases titled *Madhushree Khaitan v. Vatika Limited*, bearing complaint No. 1239 of 2021, and *Tanya Mahajan v. Vatika Limited*, bearing complaint no. 343 of 2021, clarified that builders are wrongly categorizing investments of investors as 'deposits', instead of 'investments', as there exist a relationship of 'builder-buyer' between the builder and the investor.[27]

In *Meenu Chopra v. Innovative Infra Developers Pvt. Ltd*.[28] Hon'ble NCLT, Principal Bench, New Delhi considered the fact that the clause for assured return is not required to be separately prepared and therefore the agreement having purchase of property for consideration and having clause with respect to assured return would fall under the definition of allottee.

TREATMENT OF CLAIMS OF HOMEBUYERS/ALLOTTEES

Homebuyers are more interested in their dwelling unit rather than economic interests of the CD. Whenever a CD is admitted under CIRP, most of the homebuyers are unaware of such process and therefore do not understand the non-consequences of filing claim with IRP/RP. The publication in the newspaper is normally done in the area where CD has its registered office and corporate office and there is every likelihood that all homebuyers could not know within the 14 days period allowed in Form-A to file their claim and practically homebuyers who are 100 in number neither come to know about the CIRP nor did they file their claim within the 14 days' time allowed.[29] Even in maximum 90 days period as provided in section 12(2), on several occasion, homebuyers could not file their claims. The homebuyers are a class belonging to middle class of society and majority of whom, who book flat has taken loan from banks and other financial institutions and they are saddled with liability to pay their loan from their hard-earned income they make payment to the CD in hope of getting a possession of the flat for their residence. Non-submission of claim within the time prescribed is a common feature in almost all projects of real estate.

Such issue has been dealt by Hon'ble NCLAT in the judgment of *Puneet Kaur v. K V Developers Pvt. Ltd.*[30], wherein the Court took cognisance of unawareness of homebuyers and made following observations:

> ...Even though, Interim Resolution Professional/Resolution Professional are not obliged to include the name of such Homebuyers, who have not filed the claim within the time in their List of Creditors, but there is no reason for not collating the claims of such Homebuyers whose claims are reflected from the records of the Corporate Debtor, including their payments and allotment.
>
> When the allotment letters have been issued to the Homebuyers, payments have been received, there are Homebuyers and there is obligation on the part of real estate Company to provide possession of the houses along with other attached liabilities. The liability towards those Homebuyers, who have not filed their claim exists and required to be included in the Information Memorandum....

The above observations are signs of relief for the homebuyers because the ultimate purpose of CIRP is to find all the liabilities of CD and take appropriate steps towards its resolution. The non-inclusion of such homebuyers would lead to unfair and unjust resolution of the CD and unjust enrichment to a few. The objective of bringing homebuyers under the ambit of IBC would fail if all the homebuyers are not treated at par making it duty of IRP/RP to collate all the claims whose details are reflected in the records of the CD.

Homebuyers cannot invoke insolvency proceedings to execute RERA decrees

Proceedings under RERA and IBC are at two different junctures. While IBC is developing rapidly, RERA is taking its own course to fulfil the objectives of Act. One such scenario is that recovery certificate obtained from RERA authority. RERA has its own procedure, and a recovery certificate is required to be executed before civil court to make it absolute in accordance with law. However, in one of the cases the question arose whether such decrees can be used as instrument of debt and application can be maintained under section 7 of the IBC.

The NCLAT took a view that a financial debt is always at the instance of disbursement having time value of money. In the case in hand, the debt culminated from a recovery certificate and decree is an adjudicated amount and not a debt disbursed against the consideration for the time value. Homebuyers had approached the NCLT only with a view to execute the decree in recovery certificate and recover the amount due thereunder. It is indisputable that the recovery certificate sought to be executed is the product of an adjudicatory mechanism under the RERA and realisation of the amount due under the recovery certificate tantamount to recovery effected under a money decree though mode of execution may be slightly different.[31] Therefore, decree holders are not having any locus to initiate any IBC proceedings.[32]

Authorised representative of the allottees under IBC

The authorised representative under section 21(6)/(6A) or section 24(5) shall have the right to participate and vote in meetings of the CoC on behalf of the FCs he represents in accordance with the prior voting instructions of such creditors obtained through physical or electronic means. However, the major hurdle arises in appointment of authorised representative. The duty of IRP/RP is to apply before AA seeking approval of authorised representative. The process in some cases takes time which delays the participation of authorised representative in CIRP and therefore such decisions fall directly into the hands of allottees. The application to AA is informational purpose only as AA had no power to impose RP of its choice as decision of the majority is to be respected for appointing authorised representative as well.[33] The role of authorised representative is limited as prescribed under the Code.

In *Aashray Social Welfare Society &Ors. v. Saha Infratech Pvt. Ltd. &Ors.*,[34] Hon'ble NCLAT defined the role of authorised representative as being authorised representative has a limited role assigned under the statutory scheme i.e., to attend the meetings of CoC and to cast votes on behalf of the creditors in a class. As per the statutory scheme, there is no such requirement in law that the authorised representative shall represent the creditors in a class before the AA in an adjudication. Therefore, for the purposes of any grievance against acceptance/rejection of claim, creditors in class/creditors can approach AA but authorised representative shall not have any role in such proceedings because his role commences after claims of FCs in a class is submitted in Form-CA and any decision of such class of FCs taken by more than 50% of the voting share would bind all homebuyers in such class.[35]

PROJECT-WISE CIRP

Supreme Court in case of *Swiss Ribbons Private Limited and Anr. v. Union of India and Ors.*[36] profoundly remarked that *'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'.* In view of this observation, a new concept emerged as a tool to benefit allottees, creditors, suspended management and other stakeholders of CD. Project-wise CIRP was introduced into the realm of IBC which supported real estate companies to continue as going concern and complete the project in time.

CIRP of real estate companies puts allottees in difficult circumstances which impacts their financial investments, time, and their need to take possession of properties because home is a dream for many. As such process under any litigation is time consuming, Appellate Tribunal confirmed a new experiment for speedy justice to the allottees and other stakeholders. An insolvency is between CD and creditors yet allottees are affected and therefore, courts/ tribunals have taken a sensitive view towards allottees while deciding cases. One such situation arose in the matter of *Ram Kishor Arora Suspended Director of*

M/s. Supertech Ltd v. Union Bank of India & Anr.[37] wherein Hon'ble NCLAT confirmed project-wise CIRP of a real estate company for speedy process under the supervision of IRP.

Supertech's project-wise CIRP

Interim Resolution Professional (IRP) in his report listed 20 projects of the CD which also included Eco Village II Project for which the finance was given by the Union Bank of India who had filed application under section 7 of the Code for initiation of the CIRP. By the admission of application under section 7 of the Code by the AA, CIRP commenced against the CD and when CIRP commenced against the CD, all projects which had been undertaken and under construction comes under CIRP.

The objective to pass such orders was that if FCs or OCs of '1 project' initiate CIRP against the CD, it must be confined to the specific project and must not affect any other projects of the same real estate company which are differently located and where separate plan(s) are approved by different authorities, land and its owner may be different, and primarily the allottees, financial institutions are different for such independent projects. Therefore, the hit of CIRP was narrowed down to one project only.

Also, NCLAT was influenced by the judgment of *Flat Buyers Association Winter Hills* wherein tribunal observed that secured creditor such as financial institutions/ banks, cannot be provided with the asset (flat/apartment) by preference over the allottees (unsecured FCs) for whom the project has been approved.[38] To balance the interest of creditors of that specific project, additional allocators, banks (other FCs), or OCs of other projects are not permitted to present a claim to the IRP for a specific project.

The multi projects CD has assets across the territory and therefore fetching a prospective a resolution applicant is always a tough task for RP. However, if the CD is auctioned/sold as project-wise, such process would yield more prospective buyers. A good deal would depend on location, unfinished business, availability of labour and raw material etc. Therefore, it is not feasible and viable for every prospective buyer to manage the affairs at wherever the locations of the project are.

Project-wise CIRP keeps each project separate from the other assets of CD. According to RERA laws, each project's financial records are required to be kept separately. As per rule 4(2)(I)(D) of RERA, each promoter must open a RERA separate account in a designated bank to pay for the project's land and construction costs. For each of the projects that are registered in RERA, additional RERA accounts must be formed. The promoter must provide information regarding the project-specific account while registering the project. Only RERA accounts should be used for every project. When there are numerous promoters, the major promoter who is registering the project should make the required contractual or legal arrangements to ensure the smooth running of the project.

Additionally, there are presence of provisions in state RERA that acknowledge the idea of project-wise maintenance of activities by real estate companies. For instance, rule 10 (1)(vi)(C) of the GujRERA (Matters Relating to the Real Estate Regulatory Authority) Rules, 2016, specifies that 'Gantt charts and project schedule: the plan of development works to be executed in the project and the details of the proposed facilities to be provided therein' be provided. This clause makes it clear that promoters must create a Gantt chart and a project timeline for each real estate project before submitting a Form 1.

In the case of the *Winter Hill – 77 Gurgaon,*[39] for a project of the CD in CIRP, it was held that if the same real estate company (CD herein) has other projects in another town such as Delhi or Kerala or Mumbai, they cannot be clubbed together nor the asset of the CD as such collaboration will lead to chaos and failure in achieving objectives of IBC.

The form-G of the Supertech's looked like as:

FORMG

INVITATION FOR EXPRESSION OF INTEREST

(Under Regulation 36A (1) of the Insolvency and Bankruptcy (Insolvency Resolution Process for Corporate Persons) Regulations, 2016

RELEVANT PARTICULARS		
1.	Name of the corporate debtor	Supertech Limited – · Project Eco Village II
2.	Date of incorporation of corporate debtor	December 07, 1995
3.	Authority under which corporate debtor is incorporated / registered	Registrar of Companies - Delhi
4.	Corporate identity number / limited liability identification number of corporate debtor	U74899DL1995PLC074422
5.	Address of the registered office and principal office (if any) of corporate debtor	1114 Hamkund Chambers,11 Floor 89, Nehru Place New - Delhi-110019
6.	Insolvency commencement date of the corporate debtor	March 25, 2022
7.	Date of invitation of expression of interest	August 23, 2022 The detailed invitation for expression of interest is available at: https://www.supertech limited.com/public- announcement.php
8.	Eligibility for resolution applicants under section 25(2)(h) of the Code is available at:	Information can be obtained at: https://www.supertechlimited.com/public-announcement.php
9.	Norms of ineligibility applicable under section 29A are available at:	Information can be obtained at: https://www.supertechlimited.com/public-announcement.php
10.	Last date for receipt of expression of interest	September 07, 2022
11.	Date of issue of provisional list of prospective resolution applicants	September 17, 2022
12.	Last date for submission of objections to provisional list	September 22, 2022
13.	Date of issue of final list of prospective resolution applicants	October 02, 2022
14.	Date of issue of information memorandum, evaluation matrix and request for resolution plans to prospective resolution applicants	September 22, 2022
15.	Manner of obtaining request for resolution plan, evaluation matrix, information memorandum further information	The prospective resolution applicants shall be given access and to the Virtual Data Room ("VDR") platform containing the Request for Resolution Plan, Evaluation Matrix, Information Memorandum and further information upon execution of a Confidentiality Undertaking with the Resolution Professional.

		Access to the VDR and participation in the process shall be subject to satisfaction of the conditions set out in the detailed invitation for expression of interest and in accordance with the Insolvency and Bankruptcy Code, 2016 read with rules and regulations framed thereunder, and in specific, Regulation 36A of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016
16.	Last date for submission of resolution plans	October 22, 2022
17.	Manner of submitting resolution plans to resolution professional	Details to form part of Request for Resolution Plan mentioned in point 15 above
18.	Estimated date for submission of resolution plan to the Adjudicating Authority for approval	November 21, 2022
19.	Name and registration number of the resolution professional	Name: Hitesh Goel IBBI/IPA-001/IP-P01405/2018-2019/12224
20.	Name, Address and e-email of the resolution professional, as registered with the Board	Name: Hitesh Goel Regd. Email: iphiteshgoel@gmail.com Regd. Address: C4/1002 The Legend Apartments, Sector 57, Gurgaon, Haryana, 122011
21.	Address and email to be used for correspondence with the resolution professional	Address: Supertech Limited, 21st-25th Floor, E-Square, Plot No. C2, Sector - 96, Noida, Gautam Buddha Nagar, Uttar Pradesh -201303 Email: cirpsupertech@gmail.com
22.	Further Details are available at or with	Further details can be sought by writing to cirpsupertech@gmail.com or by accessing https://www.supertechlimited.com/public-announcement.php
23.	Date of publication of Form G	August 23, 2022

Hitesh Goel
IBBI/IPA-001/IP-P01405/2018-2019/12224
Registered Address: C4/1002 The Legend
Apartments, Sector 57, Gurgaon, Haryana,122011
For Supertech Limited – Project Eco Village II

Date: August 23, 2022
Place: Noida

Flat Buyers Association Winter Hill-77, Gurgaon v. Umang real tech pvt. Ltd. through IRP And Ors.: Experiment on real estate companies during CIRP

The nurturing nature of the Code has brought homebuyers under the ambit of IBC wherein they have been given statutory powers of the FCs to initiate CIRP and to be part of CoC to bring resolution for the CD. Amidst all these developments, Hon'ble NCLAT in the matter of *Flat Buyers Association Winter Hill-77, Gurgaon v. Umang RealtechPvt. Ltd. Through IRP and Ors.*[40] has brought two new interpretation of law; a) Reversal of CIRP and b) Applicability of CIRP on specific projects.

REVERSAL OF CIRP

The law enshrined under the IBC for CIRP would commence from moratorium, appointment of IRP/RP, formation of CoC, collating claims, preparing information memorandum, request for resolution plan, publication of Form-G, inviting and scrutinising the bidders, and finally approving the resolution plan by CoC for revival of the CD. If no plan is approved or received, the CD would go into liquidation.

Hon'ble NCLAT by virtue of the above-mentioned precedent has created an exception for the real estate companies wherein the tribunal would allow an intervener/investor to infuse funds in the company (it can be promoter or related party as well) to ensure that the CD remains going concern and complete the construction of the specific project. The allottees would pay the requisite amount and take possession of their flats/apartments.

In the present case, one of the promoters, Uppal Housing Pvt. Ltd. agreed to invest in the CD and thereafter FC made an arrangement wherein they will get 30% of the amount paid by the allottees at the time of registration of the flat/apartment. The appointed IRP was directed to give notice to all the allottees and intimate about the reverse CIRP. All the procedure was conducted under the monitor and supervision of IRP. In addition, the promoter was also asked to give deadline for the completion of the project which was duly given by them by way of an affidavit.

The similar situation occurred in *Rajesh Gupta v. Babita Gupta and Ors.*[41] In this matter to affect the results of reverse CIRP, Hon'ble NCLAT pronounced major changes in the working of CIRP. Following are the directions which led to improvisation/modification of CIRP under the IBC (order dated October 16, 2019)

- IRP will not constitute CoC.
- IRP shall not give any intimation to any authority which may affect the company to keep it a going concern.
- IRP shall take assistance of suspended board of directors/officers/employees to keep the company going concern.
- The person who is authorized to sign bank cheques may issue cheques but only after approval of the IRP.
- The bank account of the CD was allowed to be operated for day-to-day functioning of the company such as for payment of current bills of the supplier's salaries and wages of the employees'/workmen electricity bills etc.

Reversal of CIRP brought IBC on standby thereby allowing Hon'ble NCLAT to make changes during the moratorium to benefit the interest of all stakeholders. The only question herein is that to what extend NCLAT can stretch its inherent powers under rule 11 of NCLAT rules.

In this whole process, FC without raising interim finance or occurring any cost of CIRP would get benefit of getting their dues once the allotment is done and money is paid by the allottees. The allotees/homebuyers are more interested in either refund or possession of the flat/apartment rather than resolution of the CD. Therefore, completion of the project can lead to possession of the flat/apartment or homebuyers can enter separate arrangement with the promoter for the refund of money. In this whole process, the CD as well as promoter retains their status.

Reasons for bringing reversal

Homebuyers have pecuniary interest

It is observed that homebuyers are mere people who want refund or possession of the flat and have no interest in revival of the CD. Homebuyers may not understand the Code and therefore, resolution of the CD would not make any benefit to them. Homebuyers themselves avail loan facilities from various banks and therefore CIRP period would add extra burden upon the homebuyers with respect to their installments. Hence, homebuyers would only have pecuniary interest limited to their own money.

CIRP difficult for homebuyers

Homebuyer does not possess any knowledge of IBC and thereby it becomes difficult for them to assess viability and feasibility of a CD. Homebuyer does not hold any commercial wisdom as financial institutions or banks. It is very difficult to say that the voting rights allotted to the homebuyers hold substantial value due to lack of market knowledge and expertise in IBC.

Unaffordable haircut for homebuyers

Supposedly, a resolution plan comes in the normal course of CIRP, resolution applicant would place certain amount of haircut from FCs. In such scenario, homebuyers being FCs who have taken loans for their flat/apartment cannot afford such haircut in distribution of money. Being unsecured FCs, the flow of distribution would always fall below secured creditors and therefore incur huge losses to the homebuyers. Reverse CIRP will bring either refund or allotment of flat/apartment, beneficial to the interest of all the stakeholders.

Secured creditor cannot have preference over homebuyers

The judgment also mentions that secured creditor cannot have preference over the allottees for which the project is approved. The banks cannot take over the flats/apartments which are ultimately meant for homebuyers. Homebuyers would be at disadvantageous position if banks take possession of the flats. Reverse CIRP may likely to get earlier possession and may relieve homebuyers from paying rent or interest to banks.

Whether reversal of CIRP is under the ambit of law?

Objective of IBC

The objective of the code is to maximise the value of assets of the CD and balancing the interest of all the stakeholders. Reversal of CIRP is within the objective of the Code as the FCs gets its dues in the reasonable time, allottees gets their flat/apartments or refund of money as per the arrangement, management of the CD retains the company, and all the process is conducted under the supervision of IRP/RP which makes it work under the ambit of IBC.

Applicability of Rule 11

Hon’ble NCLAT/NCLT derives its wide power from rule 11 of the NCLT Rules, 2016 or NCLAT Rules, 2016 which means that any law pronounced by them can be a precedent if it is passed in the interest of justice. However, it is vital to pursue the true nature of inherent powers given to the Tribunals. Rule 11 is prescribed to be acted upon within the ambit of IBC. In the present scenario, reverse CIRP is a new concept brought in by Hon’ble NCLAT which has no traces under the IBC. The procedure established by law indicates that, such introduction of new law can only be brought under force if either it has been passed by Hon’ble Supreme Court or it has been passed by the Parliament with requisite majority. Applicability and scope of rule 11 is a question which requires deliberations to understand the limit of inherent powers.

In one such matter Hon’ble NCLAT allowed extension of timeline of CIRP period beyond 330 days for 90 days because the CoC at later point in time decided to invite expression of interests (EoIs) project-wise for the CD as 25 EoIs were already received by RP.[42]

SECTION 29A: INELIGIBILITY OF PROMOTERS IN PROCESS OF RESOLUTION

After the introduction of eligibility criteria for the persons who can submit resolution plans, it became clear that promoters of the CD cannot be regarded as prospective resolution applicants. However, reversal of CIRP has given promoter chance to retain the management of the company by aiding externally without involvement of any third party. The reason behind it is two folds; a) promoters are most eligible and interested party to retain the company; b) promoters are well versed with the progress of the real estate project. It becomes quite clear that Appellate Tribunal has created as exception for the promoters for a particular scenario during the period of CIRP. It is indeed an opportunity to apply the intent of the precedent with respect to other cases as well which may open floodgates for litigation.

Analysis

It is observed that homebuyers are kept above the secured creditors. If the homebuyers have paid the requisite instalments, then it becomes duty of the IRP/RP as well as promoters to handover the flats/apartments to the allottees. The secured creditors will not have any right towards such flats/apartments. In addition, IRP/RP is expected to keep the CD as going concern while the moratorium is still in place and execute sale deed with the homebuyers with the aid of promoters. It leaves us to still understand the treatment of the land which has been kept as mortgaged for the loan availed by the CD by the FC when project has already been constructed and the flats/apartments has been allotted to the homebuyers. It has also to be seen how reverse CIRP restricts its scope to only real estate companies. Reversal of CIRP is a major step to achieve the objectives of the Code wherein the procedure would also lead to changes in the way the Code functions. The implementation of such precedent would be challenging as well as beneficial in future for stakeholders for the smooth functioning of the Code.

In the case of *Anand Murti v. Soni Infratech Private Limited and Anr.,*[43] the Supreme Court held that allowing the promoter to finish the housing project while considering the project completion proposal put forth by the promoter of the CD would be in the allottees' best interests. The Supreme Court further noted that it is highly likely that, had the CIRP been allowed, the cost that the homebuyers would have been required to pay under a third-party resolution would have been significantly higher because the offer made by the resolution applicants would have included the cost of escalation, etc.

Contradicting view in the case of M/s. Sheltrex Developers Pvt. Ltd. as no promoters have put forward any funds to avoid CIRP

In case of *Mr. N. Kumar Resolution Professional, M/s. Sheltrex Developers Pvt. Ltd. v. M/s. Tata Capital Housing Finance Ltd,*[44] RP had prayed that they should be allowed to constitute project-based CoC for conducting CIRP and issue separate EoI for each project under the control of the CD. NCLT Chennai took narrow approach regarding the concept of reverse CIRP and held applying the principles is too peculiar to the facts and circumstances and precedents cannot be used in the present scenario as inviting EoI project-wise is not a feasible as the same is against the provisions of the Code and cannot be approved by the CoC.

In the above case, Court did not the appreciate the *Winter Hills* case and failed to consider spirit of IBC as observed in Swiss Ribbon. It can be said that situations may come before AA in near future wherein some of the group of homebuyers or person other than promoters will ask for themselves to be considered as resolution applicants for the real estate company.

Secured creditor is not given priority over the allottee who holds position of unsecured creditor

The 'allottees' (homebuyers) are considered 'FCs' in the legal sense. They lack the knowledge necessary to judge the 'viability' or 'feasibility' of a 'CD.' They lack the business acumen of financial institutions, banks, and NBFCs. However, voting privileges for the plan's approval have been given to these allottees. Numerous instances where the allottees are the only FCs have come to our attention. They always face difficulty in evaluating the viability and practicality of the 'resolution plan or the business side or operation of the CD.

An asset of the CD is the infrastructure that it builds for the allottees. The assets of the CD, which is the infrastructure, are to be transferred in the favour of the allottees who are 'unsecured creditors, and not to the 'secured creditors'. In most cases, the banks, financial institutions, and NBFCs would also prefer not to accept the homes or flats in exchange for the funds they have disbursed. In contrast, the 'unsecured creditor' are entitled to the assets of the CD, including any flats or apartments and assets owned by the CD subject to the condition that entire consideration is paid by the allottees.

It is pertinent to note that the IBBI had issued circular dated June 14, 2022 for inviting suggestions/ inputs from public for effective and expeditious resolution of real estate projects, wherein one of the indicative lists of issues in a CIRP of a real estate firm was resolution project-wise or tower wise instead of CD as a whole and possibility of homebuyers themselves taking up as resolution applicant. This is a welcome step to encourage allottees to participate in the process and reduce any liability upon allottees. However, the scope and extent to which such experiments are applicable are required to be regulated and within the scope of IBC.

JDAs: STORY OF LANDOWNERS AND DEVELOPERS

A JDA between developers and landowners is quite common in Indian real estate sector wherein the landowner agrees to provide his land to a developer who in turn develops the land with his own investment. The landowner may either receive certain portion of the developed property or certain consideration or a certain portion of the developed property or may receive certain share in the profits arising from the development property according to the terms agreed upon by the parties. The development agreement serves as a license that is necessary as per section 52 of the Indian Easement Act, 1882 for the developer to enter and develop the landowner's property.

Section 52 of the Indian Easement Act, 1882:

> License defined.—Where one person grants to another, or to a definite number of other persons, a right to do, or continue to do, in or upon the immovable property of the grantor, something which would, in the absence of such right, be unlawful, and such right does not amount to an easement or an interest in the property, the right is called a license.

As stated above, to enjoy any non-easement right over somebody else's property, one should obtain a license from the landowner. Henceforth, in the cases of real estate projects, only upon granting of such license, the developer can develop the project on the landowner's property.

No 'transfer of title' takes place through JDA

A development agreement is a contract between the developer and landowner as per which the landowner provides his land, and the developer is responsible to develop land and hence no transfer of 'title' takes place while entering a JDA.

Further under section 53A of the Transfer of Property Act, 1882 which deals with part performance, legal possession of land remains with the landowner till the revenue out of the property's sale is received.

The development agreement does not facilitate any transfer of title of the landowner. Therefore, upon entering and registering the development agreement, the landowner has to grant the conveyance deed in favour of the buyers of the developed property.

Issues that may arise due to JDAs

Due to JDAs between landowner and developer wherein the title of the 'land' remains with the landowner however the development rights are with the developer, and both are separate entities, one might have several questions if CIRP is initiated against the developer company or landowner company.

a) Whether a land in which CD has development rights in its favour pursuant to development agreement can be treated as asset of CD for application of provisions of section 14(1)(d) of IBC?

The moment CIRP is commenced against the CD, moratorium under section 14 of the IBC comes into action. The purpose of moratorium is to encourage smooth process of CIRP. However, in case of real estate companies wherein land belongs to a particular entity and CIRP is initiated against the developer, the land-owning company may consider termination of its JDA and further seek possession of the land. In such situations whether moratorium can save the land for the developer company which is under CIRP.

Hon'ble Supreme Court in the matter of *Rajendra K. Bhutta v. Maharashtra Housing and Area Development Authority and Another (MHADA)*[45] dealt with issue of whether a land in which the CD has development rights in its favour pursuant to a development agreement with MHADA can be treated to be an asset of CD for application of provisions of section 14(1)(d) of the IBC?

Section 14 (1) (d) of the Code is stated hereinbelow:

> 14. (1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:—
>
> ...(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

In the above-mentioned judgment, apex court interpreted the expression 'occupied by' to mean or be synonymous with being in actual physical possession of or being used by, in contra-distinction to the expression possession, which would connote possession being either actual or symbolic. The court held that a CD holding a land under a JDA is deemed to be in actual occupation thereof, and therefore such land will be included within the assets of the CD in insolvency and therefore MHADA was restrained from taking actual possession of the land pursuant to a termination of the development agreement.

The above judgment also clarified that when it comes to any clash between the MHADA Act, 1976 and the IBC, the Code must prevail in the presence of section 238 of the Code. If the possession of the land under JDA is taken away from the CD by the landowner during the CIRP, the mandate of law to keep the CD as 'going concern' during CIRP period would fail as there might be nothing in the hands of the CD for its revival.

b) Whether joint CIRP of developer and landowner company possible?

In most of the real estate projects, land belongs to one party and the developer being another party, the real estate project is developed through collaboration between the two. Land is an integral part of the real estate project, which is developed by another company, but ownership of such land remains with landowner. In such a situation the revival of developer company shall not be possible without the land being part of the process. In such situations, whether it is possible to take charge of the assets of the landowners' property or is it possible to conduct joint CIRP of the landowner and developer being companies.

As per the provisions of IBC, no recourse is provided for joint CIRP of companies which have entered into collaboration agreement for the purpose of real estate project. However, in some of the cases Hon'ble NCLAT has dealt with such issues.

Joint CIRP with subsidiary

In the matter of *Jitendra Arora –Resolution Professional of M/s Premia Projects Ltd v. Tek Chand & Ors.,*[46] CIRP was initiated against the developer company, however the land owing company was subsidiary of the developer company. As per the RP of the developer, an ex-director was controlling both the companies and was director in both the companies. Further as per RP's submissions the ex-director had defrauded the homebuyers by collecting money from them through the CD, however failed to construct the project as promised. The asset of the land on which the project was to be developed and constructed was owned by another company being subsidiary of CD. The ex-director attempted to save his property from being auctioned thinking of fact that land shall not have any relation with CIRP of developer.

As submitted by RP piercing of corporate veil was necessary in the matter. Once the corporate veil of the two companies were taken off, the intricate business relationship between landowning company and the CD would become crystal clear. The prayer of the RP in this matter was to allow the RP to take charge of the assets of the subsidiary land-owning company or to allow RP to initiate joint CIRP of the CD and its subsidiary.

Observation and judgment by the Hon'ble NCLAT

1. Hon'ble NCLAT held that on going through the definition of 'property', 'transactions' 'transfer' under the IBC along with provisions related to information memorandum it was clear that such assets, which are transferred to or from the CD, and which are germane to the insolvency resolution of the CD and are part of the assets of the CD**,** even if held by another company**,** such assets should be included in the information memorandum as well as insolvency resolution.
2. Hon'ble NCLAT further held that the cost of project includes cost of land and cost of development, hence it was reasonable to connect land in the total asset base of the CD.
3. Further it was held that if the CD had intrinsic financial relation with other company which was controlled by the same set of directors, and their business were inter-related such companies should be seen jointly for the purpose of CIRP and relying on the Judgment of *State Bank of India and Anr. v. Videocon Industries Limited & Ors.,*[47] wherein 14-point test as to whether consolidation of individual CIRPs should be done or not, to yield maximum benefits to stakeholders was given, the Hon'ble NCLAT held that the CD and the subsidiary broadly satisfied the points enumerated in the 14-point test.

However, the Hon'ble NCLAT observed that the land-owning company was not under CIRP and therefore it is not possible to include its asset of land in the CIRP without following the due procedure as enumerated in law. A direction was issued to AA considering admission of landowner company followed by consolidation of CIRP to provide fair, just and proper relief to the stakeholders of the CD.

Joint CIRP of other companies

In the matter of *Mrs. Mamatha v. AMB Infrabuild Pvt. Ltd. & Ors.*[48] the Hon'ble NCLAT held in the matter that if two CD collaborate and form an independent corporate unit entity for developing the land and allotting the premises to its allottee, the application under section 7 is maintainable against both jointly and not individually against one or the other. It was held that in such case, both the landowner and developer if they are corporate entities should be treated to be one for the purpose of initiation of CIRP.

The above judgment indicates that joint CIRP of landowner and developer company is possible, but it has its own reservations. Such joint CIRP is detrimental to landowners who are financially sound. The most critical part of joint CIRP is if the landowner is brought down into CIRP, would that mean that all the assets of the landowners' company are into CIRP, or it is restricted to a specific project to which developer is associated. The grey area is required to be put in black and white and therefore clarity is required wherein joint CIRP should not be held against financially sound landowning companies but restricted only to land/asset in question.

Another issue is that through the joint CIRP, the land/asset in question which is of another company is brought in the radar of CIRP of developer company. The issue cannot be solved if the landowner is not a corporate entity but an individual or partnership firm. It would be interesting to see the interpretation of courts in joining such issues for the benefit of stakeholders and revival of CD.

c) Whether a land which is in question for development is on lease can be considered asset of the CD under CIRP?

The JDA is made for development of project wherein one party is the developers while the other party is not the landowner but a lessee of land on which the project is required to be developed. If CIRP is initiated against the developer company can the lessor/landowner company claim that the assets of the lessor should not be considered part of CIRP?

In the matter of *New Okhla Industrial Development Authority (Noida) v. Nilesh Sharma RP of Dream ProconPvt. Ltd. & Ors.*[49] Noida (lessor) allotted certain area to M/s Logix City Developers Pvt Ltd (Lessee) for the purpose of developing group housing project and hence a lease deed was entered into between Noida (Lessor) and M/s Logix City Developers Pvt. Ltd. (lessee) for a period of 90 years, as per terms the lessee was liable to pay a certain lease premium.

Later on, a JDA was executed between lessee and another company namely Dream Popcorn Pvt. Ltd. (CD) wherein the lessee subdivided the subject premises and transferred certain development rights on subdivided area to the CD. This development right included right to develop, market and sell subdivided area and that the JDA recognized NOIDA as the 'owner' of the plot.

The CD in pursuance of the lease deed and JDA, commenced construction of the group housing project in the name and style of 'Victory Ace' and said project was duly registered under UP RERA, however while the project was under construction, CIRP was commenced against the CD.

During the CIRP as the CoC and RP were looking to consider the resolution plan, it was felt that Noida had certain claims arising out of the lease premium payable and in order to balance the interest of all stakeholders, 'Victory Ace Society' (homebuyers association) having 234 allottees, preferred an application and also representation was issued by the RP to Noida with a request to participate in the CIRP of the CD

In response to the said representation, Noida denied participating in the CIRP on the basis that the JDA was *non-est* in law. Noida also informed that they had no contractual relationship with the CD and preferred an application with a prayer that the said premises should not be included as an asset of the CD.

The Hon'ble NCLAT in the above matter held that as per section 3(27) and judgment of Hon'ble Supreme Court in the matter of *Rajendra K Bhutta*[50] which defines 'property', it was clear that the development rights vested in CD was a 'proprietary right' and the rights under JDA shall fall within the terms 'propriety' and hence RP had duly performed its duties under section 18(1)(a)(iii) and taken control and custody of the assets of the CD.

The above Judgment of Hon'ble NCLAT made clear that joint development property even if is a leased property will be considered asset of the CD for the purpose of CIRP. Such an order from Hon'ble NCLAT is relief for the homebuyers in case the land under development project is even under lease.

d) Whether the landowners and developers jointly or severally liable for all responsibilities qua allottees? or the landowner can terminate the JDA on triggering of CIRP?

Suspended management in IBC Vs. 'promoters' as per RERA

In case of companies, board of directors of the company are responsible for the management of the company and in case of triggering CIRP against the CD such board of directors are called 'suspended management'. Hence in case of IBC of real estate developer company, there is concept of 'suspended management' and the developer's company management is only included in the suspended management. But the landowner who has entered into a JDA is not included in the definition of suspended management even though they jointly took up agreement for completion of project.

However, in 'RERA', there is concept of 'promoters' for taking responsibility of the real estate project. Definition of 'promoters' is provided under section 2(zk)[51] of the RERA.

'Promoter' means, —

(i) a person who constructs or causes to be constructed an independent building or a building consisting of apartments, or converts an existing building or a part thereof into apartments, for the purpose of selling all or some of the apartments to other persons and includes his assignees; or

(ii) a person who develops land into a project, whether or not the person also constructs structures on any of the plots, for the purpose of selling to other persons all or some of the plots in the said project, whether with or without structures thereon; or

(iii) any development authority or any other public body in respect of allottees of—

   (a) buildings or apartments, as the case may be, constructed by such authority or body on lands owned by them or placed at their disposal by the Government; or

   (b) plots owned by such authority or body or placed at their disposal by the Government, for the purpose of selling all or some of the apartments or plots; or

(iv) an apex State level co-operative housing finance society and a primary co-operative housing society which constructs apartments or buildings for its Members or in respect of the allottees of such apartments or buildings; or

(v) any other person who acts himself as a builder, coloniser, contractor, developer, estate developer or by any other name or claims to be acting as the holder of a power of attorney from the owner of the land on which the building or apartment is constructed or plot is developed for sale; or

(vi) such other person who constructs any building or apartment for sale to the general public.

> Explanation.—For the purposes of this clause, where the person who constructs or converts a building into apartments or develops a plot for sale and the persons who sells apartments or plots are different persons, both of them shall be deemed to be the promoters and shall be jointly liable as such for the functions and responsibilities specified, under this Act or the rules and regulations made there under;

Hence as per the above definition and explanation as provided under section 2(zk) of RERA, both landowner and developer come under the definition of 'promoters' and are liable for projects. However, their liabilities and responsibilities are different in different states of India because definition of promoters is taken different in each state.

For further clarification, GujRERA had issued order no- 23, dated May 23, 2019[52] wherein it was clarified that 'landowners' liabilities shall be limited to transfer of the title of land, while the promoter/ developer shall be liable for fulfilling his obligation for the entire project'. MahaRERA has taken a different view and as per its circular dated December 4, 2017[53] it stated that the liability of the promoter, whether landowner promoter or investor promoter, shall be co-terminus with the agreement and the same will be for the purpose of withdrawal of money from RERA bank account, however obligation and liabilities in respect of project shall be at par with each other. Similar circular was also passed by Jharkhand RERA on November 20, 2019 and Goa RERA on February 13, 2018.[54]

Further in the matter of *Tupe Developers &Ors. v. Bhansali Infotech LLP and Ors,*[55] Hon'ble Maharashtra Real Estate Appellate Tribunal dated July, 2019 held that, *'Admittedly, landowners are sharing the sale consideration in the project. In our view, they are squarely covered by the definition of promoter under Section 2(zk), its explanation and Circular dated 4.12.2017.'*

Hence each of the state has taken different views as far as liabilities of landowners are considered under RERA.

As far as IBC is considered the liabilities of landowner company in case of CIRP of developer companies are not defined. IBC has been referring to RERA for various definitions and explanations as far as real estate matters are concerned. The liability of landowner which comes through the definition of promoter under RERA is viewed differently by different states and therefore no consistency can be adopted by AAs. Necessary amendments are required to define scope of liability of landowner in case of CIRP of developer company.

e) What will the impact of disputes between landowners and developers on the homebuyers/allottees?

The situation may arise wherein the landowner and developer have inter-se disputes between them. In such cases there can be delay or non-completion of real estate project which will impact homebuyers if either of the party goes into CIRP.

In the matter before National Consumer Disputes Redressal Commission in the matter of *T.Murali Krishna Reddy v. Venkata Surya Ramesh Uppuluri and Ors*.[56] it was held that for the inter-se dispute between the owner and the developer, third party cannot be allowed to suffer.

Hon'ble Supreme Court in the matter of *Faqir Chand Gulati v. Uppal Agencies Pvt. Ltd. & Ors.*[57] held that where the builder commits breach of his obligations, the owner has the right to enforce specific performance and /claim damages by approaching the civil court or one can approach appropriate forum under the Consumer Protection Act, 2019 (CPA) for relief.

Hence, taking consideration of above orders of various forums it can be construed that if there is dispute between the landowner or developer the same can be solved through other forums however the same should not affect smooth functioning of CIRP.

A separate chapter is required for dealing with real estate under IBC due to its complexity. Provisions should be made in such a way that landowning company which are otherwise financially stable are not dragged into CIRP. Further, the responsibility of landowning company qua CIRP of developer company should be well defined. Separate provisions in respect of CIRP of developer company wherein landowner is not a corporate entity but an individual or a partnership firm should be included under IBC.

CONCLUSION AND SUGGESTIONS

Inclusion of homebuyers under IBC provided a parallel remedy to the homebuyers other than the remedy available in CPA and RERA. The domain of legislations is different and as a matter of fact the laws operate in complete spheres. Authority under RERA is more of a regulatory authority supervising the conduct and acts of builders to check that real estate projects come to fruition within the stated period and to see that allottees of such projects are not left in the lurch and are finally able to realise their dream of a home, or be paid compensation if such dream is shattered, or at least get back monies that they had advanced towards the project with interest.

Despite amendments being brought in, homebuyers have largely been on fringes in the CIRP of real estate companies. The homebuyers face difficulty in reaching the threshold of 10% of total allottees or 100 allottees to initiate insolvency against any real estate company as happened in the case of *Upendra Choudhury v. Bulandshahar Development Authority and others*.[58] As per section 11(4) of RERA, the promoter is responsible for forming a society or cooperative society of the allottees. In such scenarios on the absence of any collective organisation of group, homebuyers face difficulty in finding the homebuyers to reach the threshold limit. Such threshold is only to ensure that the project is not stalled on the behest of one homebuyer but if the case of one allottee is genuine then court must take the cognisance of the matter and give opportunity to the homebuyer to access the list of the other allottees and allow homebuyers to take appropriate action against the promoters. Though there remain diverse grievances of homebuyers, RERA and IBC requires striking the balance in creating rights for homebuyers to fulfil the objectives of both the legislations.

Insolvency can always be availed as an alternative remedy when a homebuyer feels that financial position of developer is deteriorating, and developer will not be able to complete the project and return the money with interest to be able to prevent further deterioration. It will help to obtain recovery of maximum amount of money invested along with interest. Completion of project may take several years due to various practical difficulties that may arise in the completion of project. Also, execution of order for payment of money will not have any fruitful result if developer does not have financial ability to pay it.

[1] Kaushik A., "Is IBC 2016 effective?", NITI Aayog.

[2] *Nikhil Mehta And Sons v. Amr Infrastructure Ltd*., Company Appeal (AT) (Insolvency) No. 07 of 2017.

[3] 2017, SCC Online NCLT 10612.

[4] 2017, SCC Online NCLT 12672.

[5] 2018, SCC Online NCLT 794.

[6] Writ Petition (Civil) No. 43 Of 2019.

[7] The Real Estate (Regulation and Development) Act, 2016 (Act No. 16 of 2016).

[8] Section 4(2)(I)D, RERA.

[9] Section 19, RERA.

[10] *Ibid.*

[11] Supra Note 6.

[12] Case Analysis: *Pioneer Urban Land and Infrastructure Ltd. and Anr. v. Union of India and Ors.*

[13]Satra J. et. al., "Remedies for Home Buyers under RERA & IBC - A Comparative Analysis".

[14]Jain N. (2020), "Homebuyers Conundrum: Is there even a dispute between RERA and IBC?".

[15] Supra Note 6.

[16] Supra Note 2.

[17] Civil Appeal No. 6486 of 2019.

[18] Supra Note 6.

[19]*Manish Kumar v. Union of India and Another*(s) (2021 SCC Online SC 30).

[20] Rajput J. (2022), "Homebuyers & IBC (Amendment) Act, 2020: Four Years, Two Amendments And Journey still Continues", August 30.

[21] Company Appeal (AT) (Insolvency) No. 821 of 2021 and 940 of 2021.

[22][2020] ibclaw.in 06 SC.

[23]IA/161(MP)2022 in C.P.(IB)/56(MP)2021.

[24]CP (IB) 2228(PB)/2019.

[25] Company Appeal (AT)(Insolvency) No. 83 of 2020.

[26] Supra Note 2.

[27]"How RERA assuring assured returns to investors", *The Bureaucrat.*

[28] Company Petition (IB) No. 485(PB)/ 2017.

[29] Company Appeal (AT) (Insolvency) Nos. 390, 391, 392, 393 & 394 of 2022.

[30] *Ibid.*

[31] *Sh. Sushil Ansal v. Ashok Tripathi* (Company Appeal (AT) (Insolvency) No. 452 of 2020).

[32] *Abhijit Jasrasaria v. Jop International Ltd.* (Company Appeal (AT) (INS) No. 187 of 2021), *Sunitha Venkatesh Financial Creditor v. Oragadam City Developers Private Limited* (2022 SCC online NCLT 19) and *Anitha Arun v. Oragadam City Developers Pvt. Ltd.* (IBA/1370/2019).

[33]*Prakash Shankar Mishra & Ors. v. Ashok Kriplani & Anr.* (Company Appeal (AT)(Insolvency) No. 34 of 2020).

[34] Company Appeal (AT) (Insolvency) No. 904 of 2021.

[35] Civil Appeal No. 3395 Of 2020.

[36]AIR 2019 SC 739.

[37] Company Appeal (AT) (Insolvency) No. 406 of 2022.

[38] Company Appeal (AT) (Insolvency) No. 926 of 2019.

[39]*Ibid.*

[40]*Ibid.*

[41] Company Appeal (AT) (Insolvency) No. 1056 of 2019.

[42] *Whispering Tower Flat Owner Welfare Association v. Abhay Narayan Manudhane, RP of Corporate Debtor and Ors.* (Company Appeal (AT) (Insolvency) Nos. 896, 980 & 1045 of 2021).

[43] Company Appeal (AT) (Insolvency) No. 1507 of 2019.

[44]IA(I.B.C.)/1245(CHE)/2020 in CP(IB)/889(CHE)/2019.

[45]Civil Appeal No. 12248 of 2018.

[46]CA No.1069 of 2020.

[47]Company Appeal (AT) (Insolvency) No. 658 of 2019.

[48]Company Appeal(AT) (Insolvency) No.155 of 2018.

[49]Company Appeal (AT) (Insolvency) No. 288 of 2021.

[50] Supra Note 45.

[51] The Real Estate (Regulation and Development) Act, 2016.

[52] Gujarat Real Estate Regulatory Authority, Order No-23, May 23, 2019.

[53] Maharashtra Real Estate Regulatory Authority-MahaRERA Circular No.12/2017.

[54] Jharkhand Real Estate Regulatory Authority-JHARERA Circular No.01/2019, November 20, 2019 and Goa Real Estate Regulatory Authority-No-11/35/2017-DMA/3390(A).

[55] Appeal Nos. AT005000000010617, AT005000000010673, AT005000000010674, AT005000000010676 and AT005000000010677.

[56] First Appeal No.1279 of 2014.

[57] Civil Appeal no 3302 of 2005.

[58] Writ Petition (Civil) No 150 of 2021.

ABOUT THE AUTHORS

Ms. Ajanta Gupta is currently a Research Associate in IBBI. 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 is working as Executive Director in IBBI since 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.

Ms. Alankrita Pathak is a 3rd year law student currently pursuing B.A. LLB from Gujarat National Law University. She is deeply committed to a career in commercial law and dispute resolution, talking in a broader sense. Fields like Insolvency and Mergers and Acquisitions interest her.

Mr. Jay Shah is currently pursuing B.com LLB (Hons.) at Gujarat National Law University and is currently in 3rd year. He is interested in business and commercial laws at large, specifically in Mergers and Acquisitions, Insolvency Law and Securities Law.

Mr. Anil Kumar is a Research Scholar at SP Jain School of Global Management, Mumbai, India. He is an Agri-Business Management professional with having more than 15 years of work experience in Agri-input companies and banking sectors, currently working with PwC India and based out at Delhi-NCR.

Dr. Suneel Sharma is the Program Director, SP Jain School of Global Management. He has 27+ years of experience in Digital Technologies and Analytics. He is actively involved in deep-tech research in the area of Cognitive Automation, Risk, and Operation analytics. Being part of local and global venture ecosystems, he is consulting businesses and VCs. Presently he is engaged with over 20 ventures in domains like Automation, MarTech, FinTech, MedTech, EdTech, New Media, SaaS, and D2C. Dr. Sharma did his Graduation from BITS Pilani, Post Graduate Course in Entrepreneurship from IIM Bangalore, Ph.D. in Computational Finance from University of Rajasthan, and Post-Doctoral studies in Certified Academic Practice at Lancaster University, UK.

Dr. Mehregan Mahdavi is the Dean at Sydney Institute of Higher Education (SIHE), Sydney, Australia. He finished his Ph.D in the area of Web Data Management at the School of Computer Science and Engineering, UNSW. He then joined Macquarie University as a research fellow and continued working as an assistant professor in the department of computer engineering, the University of Guilan. He has been collaborating with SP Jain School of Global Management for the supervision of research students. His research area includes recommender systems, Data Analytics, Big Data, Service Oriented Architecture, and e-learning.

Ms. Aparna Ravi is a Partner at Samvad Partners where she co-heads the Firm's insolvency and restructuring practice. Her practice focuses on banking, finance and restructuring, insolvency law and general corporate advisory matters. She was a member of the Bankruptcy Law Reform Committee and the Cross Border Insolvency Rules and Regulations Committee constituted by the Central Government and writes and delivers lectures regularly on insolvency law reform in India. She also edited the 6th edition of Mulla: The Law of Insolvency in India, a treatise on personal insolvency law that was published by Lexis Nexis in September, 2017. She has been a visiting faculty at the National Law School of India University, Bangalore and is an adjunct faculty at the Indian Institute of Corporate Affairs.

Mr. Aakash Sherwal is a member of Samvad's dispute resolution team with a focus on litigation concerning Insolvency and Bankruptcy Code, Contractual Disputes, Corporate Fraud and Arbitration. He has appeared as counsel before various fora including Supreme Court, High Court, National Company Appellate Tribunal, National Company Law Tribunal and Trial Courts. He's also been appointed as Court commissioner to assist with court proceedings.

Mr. Archit Gupta, having experience of more than 6 years in the field of restructuring, debt syndication, stress and insolvency resolution etc., is partner in SPAA & Associates, Delhi. He was part of the foundation batch of Graduate Insolvency Programme, IICA. In the past, he has been associated with GT Restructuring Services LLP.

Ms. Aakriti Gupta, a law graduate, is currently practicing at the Punjab and Haryana High Court in taxation and corporate law matters. She is currently associated with SGA Law Offices, Chandigarh and SPAA & Associates, Chartered Accountants, Chandigarh. In past she has been associated with Grant Thornton Bharat LLP, Kaithan& Co., Link Legal etc.

Mr. Ashish Vyas is an Insolvency Professional, Registered Valuer and a qualified Chartered Accountant with more than 17 years of experience in Assurance, Project Finance, Consultancy to Stressed Assets and Cash Flow management of Cash Deficit Entities. He is involved in various corporate insolvency resolution processes and liquidations. He has co-authored, 'Handbook on Liquidation Process and Voluntary Liquidation Process', and authored a book 'Quick Insight on GST - Banking Sector' apart from various articles. He was sub-group member of 'Editorial Board Committee' of WIRC of ICAI for the year 2017-2018.

Ms. Disha Choubisa is a post-graduate in economic (M.A.) and Batchelor of Education (B.Ed.) and Batchelor of Arts (B.A.). She was central government employee and served as Post Graduate Teacher at Jawahar Navodaya Vidyalaya for Economics subject. She has working experience of the corporate insolvency resolution process and liquidation process right from running corporate debtor as going concern, managing and monitoring its operations, verification of claims, preparation of information memorandum, conducting meeting of CoC, invitation of expression of interest, evaluating eligibility of resolution applicant, and analyzing resolution plans.

Mr. Bahram N Vakil is the founding partner of AZB & Partners and is renowned for his vast experience in restructuring, bankruptcy and infrastructure and project finance matters. He has served on various high–level government committees on financial reforms, foreign direct investment, and securities market reforms. Amongst these, he was appointed as a key member of the Dr. T K Viswanathan Bankruptcy Law Reforms Committee, constituted by the Ministry of Finance, to draft the Insolvency and Bankruptcy Code, 2016 (IBC), and the Insolvency Law Committee, constituted by the MCA to recommend amendments to the IBC.

Mr. Nilang T Desai is a Senior Partner with AZB & Partners. He is an advocate licensed to practice law in India and England and is also a qualified chartered accountant. He advises resolution professionals, creditor committees, interim finance providers, banks, financial institutions, international corporations, distressed asset funds, resolution applicants/bidders and on occasion, borrowers. His practice focusses on restructuring and insolvency transactions as well as complex cross-border structured finance transactions.

Mr. Suharsh Sinha is a Partner with AZB & Partners, specializing in restructuring & insolvency, banking & finance and structured finance. He advises asset reconstruction companies, hedge funds and banks in the acquisition of distressed debt and debt restructuring. Additionally, he advises acquirers, lenders and insolvency professionals in several complex cases referred to the Insolvency and Bankruptcy Code, 2016. He was appointed as a consultant to the Bankruptcy Law Reforms Committee and IBBI, which was instrumental in drafting the policy and legislation behind the IBC.

Ms. Saloni Thakkar is a senior associate in AZB & Partners restructuring and insolvency group. 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, resolution applicants, resolution professional in the corporate insolvency resolution processes of certain companies including financial service providers. She has participated in the discussions of the Task Force set up by the Reserve Bank of India on the Development of Secondary Market for Corporate Loans as a special invitee, and also participated in presentations before other regulatory committees.

Mr. Debaranjan Goswami is a master's student at Melbourne Law School and completed his B.A. LLB (Hons.) from National Law University, Delhi in 2019. Previously, he has been a Legal Manager with ICICI Bank and worked as a commercial litigator. His areas of interest are insolvency and bankruptcy law, international financial transactions, financial services law, and arbitration.

Dr. Andrew Godwin is Special Counsel at Australian Law Reform Commission and Principal Fellow at Melbourne Law School. He joined the Australian Law Reform Commission as Special Counsel for the review of the legislative framework for corporations and financial services regulation in December, 2020 and holds several senior positions at Melbourne Law School. Before entering academia, Dr. Andrew had 15 years' experience in corporate and finance practice, including 10 years in Shanghai where he spent most of his time as a partner and chief representative of the international law firm, Linklaters. His teaching and research interests include financial regulation (particularly disclosure and regulatory systems), finance and insolvency law, transactional law, the regulation of the legal profession and professional and transactional skills for lawyers. He holds a doctoral degree and Master of Laws from the University of Melbourne.

Ms. Deeksha Dhingra is a 4th year, B.A. LLB(H) student at Symbiosis Law School, Pune. She is interested in corporate laws, especially in the field of mergers and acquisitions and IBC. She also has a keen interest in sketching, painting and theatre.

Mr. Deepansh Jain is a 4th year, B.A. LLB(H) student at Symbiosis Law School, Pune.He has a keen interest in corporate laws and capital markets. He is also a finance enthusiast and an avid sportsperson.

Ms. Muskan Khandelwal is a 4th year law student at Symbiosis Law School, Pune where she is pursuing BBA LLB(H) degree with a focus on M&A, startup and corporate law. In addition to this, she is currently honing her skills by interning with a thriving startup. Her experience of working with and knowledge of foreign jurisdictions adds a unique dimension to her skillset, positioning her as a well-rounded, versatile legal professional.

Ms. Deepanshi Gupta is a law graduate from Campus Law Centre, Faculty of Law, University of Delhi and qualified Company Secretary. One of the highest honours she received is Dr. Shankar Dayal Sharma (Former President of India) Gold Medal for her all-round excellence. She has various publications to her name in reputed journals. She has won and judged numerous debating tournaments. Currently, she is working with Aekom Legal.

Mr. Dhruv Kohli is a 3rd year law student currently pursuing B.A.LLB from Gujarat National Law University. He possesses keen interest in the field of Insolvency and Bankruptcy along with Dispute Resolution and finds himself working in the same arena in a few years.

Dr. B. Charumathi is professor of accounting and finance and presently heading the Department of Management Studies, Pondicherry University. She has 25 years of teaching and research experience with specialization in corporate financial reporting and current research interest in corporate social justice, forensic accounting and antifraud disclosure. She has received many awards including the 1st Gurushreshtha award of ICSI (2022), AICTE's Career Award, among others and is the Indian Project Investigator of MoE sponsored SPARC international project on IFRS for SMEs. She is the board member of Pondicherry University Stepup Hub (PUSH), a section 8 company to promote innovation ecosystem.

Ms. Beemamol M is MBA from NIT, Calicut and a full time Ph.D. research scholar in the Department of Management Studies, Pondicherry University and her research topic is forensic accounting and anti-fraud disclosure. She is the recipient of Jawaharlal Nehru Memorial Fund scholarship for doctoral studies 2021-22 and Savitribai Jyotirao Phule Single Girl Child Fellowship 2022-23 from the UGC.

Dr. Ilias Kapsis is as an Associate Professor at the School of Law, University of Bradford, UK. He holds a Ph.D from the University of Bristol, UK, an LLM from the University of Bristol and an MBA from the University of Bradford, UK. His research expertise includes regulation and competition in financial and technology markets. Recent research projects include the regulation of blockchain and crypto assets; the regulation of artificial intelligence in financial services; and the regulation of fintech.

Dr. Neeti Shikha is working as a lecturer at the School of Law, University of Bradford, UK. She has previously worked as an associate dean, Indian School of Public Policy, New Delhi. In 2019, she was selected as founding Head, Centre for Insolvency and Bankruptcy, Indian Institute of Corporate Affairs, Government of India. She also serves as member of the INSOL International Academic Steering Committee. She has published extensively in area of corporate governance and insolvency laws. She has three books to her credit. She holds a Ph.D. from National Law University Jodhpur and a Masters from University College London, UK.

Dr. Isha Goel is Assistant Professor in Department of Commerce, Daulat Ram College, University of Delhi. She has over 11 years of teaching experience. She obtained her PhD from Department of Commerce, Delhi School of Economics, University of Delhi in 2018. She has qualified Professional programme of the Institute of Company Secretaries of India. She has presented papers at various international and national conferences and acted as resource person for various skill development programmes & workshops.

Dr. Sunita Gupta is currently serving as an Associate Professor in Commerce in Daulat Ram College, University of Delhi. She has teaching experience of more than 28 years. She has attained degrees of M.Phil, Ph.D and LLB from University of Delhi, and CMA from ICMAI. She is a lifetime member of Indian Commerce Association and India Accounting Association. She co-authored a book on 'Corporate Accounting' for B. Com (Hons), in 2013, published by Pearson Education. She has various national and international Paper Presentations and Publications to her credit in India & abroad on various contemporary issues. As a resource person, she has conducted more than 160 workshops to spread financial education to different stakeholders. She is a recipient of 'National Award' from National Centre for Financial Education (NCFE) twice for distinguished contribution to promote NCFE-FLAT 2013-14 and 2014-15 examination among schools.

Dr. Puranjoy Ghosh completed his post-graduation and Doctoral degree from the University of Burdwan joined civil practice. He subsequently joined teaching profession in the year 2002 and now working as Assistant Professor at School of Law, KIIT (Deemed to be University), Bhubaneswar, Odisha since 2012. His area of interests are Procedural Laws, Property Law, Insolvency Laws, International Commercial Arbitration, Law on Corporate Finance, etc. His first research scholar has been awarded PhD on ‘Third Party Funding in International Commercial Law: A Study with reference to India in 2022’.

Ms. Kavya Lalchandani is currently an Assistant Lecturer at Jindal Global Law School. She graduated at top of her class at National Law University Odisha where she studied B.B.A. LL.B. (Hons). She then went on to pursue her Master of Corporate Law (MCL) from University of Cambridge. She is also a recipient of Nehru Trust Scholarship and Becker Law Studentship. Her research interests include insolvency and restructuring, company law, contracts and competition law.

Ms. Khyati Sharma is a 4th year student of BBA.LLB (Hons) from Symbiosis Law School Pune. She aspires to do MBA after a few years and is highly interested in Insolvency and Bankruptcy as a subject. She is highly interested in legal Research and Drafting.

Mr. Kumar Saurabh Singh is a Partner in the Banking & Finance and Restructuring & Insolvency practice group in Khaitan& Co. He has significant experience in all variations of debt financing, including asset finance, project finance, trade finance, cross-border financing and securitisation. He also focuses on the insolvency and restructuring practice of the firm and is involved in CIRP of some of the largest non-performing accounts in India for various sectors like steel, cement, power, construction, manufacturing, hospitality, etc. He was nominated as the ‘Banking & Finance Lawyer of the Year’ and ‘Restructuring & Insolvency Lawyer of the Year’ by IFLR for IFLR1000 India Awards 2020.

Mr. Ashwij Ramaiah is a Senior Associate at the Mumbai office of Khaitan & Co. He is a graduate from NLSIU with a keen interest in debating & mooting. He was also a speaker at the 11th edition of the NSIU Student Bar Debate alongside many eminent speakers consisting of Mr. Ram Jethamalani, Mr. Raju Ramachandran and Dr. Sudhir Krishnaswamy and argued in favour of the constitutionality of the National Judicial Appointments Commission Bill, 2014. Recently, he was recognised as one of the top 30 lawyers and legal influencers under the age of 30 by BW Legal World.

Mr. Rohitesh Tak is an Associate in the Restructuring & Insolvency practice group at the Mumbai office of Khaitan & Co. He is engaged in advising clients on various matters involving one-time restructurings, resolution and turnaround of distressed companies. He graduated from the National University of Advanced Legal Studies, Kochi (2015-20). He was the founding ‘Editor-in-Chief’ of the ‘NUALS IBC E-Newsletter’, a quarterly publication that provides critical updates on the current developments in the field of Insolvency and Bankruptcy Law. He is also the founding ‘Editor-in-Chief’ of the ‘Corporate Distress and Survival Law Review’.

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 Code was upheld by the Supreme Court, resolution of Essar Steel, resolution of the IL&FS group, and resolution of Dewan Housing Finance Corporation Limited.

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 Dewan Housing Finance Corporation Limited. He regularly advises and represents clients before various forums including the NCLT, NCLAT, various High Courts and the Supreme Court.

Mr. Karan Sangani is an associate with the Dispute Resolution practice of Cyril Amarchand Mangaldas. He has also contributed to the monthly column titled 'Insolvency Law in Review' on Live Law.

Mr. Mayannk Sharma is a 3rd year B.A. LL.B. (Hons.) student at Jindal Global Law School. His interest lies in researching and writing on contemporary issues, particularly on the intersection of commercial and constitutional viewpoints. He is also a senior editor at Mapping ADR, Jindal Global Law School's flagship blog dedicated towards contributing to the growing importance of alternative dispute settlement.

Mr. Ryan Joseph is a 3rd year BBA. LL.B. (Hons.) student at Jindal Global Law School. His plan for assisting India in becoming a leading economy motivates him to closely work with Indian startups and he currently heads the Trademarks team at the Jindal Intellectual Property Cell and is a Student Consultant at Legal Entrepreneurship Cell in Jindal. He has a strong interest in General Corporate, M&A and restructuring.

Ms. Sanjitha Ravi is a 3rd year B.B.A. LL. B. (Hons.) student at Jindal Global Law School. An avid reader with a penchant for trying new things, she started a digital marketing company, Papre (pronounced 'Paper') Content Solutions in Coimbatore, Tamil Nadu in 2020 where she is the Chief Operating Officer. Her interests lie in the field of corporate laws, with a focus on technology laws, investment funds and capital markets.

Ms. Mehreen Garg is a 5th Year BBA LLB student at Jindal Global Law School. She is also the Assistant to the Founder, Insolvency Law Academy.

Mr. Arjya B. Majumdar is a Professor at Jindal Global Law School with over 16 years of experience in the corporate law industry and academia.

Mr. Mohammadali Momin is a Ph.D. scholar under the Faculty of Commerce at Veer Narmad South Gujarat University Surat and also awarded by SHODH the Doctoral Fellowship from Government of Gujarat. He has two years of experience in the area of research as he has worked as a research assistant with the Department of Commerce and Management of Hemchandracharya North Gujarat University Patan. He has a specialization in Finance Management and Accountancy. He has worked on various funded research projects as Research Assistant. He has published research articles in Scopus/Web of Science/UGC Care and other peered reviewed journals.

Dr. Dhimen Jagdishbhai Jani is head of BBA Department in Dolat-Usha Inst. and Dhiru-Salra Inst. of Management and Commerce, Valsad affiliated to VNSGU, Surat. He has been in academic field for the last 14 years. He is also PhD guide in Department of commerce in VNSGU Surat. He is also certified resource person by National Institute of Securities Market. He has delivered more than 700 national Financial Education workshops under the banner of SEBI and NCFE. His research was also published in international newspaper 'The Hindu-Business Line' in November, 2014. He has published more than 13 empirical research papers in national and international journals.

Dr. Nimesh Bhojak is currently working as an Assistant Professor at the Department of Hospital Management at HNGU Patan. He is a financial management and health economist faculty with basic training with Master's and Bachelor's in Financial Management. His research and teaching interest include personal health finance, public health finance, corporate based healthcare finance, hospital finance, health insurance, health econometrics, and application of financing model in healthcare. He has published research papers in different peer-reviewed international and national journals.

Mr. Muhammed Suhail PS is a doctoral student in Finance at the Department of Management Studies, Indian Institute of Technology, Madras. His research interests are corporate financial distress and bankruptcy, financial reporting, and corporate governance.

Mr. Arun Kumar Gopalaswamy is a Professor in Finance at the Department of Management Studies, Indian Institute of Technology, Madras. His research interests include corporate governance, development finance, and joint ventures & alliances.

Mr. Pranay Agarwal is a student of 3rd year, B.A.L.L.B. (VI Semester) at Gujarat National Law University, Gandhinagar.

Mr. Ayaan Vali is a student of 3rd year, B.A.L.L.B. (VI Semester) at Gujarat National Law University, Gandhinagar

Mr. Ravindra Beleyur is currently the Proprietor of Beleyur & Associates, Chartered Accountants based in Bengaluru. His firm and he currently focus only on work related with Insolvency Profession and his firm was focusing on Strategy Management Consulting during 2005 to 2017. He has overseen three successful resolutions and liquidation of four companies to date. He was working in various industries for 16 years upto 2003– which included the turn-around experience in the role of a CEO of a polyester yarn manufacturing company in Indonesia after Southeast exchange rate crisis during 1997-98. He did his full-time MBA from Cranfield School of Management, UK after his turn-around experience during 2003-04.

Mr. Shashank Sharma (MBA in Finance, UGC - NET and JRF) is pursuing Ph.D. full-time at Gautam Buddha University (State University), Greater Noida in the area of financial distress and insolvency. He is also pursuing Chartered Accountancy course from ICAI. He has completed his post-graduation as MBA (Finance) from Gautam Buddha University in 2018. In addition, he has been associated with two research projects funded by NITI Aayog.

Mr. Ajay Kumar Kansal (M.com, UGC-NET, Ph.D.) is working as an Assistant Professor in Finance at Gautam Buddha University (State University), Greater Noida, since 2016. He has over twenty-six years of experience in academics and research, which includes thirteen years at CCS University, Meerut and six years at Delhi University, New Delhi. He has contributed to the areas of entrepreneurship, asset quality management in banking sector, and macroeconomic events in SAARC Nations.

Mr. Sumit Banerjee is a doctoral candidate in the area of Finance & Accounting at the Indian Institute of Management 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 articles on banking, accounting and finance in leading national dailies.

Mr. Rupesh Sharma is a doctoral candidate in the area of Finance & Accounting at the Indian Institute of Management Tiruchirappalli. Prior to this, he has taught core courses in Finance and Economics at Amity Business School, Greater Noida. His research interests lie in the area of banking, credit risk assessment, and corporate governance. His work has been published in internationally reputed journals and as book chapters in edited books.

Dr. Swechha Chada is an Assistant Professor of Finance at Great Lakes Institute of Management, Chennai and a PhD 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. Her work has been published in internationally reputed journals and she has also contributed newspaper articles to Financial Express.

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 onover 400 domestic and cross-border M & A transactions. He is currently a Partner in Deloitte India Insolvency Professionals LLP. He has been appointed as the Resolution Professional/

Liquidator for various projects including Bhushan Steel Limited, Binani Cement Limited, Aircel group of companies, Bharati Defence and Instrastructure Limited and Aditya Birla Idea Payments Bank Limited. He is currently the Resolution Professional for Future Retail Limited.

Mr. Ankur Bhargava is a Chartered Accountant by qualification. He has over 13 years of experience in Restructuring practice including Insolvency and Bankruptcy cases as well as in the industry. He has worked in Infrastructure & Real Estate sector and has headed various departments & major functions including Finance, Accounts, Taxation, MIS, HR, Sales & Commercial Operations. He has worked on several IBC cases in supporting the Insolvency Professional including Supertech Ltd., OCL Iron and Steel Ltd., Hacienda Projects Pvt. Ltd., Punj Lloyd Ltd., Educomp Infrastructure & School Management Ltd., C&C Constructions Ltd., Lanco Vidarbha Thermal Power Ltd., etc.

Mr. Asman Avinav Joshi is a student of the Graduate Insolvency Programme offered by the IICA, under the aegis of Ministry of Corporate Affairs, Government of India. As part of the GIP curriculum, he is currently interning with Deloitte India Insolvency Professionals LLP. He is a law graduate from Symbiosis Law School, Pune with a specialization in business and commercial laws.

Mr. Virendra Kumar Gupta is an Ex-Member of the Income Tax Appellate Tribunal and the National Company Law Tribunal. He is a Chartered Accountant and is having practice experience of more than 18 years. He is a law graduate also and has 5 years of experience in legal consultancy. He also has experience in Administration, Finance, Accountancy, Taxation and Management in Private sector at higher managerial positions in prestigious organisations such as Seamec Limited and Jagson International Limited. Currently, he is practicing as a legal consultant at Mumbai.

Ms. Farzeen Cyrus Pardiwalla is an Advocate registered with the Bar Council of Maharashtra & Goa since 2021. She completed her B.Sc. from Jai Hind College, Mumbai and her LLM in Constitutional Law from NMIMS, Mumbai. Her areas of law practice include litigation arising out of disputes pertaining to Constitutional Law, Corporate Reconstruction Laws, Commercial Laws and Criminal Laws. She is currently associated with the Chambers of Amir Arsiwala.

Mr. Vidit Divya Kumat is an Advocate registered with the Bar Council of Maharashtra & Goa since 2018. He completed his BA LLB (Hons.) from the School of Law, Christ University, and his MBA (Law) from NMIMS, Mumbai. His areas of law practice include Criminal Litigation, Labour laws, Insolvency and Bankruptcy laws and Laws relating to Art and Cultural property.

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 (AGP) before High Court of Gujarat. He has handled and appeared in various civil, criminal, corporate, cyber and tax 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 National Company Law Tribunal etc. He is regular faculty and speaker at ICAI, ICSI, Nationalized banks, CAG and author of various corporate and tax journals.

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 Insolvency and Bankruptcy Code, 2016 on daily basis and handled more than 100 cases appearing for Resolution Professionals, Resolution Applicants, Suspended Board and Committee of Creditors.

Ms. Sejal Palan is a practicing Company Secretary since the year 2014 and deals in various ROC compliances required by the Companies under Companies Act, 2013 and LLP Act. She also advises and appears on the matters before NCLT in respect of Insolvency and Bankruptcy Code, 2016 and Companies Act, 2013.She was Chairperson of Rajkot Chapter of Institute of Company Secretaries of India for the year 2019.

भारतीय दिवाला और शोधन अक्षमता बोर्ड
Insolvency and Bankruptcy Board of India

Insolvency and Bankruptcy Board of India

7th Floor, Mayur Bhawan, Shankar Market, Connaught Circus, New Delhi - 110001

www.ibbi.gov.in

This publication has been edited by the Research Division of the IBBI. The contents of this publication are for awareness and educational purposes only. The view and opinions expressed in the publication are of the authors and not necessarily of the IBBI.

978-81-947537-3-5