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Insolvency and Bankruptcy Board of India

Transforming Insolvency Resolution in India

Transforming Insolvency Resolution in India 2025

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PREFACE

The Insolvency and Bankruptcy Code, 2016 (IBC/Code), represents a landmark reform in India's financial and legal systems, providing a consolidated framework to address insolvency and bankruptcy for corporations, partnerships, and individuals. Before the IBC, the country's insolvency system was governed through multiple laws, with cumbersome & prolonged procedures. The IBC streamlined these process into a single & cohesive legislation, aiming to resolve insolvency in a time-bound manner, while ensuring realisation of maximum asset value as well as balancing of interests of all stakeholders. The Code led to a paradigm shift in the approach by placing creditors at the center of the resolution process and empowering them to initiate insolvency proceedings and participate actively in decision-making. It also stipulates the requirement for the timely completion of the corporate insolvency resolution process (CIRP). The IBC thus, encourages the revival and restructuring of distressed entities, supporting preservation of jobs and protecting the broader economic fabric of the country. In scenarios where revival is unviable, the Code provides a clear, transparent mechanism for liquidation, ensuring, thereby, orderly asset distribution. While promoting ease of doing business, the IBC also aims to build a robust framework for financial and economic resilience of the country.

2. The results from IBC can be assessed from the fact that, as of December 2024, a total of 8,175 cases were initiated under the Code, with 6,192 of them being successfully closed. Out of the total, while 3,485 companies accounting for 56% of the total closures were rescued, 2,707 cases led to liquidation. Of the rescued cases, 1,236 were closed due to appeals, reviews, or settlements, 1,130 cases were withdrawn, and 1,119 cases saw the approval of resolution plans. It is noteworthy that around 39% of the CIRPs that resulted in resolution plans were previously under the Board for Industrial and Financial Reconstruction (BIFR) or had been defunct.

3. The Economic Survey of 2024-25 has commended the IBC for transforming the behaviour of distressed companies, emphasizing its role as a deterrent that has encouraged firms to address financial distress proactively rather than face the consequences of a formal resolution process. The Code's credible prospect of ownership transfer has significantly influenced debtor behaviour, as the potential loss of control over a company serves as a strong deterrent, prompting disciplined management and discouraging actions that could lead to insolvency. This impact is evident from the fact that, as of March 2024, over 28,818 cases involving a total debt of ₹10.22 lakh crore were withdrawn before reaching the admission stage. While ensuring expeditious recoveries, the IBC has also encouraged Indian banks to adopt a pro-active approach in managing their non-performing assets (NPAs). By emphasizing resolution over liquidation, the Code has encouraged banks to move away from protracted legal proceedings and adopt a more proactive, practical, and creditor-driven approach to maximize the realised value of distressed assets. The RBI's *Trend and Progress of Banking in India 2023-24* report, released on December 26, 2024, highlights the IBC as the dominant recovery mode, accounting for 48.1% of recoveries. The unparalleled contribution of the IBC in the form of bringing financial discipline is also reflected in terms of a sharp dip in the gross NPA ratio of Scheduled Commercial Banks to 2.54 per cent as on end-September, 2024, which is the lowest since March 2011.

4. As the regulatory body responsible for regulating the profession as well as processes under the IBC, Insolvency and Bankruptcy Board of India (IBBI) is at the forefront of promoting research that enhances the understanding of insolvency processes, challenges, and outcomes. By fostering an environment conducive to research, IBBI helps improve the functioning of the insolvency framework and ensures informed & timely decision-making within the sector.

Moreover, IBBI actively collaborates with academic institutions, think tanks, and research organizations to support the development of high-quality research in the field of insolvency, which has increasingly become a multi-disciplinary area of study.

5. One such initiative was the 3rd International Research Conference on Insolvency and Bankruptcy, jointly organised by IBBI and the Indian School of Business (ISB), Hyderabad. The conference was held from 2nd to 3rd July, 2024, at the ISB in Hyderabad. The infrastructure and faculty support from ISB was pivotal in not only providing a world-class platform for organising the event but also equally crucial in making the conference a great success. This could also facilitate bringing together a diverse group of stakeholders from various sectors, academia, researchers, policymakers, industry experts, and practitioners in the field of insolvency on one platform for exchange of their ideas, sharing research findings, and discussing the evolving dynamics of IBC ecosystem in the country.

6. The conference facilitated cross-disciplinary collaboration, allowing participants from law, economics, finance, and business management to engage in insightful discussions. The speeches delivered during the conference significantly contributed towards advancing the dialogue around the Code. The subsequent panel discussions also made it possible to bring together industry leaders for exploring strategies to attract investments, enhance value realization, and identify critical reforms to further strengthen the framework for resolving distressed assets under the IBC. Panelists also shared their perspectives on innovative practices, simplification of procedures, and legal amendments required to streamline resolution processes. The discussions also emphasized upon the need to adopt practical steps to reduce delays and improve the IBC's effectiveness in achieving swift and efficient outcomes.

7. With more than 200 attendees present in person, the conference was a remarkable event that showcased the widespread interest in the topics discussed. Out of the 142 research proposals which were received for the conference, 59 were shortlisted, and ultimately, 26 papers were presented during the conference. Of these, 12 papers have been included in this publication. The papers have highlighted the diverse impact and evolving discourse surrounding the Code. They have tried to explore its transformative influence on credit channels within the Indian banking systems, its significant role in fostering entrepreneurial activity across Asia, and its efficacy in achieving substantial recovery rates. The research studies also have thoughtfully explored the opportunities and subtle developments brought about by evolving jurisprudence and the potential of innovative tools like Special Situation Funds (SSFs) in resolving non-performing loans. They also investigate valuation regimes, the implications of insolvency processes for non-incorporated persons and municipal entities.

8. This compilation of research papers, presented at the 3rd International Research Conference on Insolvency and Bankruptcy, stands as a reflection of meaningful engagement with the evolving landscape of insolvency and bankruptcy. Each contribution reflects the dedication and expertise of researchers, practitioners, and policymakers in embracing the opportunities within this critical field. By encouraging inter-disciplinary discourse and offering innovative perspectives, this publication seeks to deepen the understanding and application of insolvency frameworks, particularly in the Indian context. We hope this collection not only offers actionable insights for advancing effective resolutions, but also contributes in fostering economic resilience and shaping a robust insolvency ecosystem in India, over the period of time.

Thank You
Dr. Bhushan Kumar Sinha
(Whole Time Member)

01

UNRAVELLING JURISPRUDENTIAL ODYSSEY: NAVIGATING PATHS THAT STRAY FROM THE LEGISLATIVE INTENT OF THE IBC

Shardul S. Shroff, Aishwarya Satija and Kritika Poddar

ABSTRACT

Recent years have witnessed numerous instances where the interpretation and application of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) in case law deviates from its foundational principles. Amidst this, the National Company Law Tribunal (NCLT) stands out for its commendable judicial innovation, stepping in to fill legal voids, as necessary. Judicial innovation, while beneficial, should ideally be accompanied by legislative changes to confer upon it the highest level of sanctity, especially in the context of an economic law like the IBC that fundamentally relies on certainty and predictability. In this background, the paper examines the foundational principles of the IBC, critically analyzes the evolving jurisprudence that poses a potential threat to these principles and emphasizes the need for interpreting the IBC in accordance with its legislative intent.

INTRODUCTION

In 2016, India made significant changes to its insolvency laws by enacting the IBC that codifies and consolidates all insolvency laws relating to companies, unincorporated businesses, and natural persons. The enactment of the Code was a result of nearly two decades of reform efforts that were aimed at *inter alia* promoting entrepreneurship, increasing availability of credit, and reducing cost of capital.[1]

The erstwhile statutory regime for corporate rescue namely the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) was marred with substantial flaws. Although intended to offer a prompt mechanism for revitalising sick industrial companies, the SICA garnered widespread criticism for its failure to deliver timely rescues, with proceedings often extending to 5-7 years.[2] Factors contributing to this delay included routine challenges to Board of Industrial and Financial Reconstructing (BIFR) decisions, the BIFR's struggle to differentiate between cases fit for rehabilitation and winding up, excessive focus on entity preservation, anti-creditor nature of the BIFR proceedings, and automatic moratorium on enforcement proceedings.[3] The trigger event for initiation of proceedings under SICA was based on a net

[1] The Report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design, https://www.ibbi.gov.in/uploads/resources/BLRCReportVol1_04112015.pdf, at 14.

[2] Interim Report of The Bankruptcy Law Reform Committee, at 39.

[3] Debanshu Mukherjee, *Decoding the Bankruptcy Code*, India Business Law Journal, February 2016; https://vidhilegalpolicy.in/wp-content/uploads/2019/05/Article-Debanshu-IBLJBankruptcyCode.pdf.

worth erosion test to determine if the company was a 'sick company'. This determination was significantly time-consuming and led to erosion of the company's value, leaving effectively no scope for rescue and restructuring. BIFR proceedings were also deemed 'notoriously dilatory',[4] allowing debtor companies to exploit SICA provisions to evade debt repayment, exacerbated by promoters retaining control and extracting value from the proceedings.

In response to these challenges, the IBC was instituted as a streamlined corporate insolvency framework, characterised by some key features including an objective trigger based on payment default enabling early stress detection and stakeholder intervention; emphasis on time-bound resolution by prescribing timelines for various processes; curtailment of the company management's authority during a corporate insolvency resolution process (CIRP); transferring control of the corporate debtor (CD) to an independent Insolvency Professional (IP) to prevent asset stripping; flexibility in the development of resolution plans that provide the best commercial decision for reviving the CD; and establishment of a clear hierarchy for distribution among all stakeholders.

Notwithstanding the unequivocal legislative intent and the endorsement of such intent by multiple government reports, jurisprudence developed under the IBC has consistently veered off course. Recent years have witnessed numerous instances where the interpretation and application of the IBC in case law deviates from its foundational principles, posing a threat to the timely initiation of proceedings under the IBC, undermining the rights of secured creditors as established by the law and casting doubts on the well-established principle of the clean slate doctrine marking only a few instances among several.

In this background, this research paper conducts a thorough examination of the foundational principles of the IBC, critically analysing the evolving jurisprudence that poses a potential threat to these principles and discusses the need for and importance of interpreting statutes in accordance with their legislative intent.

PRINCIPLES UNDERLYING THE DESIGN OF THE IBC

Background to enactment of the IBC

The approach and design of the IBC was a result of the experience of implementation of the erstwhile insolvency laws in India. Thus, it is worth noting the context in which the IBC was enacted.

During the mid-2010s, the Indian banking sector witnessed an increase in stressed assets with several overleveraged Indian companies defaulting on repayments. This resulted in piling up of non-performing assets (NPAs) with banks and financial institutions. Despite lapses in the reporting of actual NPAs by banks, India recorded net NPAs amounting to 3.5 lakh crore in 2015.[5] The net NPA saw an increase of approximately 6% in 2017 after the enactment of stricter rules for reporting of NPAs in 2016 by the Reserve Bank of India.[6] The ballooning of NPAs was exacerbated by the low recovery rates of banks during this period. In 2015-2017,

[4] *supra* note 2, at 41.
[5] RBI, *Database on Indian Economy*.
[6] *Id.*

Indian banks could only recover 26.4% of their loans on average, with public sector banks recovering merely half of the recovery made by private sector banks.[7]

The ineffectiveness of the insolvency regime at the time significantly contributed to this dire state of the Indian banking industry. Prior to the enactment of the IBC, India had a plethora of legislations dealing with resolving financial distress. This meant that the laws dealing with corporate insolvency were fragmented, overlapping and often conflicting. The insolvency regime was plagued by rampant delays leading to measly recoveries for creditors. The Doing Business Report prepared by the World Bank in 2014-15 suggests that in India, "*resolving insolvency takes 4.3 years on average and costs 9.0% of the debtor's estate, with the most likely outcome being that the company will be sold as piecemeal sale. The average recovery rate is 25.7 cents on the dollar.*"[8] The inefficiency of the corporate rescue and winding up/liquidation regime in India led to a situation where most creditors preferred to initiate separate recovery proceedings (often involving the same assets) irrespective of the viability of the company. This led to conflicts, disorderly distribution, delays, and depletion in value of the company, which could have otherwise been rescued.

Given this, on 22 August 2014, the Ministry of Finance formed the Banking Law Reforms Committee (BLRC) headed by Dr. T.K. Viswanathan. The mandate of the BLRC was to create a uniform framework that would cover matters of insolvency and bankruptcy of all legal entities and individuals, save those entities with a dominantly financial function. The BLRC submitted –

(i) An interim report in February 2015, containing the drawbacks of the existing insolvency regime at the time, international best practices and provided key recommendations for its approach to designing an insolvency law for India.

(ii) A final report in November 2015 wherein Volume 1 provides the rationale for design of a new Insolvency and Bankruptcy Code, and Volume 2 provides the draft law. The IBC, as drafted by the BLRC, is a consolidated insolvency and bankruptcy framework that aims to improve the time taken to resolve insolvency which in turn would maximise value of assets of the CD.

A modified version of the draft Code submitted by the BLRC, with public comments incorporated, was tabled in Parliament in the winter session on 23 December 2015. Thereafter, a Joint Parliamentary Committee on Insolvency and Bankruptcy Code, 2015 (JPC) was set up to analyse the draft bill in detail. The JPC submitted its report, along with a modified Bill, in April 2016 and the IBC received Presidential assent on 28 May 2016.

Objectives and Principles in the design of the IBC

The BLRC laid down the following policy objectives that a well-designed insolvency law must address –

(i) the protection of creditor interests by maximising returns to creditors;

(ii) the promotion of economic growth through efficient reallocation of resources;

[7] RBI, *Insolvency and Bankruptcy Code and Bank Recapitalisation*, (Dec. 17, 2017).

[8] *supra* note 2, para 2.3.

(iii) the development of credit markets;

(iv) the protection of other stakeholders such as employees and shareholders; and

(v) enhancement of investor confidence.[9]

An efficient insolvency regime must strike the right balance between the interests of all the stakeholders of the distressed entity by reasonably allocating the risks among them. However, the BLRC was cognizant that the law in the books is not solely sufficient for creating such a regime, and the institutional context within which it operates plays as significant a role as the substantive law itself.[10] Therefore, it recommended a complete overhaul of the insolvency law and its institutional framework by enactment of a unified and comprehensive Code to deal with insolvency of corporate entities, individuals and partnership firms.

The BLRC defined three key objectives when designing the provisions of the IBC, i.e. (a) quicker turnaround by lowering the time undertaken for resolution; (b) maximising value by lowering the loss in recovery to creditors; and (c) boosting credit by achieving increased levels of debt financing.[11] It adopted a principle-based approach while designing the law to achieve these goals. To arrive at these principles, the BLRC reviewed most well-developed insolvency and bankruptcy regimes across the globe and carved out the following core features that were common to all –

(i) a clear and linear process that creditors and debtors follow once an insolvency process is triggered;

(ii) a collective mechanism for resolving insolvency within a framework of equity and fairness to all stakeholders to preserve economic value in the process;

(iii) a time bound process that either ends in keeping the firm as a going enterprise or liquidates and distributes the assets to the various stakeholders.[12]

In line with these, the BLRC laid down the principles underlying the design of the IBC tailored for the Indian context. These foundational principles, discussed below, are vital tools for interpreting the law in a way that effectively meets its objectives[13] -

(a) Early detection of distress and easy trigger – The primary principle in the design of the IBC is to detect distress and assess viability of an enterprise as early as possible.[14] The BLRC underscored the importance of timeliness in addressing financial distress and noted that identifying such distress at an early stage is key to preserving the value of the enterprise. Given this, the IBC provides a simple default test for initiating an insolvency resolution process whereby the process is triggered if it is established

[9] *supra* note 4, para 2.2.
[10] *Id.*
[11] *supra* note 1, para 3.4.1.
[12] Debanshu Mukherjee, Priyadarshini Thyagarajan, and Anjali Anchayil, *The place of a collective liquidation process in an effective bankruptcy regime: A comparative analysis*, Working Paper, FRG IGIDR (2015).
[13] Please note that we have focused on design principles relating to corporate insolvency and have not considered principles for individual insolvency as put down by the BLRC.
[14] *supra* note 1, para 3.4.2.

that the debtor made a payment default that is above the requisite threshold.[15] This marks a shift from the balance sheet tests required under the erstwhile insolvency laws for initiation of rescue and winding up procedures. These tests required courts to undertake detailed assessments of the financial health of the enterprise by assessing its books of accounts and were mired by inconsistent jurisprudence and protracted litigation. Thus, the BLRC recommended an objective mechanism for triggering an insolvency resolution process with little to no discretion for the tribunal to establish insolvency.[16] Further, the IBC also allows both the creditors (financial and operational) and the debtor to initiate the insolvency resolution process albeit with differing documentary requirements for each.[17]

(b) **Judicial intervention limited to matters of procedure –** The delineation of the decision-making powers of the creditors committee as opposed to the insolvency tribunal is central to the design of the insolvency resolution process. The BLRC distinguishes between business decisions that assess the viability of the enterprise and decisions that ensure procedural fairness. The BLRC recommended that the law must explicitly state that the viability of the enterprise is a matter of business, and that matters of business can only be negotiated between creditors and debtor.[18] The final decision regarding rescue of the entity must be an agreement among creditors who are the financiers willing to bear the loss in the insolvency. Thus, the role of the NCLT as the Adjudicating Authority (AA) in a CIRP is limited to ensuring adherence to the applicable laws and procedural rules, maintaining procedural fairness, and hearing allegations of violation and fraud during the process.[19] To buttress the rationale for a limited role of the AA, the BLRC noted that the key reasons for failure of the erstwhile rescue procedures under Indian insolvency law included lack of institutional capacity and excessive judicial intervention.

(c) **Creditors in control –** The IBC departs from its predecessors and replaces a debtor- in-possession model with a creditor-in-control model. Under the erstwhile regime, the promoters retained control of the management of the company while it was undergoing insolvency which led to siphoning off funds and stripping the company of its assets and value. For example, SICA was grossly misused by the debtor company as a reference with BIFR was deliberately filed to seek an automatic stay on creditor enforcement against the company.[20] The moratorium was an effective cover for promoters of distressed companies to continue with business as usual, often bleeding the company further or stripping its assets.[21] In stark contrast, upon initiation of CIRP under the IBC, the board of directors of the insolvent company are suspended and the management of the

[15] Insolvency and Bankruptcy Code, 2016, § 4.
[16] *supra* note 1, para 3.4.2.
[17] Insolvency and Bankruptcy Code, 2016, § 7, § 8, § 9.
[18] *supra* note 1, para 3.4.2.
[19] *Id.*, Chapter 5, at 74.
[20] Kang & Nayar; Omkar Goswami, *'Corporate Governance in India' in Taking Action Against Corruption in Asia and the Pacific* (ADB 2002) 94.
[21] Committee on Financial Sector Reforms, *A Hundred Small Steps,* https://www.jrvarma.in/reports/Raghuram-Rajan/cfsr_all.pdf, at 173.

company vests with the IP appointed as the interim resolution professional.[22] A committee of creditors (CoC) is formed comprising all unrelated financial creditors (FCs) of the CD.[23] It is worth noting at this juncture that the IBC divides creditors into two key categories – FCs (who disburse credit against consideration for the time value of money) and operational creditors (OCs) (who grant credit against the provision of goods and services, including employees and debts owed to the Central Government, State Government, and other authorities). Unlike FCs, OCs do not form part of the CoC.[24] This distinction is crucial since the CoC is tasked with taking business decisions regarding the viability of the debtor during the CIRP. This includes evaluating proposals to keep the entity as a going concern, making key decisions regarding management of the company during the process, and deciding on liquidation where a revival is not viable. To ensure fruitful negotiations, the IBC also provides for a calm period in the form of a "*time bound moratorium against debt recovery actions and any new cases filed*"[25] against the debtor company.[26]

(d) **Time-bound process for maximisation of value –** The BLRC places huge emphasis on the crucial role of time in resolving insolvency for the purposes of maximising value available to stakeholders. The BLRC Report also notes this in the following terms:

> **Speed is of essence**
>
> Speed is of essence for the working of the bankruptcy code, for two reasons. First, while the "calm period can help keep an organisation afloat, without the full clarity of ownership and control, significant decisions cannot be made. Without effective leadership, the firm will tend to atrophy and fail. The longer the delay, the more likely it is that liquidation will be the only answer. Second, the liquidation value tends to go down with time as many assets suffer from a high economic rate of depreciation.
>
> From the viewpoint of creditors, a good realisation can generally be obtained if the firm is sold as a going concern. Hence, when delays induce liquidation, there is value destruction. Further, even in liquidation, the realisation is lower when there are delays. Hence, delays cause value destruction. Thus, achieving a high recovery rate is primarily about identifying and combating the sources of delay… The most important objective in designing a legal framework for dealing with firm failure is the need for speed.[27]

Given this, the BLRC recommended a limited timeline of 180 days extendable once by 90 days[28] for the completion of the CIRP along with timelines for different stages within the process.

(e) **Equitable treatment of creditors in a collective process –** In line with international best practices on insolvency laws, the BLRC recommended that the IBC must ensure

[22] Insolvency and Bankruptcy Code, 2016, § 17(1).
[23] Insolvency and Bankruptcy Code, 2016, § 21(2).
[24] *Id.*
[25] *supra* note 1, chapter 5, at 74.
[26] Insolvency and Bankruptcy Code, 2016, § 14.
[27] *supra* note 1, at 14-15.
[28] This has now been amended and a maximum timeline of 330 days has been provided in the IBC for completion of the CIRP. *See* Section 12, Insolvency and Bankruptcy Code, 2016.

that the insolvency and liquidation processes are collective in nature.[29] This means that the law should deal with all creditors of the distressed company equitably by balancing their competing interests. Once insolvency is triggered, the interests of the general body of creditors trumps individual interests of each creditor. Notably, however, this does not mean that differently placed creditors are to be treated equally or that all commercial bargains made by creditors prior to insolvency (like security interest) are to be disregarded.[30]

(f) **No prescriptions on solutions to resolve insolvency** – The BLRC recommends that the law should first attempt to rescue a distressed company to ensure that maximum value is derived for stakeholders in instances where the company or its business is economically viable. Failing such an attempt at rescue, however, the company should be liquidated.[31] A plan for revival of the CD, i.e. the resolution plan, would require a 75% majority in value terms of the CoC (this threshold is now amended to 66%). Thereafter, when such plan is approved by the AA, it would bind all stakeholders of the CD. The BLRC noted that the choice of the solution to revive the distressed company depends on the decision of the CoC and there are "*no constraints on the proposals that the Resolution Professional can present to the creditors committee*".[32] Thus, the CoC should have discretion to choose a plan that is the most value maximising in the facts and circumstances of a given case. Other than ensuring that the resolution plan is approved by the requisite threshold of the CoC, the AA is only required to assess whether the plan meets legal requirements such as granting priority to interim finance, complying with existing laws, providing for payment to creditors who are not on the CoC, etc.[33] Further, the BLRC also intended for the law to be outcome neutral and recommended that where a rescue is not possible, a liquidation should be ordered expeditiously.[34] This agnostic approach in deciding the best remedy to deal with a distressed company is influenced by the failure of the erstwhile SICA regime due to its bias towards rescue, even of commercially unviable companies.

(g) **An irreversible, time-bound liquidation with defined payout prioritisation –** The BLRC envisaged that a liquidation would be ordered by the AA where no plan has been agreed to by the CoC or where the plan does not meet the requirements for approval by the NCLT. Such liquidation process should have finality and be irreversible to ensure that no value depletion is caused due to continual attempts at rescuing unviable enterprises. Further, the liquidation process was recommended to be a time bound process with the priority of distribution amongst stakeholders clearly laid down in the law. In designing this priority, the BLRC noted the importance of "*incentivising all stakeholders to participate in the cycle of building enterprises with confidence*". Thus, one of the key changes made in the payment priority provided in the IBC compared to erstwhile

[29] *supra* note 1, para 3.4.2.
[30] UNCITRAL, *Legislative Guide on Insolvency* (2005), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf, at 11.
[31] *supra* note 1, para 3.4.2.
[32] *supra* note 1, chapter 5, at 75.
[33] *Id.*
[34] *Id.*

insolvency laws is placing crown debts (or government dues) below the dues owed to FCs. The BLRC noted that this demotion of government dues in the payment priority under the IBC "*would increase the availability of finance, reduce the cost of capital, promote entrepreneurship and lead to faster economic growth*" in the long run.

JUDICIAL DEVIATIONS FROM THE DESIGN PRINCIPLES OF THE IBC

Admission on proving default

As discussed above, one of the primary principles underlying the design of the Code is a quick and easy trigger for the insolvency process which is based on an objective criterion that places the least cost on the AA. Therefore, the IBC provides that an application for initiation of a CIRP is to be admitted where the applicant proves default by the CD that is above the requisite threshold.[35] The rationale for this simple mechanism for initiation of insolvency proceedings under the IBC is that erstwhile insolvency laws witnessed inordinate delays in admission due to the subjective criteria of proving insolvency provided therein. This is evident from the discussion on the experience of implementation of SICA in the Interim BLRC Report.

The Interim BLRC Report relies on doctoral research of Kristin van Zwieten (now Clifford Chance Professor of Law and Finance at the University of Oxford), who conducted a comprehensive study of the development of corporate insolvency law in India, particularly considering the influence of the courts in the failure of the liquidation and corporate rescue procedures.[36] One of the findings of this research was that the wide discretion available with the courts in India under the erstwhile insolvency regime 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.[37] This, in turn, had affected the efficiency of the process as a whole.

Accordingly, in designing the IBC, the BLRC envisioned the role of the NCLT to be limited to determining that evidence of default is provided and that the application meets the procedural requirements provided under law.[38] No further discretion is intended to be provided to the NCLT in deciding whether to admit or reject an application for initiation of CIRP. This is also evident from the Notes on Clauses appended to the Insolvency and Bankruptcy Bill, 2015 (Bill) which has now been enacted as the IBC. For instance, the Notes to Clause 7 of the Bill (now Section 7 of the IBC) that deals with the application for initiation of CIRP by an FC provide that –

> …Once the adjudicating authority/Tribunal is satisfied as to the existence of the default and has ensured that the application is complete and no disciplinary proceedings are pending against the proposed resolution professional, it shall admit the application. The adjudicating authority/Tribunal is not required to look into any other criteria for admission of the application. It is important that parties are not allowed to abuse the legal process by using delaying tactics at the admissions stage.[39] ("Emphasis Supplied")

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[35] Section 4 read with Sections 7, 9 and 10, Insolvency and Bankruptcy Code, 2016.

[36] *supra* note 4, para 4.1B, at 42-43; *See* van Zwieten, K., *The Demise of Corporate Insolvency Law in India*, University of Oxford, 2012.

[37] *Id.*

[38] *supra* note 1, Chapter 5, at 79.

[39] Clause 7, Notes on Clause, Insolvency and Bankruptcy Bill, 2015.

This limit on discretion of the AA at the admissions stage has also been upheld by the Supreme Court in cases like *Swiss Ribbons v. Union of India*[40] and *Innoventive Industries Limited v. ICICI Bank and Another*[41] wherein it was held that for admission of a CD into CIRP, only the existence of debt and default needs to be demonstrated (commonly known as twin test).

Despite the above, the Supreme Court in its recent decision of *Vidarbha Industries Power Ltd. v. Axis Bank Ltd.*[42] (*Vidarbha Industries*) has held that the AA (i.e. the NCLT) while hearing an application filed by an FC under section 7(5)(a) of the Code for admission of a CD into CIRP, has discretionary powers in making an assessment as to whether the application ought to be admitted irrespective of the existence of debt and default. The Supreme Court has held that the factors relating to financial health of a debtor are relevant for assessment by the NCLT before it decides to admit the CD into CIRP.

In this case, the adjudicated claim of the debtor against a third party (although under appeal) was more than the debt owed by it to the FC for which petition for initiation of CIRP was filed before the NCLT. The Supreme Court held that in such cases where initiation of CIRP is opposed on the ground of existence of an award or a decree in favour of debtor and such award / decretal amount exceeds the amount of debt owed to the FC, the application of such creditor has to be kept in abeyance, unless there is good reason not to do so. The Court noted the language of section 7(5)(a) in comparison to section 9(5) (applicable to application filed by an OC) of the Code and observed the use of word *"may"* in section 7(5)(a) as against *"shall"* in section 9(5). Relying on this, the Court concluded that fulfilment of the twin test requirements merely gives a right to the FC to apply to the NCLT for initiation of CIRP but does not mandate the NCLT to admit such an application.

Resultantly, the judgment of the Supreme Court in *Vidarbha Industries* has enlarged the role of the NCLT at the threshold and granted it discretion to not admit an application, even when the objectively defined threshold of existence of debt and default stands proved in accordance with provisions of the Code and its interpretation by the Supreme Court. This is starkly opposed to the legislative intent of the IBC which is buttressed by the Notes on Clauses to section 7 quoted above which have been overlooked by the Supreme Court in interpreting section 7 of the IBC. Further, despite a subsequent order of the Supreme Court in review[43] of the *Vidarbha Industries* decision to clarify that the same was held in context of the facts of the said case, various benches of the NCLT have relied upon the *Vidarbha Industries* decision to reject initiation of CIRP by going into subjective factors beyond the existence of debt and default.[44] This has added significant delays in admission of CIRP, which is in addition to the huge pendency and delays at the NCLTs at the admission stage despite observance of the objective twin test, and clogged the already choking NCLT infrastructure.

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[40] (2019) 4 SCC 17.
[41] (2018) 1 SCC 407.
[42] (2022) 8 SCC 352.
[43] Axis Bank Limited v. Vidarbha Industries Power Limited, (2022) 8 SCC 352.
[44] Bank of Maharashtra v. Newtech Promoters and Developers Private Limited, C.P. (IB) No. 2465/NCLT/ND/2019, NCLT, New Delhi, order dated October 14, 2022; State Bank of India v. Krishidhan Seeds Pvt. Ltd., C.P. (IB) No. 500/NCLT/MP/2018, NCLT, Indore, decided on August 25, 2022.

In a subsequent decision, the Supreme Court in *M. Suresh Kumar Reddy v. Canara Bank and Others*[45] (*Suresh Kumar*) has distinguished *Vidarbha Industries* and reaffirmed the twin test established in previous judgments under the IBC. The Apex Court noted that the review petition for the decision in *Vidarbha Industries* has specifically clarified that observations made in this decision by the Court regarding additional grounds for admission of CIRP applications, such as solvency and viability of a CD, should only be understood to be made for the specific facts in *Vidarbha Industries* and must not be treated as universally applicable. It was also clarified that views expressed in a judgment cannot be taken to reflect the actual provisions of a statute. The Code as well as various judgments interpreting the Code clearly state that the NCLT's discretion is limited to the satisfaction of debt and default. Thus, the Court held that *Vidarbha Industries* cannot be relied upon to deviate from this settled position.

Although the judgment in *Suresh Kumar* has clarified the legislative intent and rectified the effects of *Vidarbha Industries* to a certain extent, it should be noted that both these cases have been decided by two-judge benches of the Supreme Court. Thus, *Suresh Kumar* has potentially diluted the precedential value of *Vidarbha Industries* without explicitly overruling the same. A judgment by a larger bench of the Supreme Court or a statutory amendment clarifying the intent of the law are necessary to ensure that the rigours of the admission process under the IBC are not diluted. Notably, on 18 January 2023, the Ministry of Corporate Affairs (MCA) invited public comments on several proposed changes to the IBC, including an amendment to Section 7 to clarify the same. However, no such amendment has been introduced in the IBC yet.

Rescue as primary aim and scope of resolution plans

Rescue as primary aim

Several judgments interpreting the IBC have held that the primary goal of the law is to rescue a distressed company through the resolution process and have considered that liquidation should be the last resort.[46] In *Binani Industries Ltd. v Bank of Baroda,*[47] the National Company Law Appellate Tribunal (NCLAT) laid down the aims of the Code and noted that the–

> The first order objective is "resolution". The second order objective is "maximisation of value of assets of the 'Corporate Debtor'' and the third order objective is "promoting entrepreneurship, availability of credit and balancing the interests". This order of objective is sacrosanct.[48]

Given that liquidation under the IBC is only permissible on failure of a CIRP, courts have repeatedly held that the objective of the Code is to "*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*"[49]. In *K.N. Rajakumar' v. V. Nagarajan & Ors.*,[50] the Apex Court noted that –

[45] Suresh Kumar Reddy v. Canara Bank & Others, Civil Appeal No. 7121 of 2022, order dated May 11, 2023, Supreme Court of India.
[46] *For instance,* Swiss Ribbons (P) Ltd. v. Union of India, (2019) 4 SCC 17.
[47] Company Appeal (AT) (Insolvency) No. 82 of 2018, Judgement dated 14th November, 2018 of the NCLAT.
[48] *Id.,* para 17.
[49] Swiss Ribbons (P) Ltd. v. Union of India, (2019) 4 SCC 17.
[50] Civil Appeal No. 1792 of 2021, Judgment dated 15 September, 2021 of the Supreme Court of India.

> It could thus be seen that one of the principal objects of the IBC is providing for revival of the Corporate Debtor and to make it a going concern. Every attempt has to be first made to revive the concern and make it a going concern, liquidation being the last resort.[51] (Emphasis Supplied)

This rescue focused approach of Indian courts has prompted the conduct of multiple rounds of bidding with the aim of reviving companies during CIRP, often leading to inordinate delays and erosion of value.[52] The NCLAT in *Y. Shivam Prasad*[53] has gone a step further and held that even where a liquidation order is passed, the liquidator must first attempt to revive the company and run it as a going concern before selling the assets of the company. This has led to going concern sale of the CD being attempted in several liquidation proceedings subsequently. The concept of attempting going concern sales has even been incorporated into the regulations governing the liquidation process.[54] This means that no matter whether the market sees value in the company, a long-drawn process to keep the company running at all costs will often be undertaken.

The above-mentioned interpretation of the IBC as prioritising resolution regardless of failed attempts at garnering resolution plans in CIRP is however completely at odds with the statute's legislative intent. The BLRC in its interim report noted that one of the key reasons for the failure of SICA was that courts endlessly attempted to rescue companies, which ultimately led to destruction of value and low returns for creditors.[55] In this regard, the BLRC relied on research undertaken by Professor Van Zwieten who analysed a set of 1066 judgments under the SICA and argued that "*while the existing literature on the SICA has largely linked the failure of the corporate rescue procedure under the SICA to the formal features of the legislation, an equally or more convincing explanation for the SICA's failure lies in the interpretation and application of SICA provisions by courts.*"[56] Van Zwieten concludes that one of the primary judicial 'innovations' that led to the downfall of SICA was the development of judicial practice in the High Courts of permitting companies to explore rehabilitation options even after the issuance of a liquidation opinion by the BIFR.[57] She notes –

> Arguably the most important judicial innovation revealed by the SICA cases is a largely informal one: a judicial practice of permitting the SICA company, its promoters or its workers to explore the possibility of its rehabilitation after the issuance of a liquidation opinion by the BIFR. Relief came in a variety of forms, sometimes on an interim basis (for example, by a stay of the BIFR's liquidation opinion, or an adjournment of the hearing on the BIFR's liquidation opinion), and sometimes in the form of directions to propose a scheme, either before the court or (on remittance to) the BIFR... Crucially, relief of this form did not depend on any finding of error on the part of the BIFR: what was being offered to petitioners was, to varying degrees and on a rather ad hoc basis, a form of merits review.[58] (Emphasis Supplied)

[51] *Id.*, para 16.
[52] For instance, Vistra ITCL (India) Ltd. v. Torrent Investments Pvt. Ltd. & Ors., Company Appeal (AT) (Insolvency) No. 132, 133 & 135 of 2023 & 139 of 2023, Order dated 2 March 2023 of the NCLAT.
[53] Y. Shivam Prasad v. S. Dhanapal & Ors., Company Appeal (AT) (Insolvency) No. 224 of 2018, Order dated 27 February 2019 of the NCLAT.
[54] Regulation 2B, Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016.
[55] *supra* note 4, para 4.1B, at 42-43; van Zwieten, K., *The Demise of Corporate Insolvency Law in India*, University of Oxford, 2012.
[56] *supra* note 4, para 4.1B, at 42.
[57] *Id.*
[58] van Zwieten, K. *supra* note 36, at 242.

Van Zwieten notes that this judicial development introduced several delays in the SICA process, allowing debtors to delay repayment to creditors and siphon off assets during the pendency of the lengthy litigation.[59] As an example of delays involved in the process, one may note the case of Gujarat High Court in *Madhu Textiles Ahmedabad Ltd v. Official Liquidator*[60] where the BIFR recommended liquidation in 2000 after two failed attempts at schemes since the company registered with the BIFR in 1992. While adjudicating an application by the company praying for rehabilitation, the High Court allowed it to propose a scheme of arrangement in 2002. The High Court subsequently concluded that a winding up hearing would have to be scheduled after the company submitted a scheme that failed to garner the requisite creditor approval in 2005. Such delays eventually led to increased costs for certain creditor groups under the SICA and an erosion in the company's asset value.[61]

It may appear in the short term that keeping a company running will always be the best outcome as it preserves jobs and avoids the impression that banks have unfairly captured the wealth of the company. However, India's experience with SICA suggests that this assumption is incorrect and that the long-term ill effects of such a rescue focused approach need to be considered. Keeping the capital of financial institutions tied up in companies that have not been viewed as valuable by the market impedes the ability of such institutions to finance viable projects that can provide a higher number of economically useful jobs. The IBC has been designed with the intention of freeing up capital in a timely manner when a company is not commercially viable. This is evident from the bar on attempting another resolution process once liquidation has been ordered under the IBC.[62] Further, the BLRC Report has specifically noted that preservation of time value is of primary importance in collective action proceedings like insolvency and has therefore recommended that liquidation orders should be irreversible.[63]

Given that going concern sales during liquidation go against the legislative intent of the IBC, the 32nd Standing Committee on Finance recommended that going concern sales should be disallowed in the regulations governing the liquidation process.[64] However, this recommendation has not yet been accepted by the Government.

Limited scope of resolution plans

Instead of attempting to revive a company that has been ordered to be liquidated, perhaps a more effective remedy is to expand the scope of resolution plans during the CIRP. The IBC requires that a CIRP is attempted before a liquidation process commences. Thus, any revival that can be undertaken should ideally be within the procedure and timelines of the CIRP. Accordingly, having flexibility in the manner of rescue that can be made under a resolution plan is likely to increase the chances of revival of distressed companies during CIRP. This is in line with the way the BLRC envisaged for the IBC to operate. However, judicial authorities have generally interpreted the definition of 'resolution plan' narrowly, thereby limiting the scope of rescue in the CIRP.

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[59] *Id.*
[60] I (2006) BC 98.
[61] van Zwieten, K. *supra* note 36, para 8.2.2 and 8.3.
[62] Insolvency and Bankruptcy Code, 2016, § 11(d).
[63] s*upra* note 1, chapter 5, para 5.5.
[64] Standing Committee on Finance, *Implementation of Insolvency and Bankruptcy Code- Pitfalls and Solutions*, at 27.

Section 5(26) of the Code defines a resolution plan as *"resolution plan" means a plan proposed by resolution applicant for insolvency resolution of the corporate debtor as a going concern in accordance with Part II. Explanation. - For removal of doubts, it is hereby clarified that a resolution plan may include provisions for the restructuring of the corporate debtor, including by way of merger, amalgamation and demerger;*" The legislative intent in defining the scope of the resolution plan was to allow creditors with flexibility to design varied kinds of resolution plans including to allow both reorganisation and going concern sale of the CD as whole or in part. The rationale behind this was that creditors should have the freedom to take business decisions to arrive at the most value maximising way of resolving the CD's distress. This legislative intent is evident from the discussions of the BLRC in its interim and final reports noted below:

- The Interim Report of the BLRC notes the benefits of allowing flexibility to stakeholders to choose the mode of resolution that is most suited to the facts and circumstances of a particular case. It discussed that –

> It is widely recognized that as long as a failing company remains economically viable it should be first subject to a reorganization or rescue process (and not liquidation). Unlike liquidation, where the company is closed down, reorganisation is a process of "organizational rebirth" where the "debts are renegotiated, costs are cut and the firm may be shrunk, in order to return to profitable operations". Such reorganisation could also involve change of owners or management. It is important to point out that although a company's economic viability differs from its financial health (which is primarily related to its level of indebtedness), there could be a strong link between the two, i.e. a company's financial health could be a strong indicator of its economic viability. It may be noted that reorganization is not the only efficient rescue mechanism for saving a financially distressed company. The business could also be sold on a going concern basis (and proceeds distributed to the creditors) followed by liquidation of the residual entity (especially, when there is a ready market for that business). Some scholars argue that such approaches afford the possibility of avoiding protracted negotiations with various stakeholders and other costs associated with the reorganization process.[65]

- Further, the BLRC Report notes that "*All decisions on matters of business will be taken by a committee of the financial creditors. This includes evaluating proposals to keep the entity as a going concern, including decisions about the sale of business or units, retiring or restructuring debt.*",[66] and recommends that the IBC should not be prescriptive regarding the desired outcomes of an insolvency process.[67]

- This legislative intent is also reflected in the Notes on Clauses appended to the Insolvency and Bankruptcy Bill, 2015, wherein the notes to Clause 31 (now section 31 of the IBC) state that

> … a resolution plan may provide for any proposal for its insolvency resolution (including sale of the business as a going concern, takeover of the corporate debtor by another entity, reorganising or retiring debt etc. — all in compliance with law) … Where the resolution plan meets the criteria set out in Clause 31(1), the adjudicating authority

[65] *supra* note 4, at 32.
[66] *supra* note 1, chapter 5, at 74.
[67] *Id.,* at 75.

> shall sanction the plan. The plan shall be binding on the corporate debtors, its creditors, employees, shareholders, guarantors and other stakeholders.[68]

However, interpretation of the definition of 'resolution plan' by judicial authorities has been limited in scope. In *Binani Industries Ltd. v. Bank of Baroda,*[69] the NCLAT noted that a 'resolution plan' means a plan proposed by a resolution applicant for insolvency resolution of the CD as a going concern in accordance with Part II. While noting that the Code in totality does not spell out the exact nature of a resolution plan and leaves it up to the imagination of stakeholders, it was held that the resolution plan cannot provide for sale of CD. While discussing the scope of a resolution plan, the Appellate Tribunal noted that –

> It is not a sale. No one is selling or buying the 'Corporate Debtor' through a 'Resolution Plan'. It is resolution of the 'Corporate Debtor' as a going concern. One does not need a 'Resolution Plan' for selling the 'Corporate Debtor'. If it were a sale, one can put it on a trading platform. Whosoever pays the highest price would get it. There is no need for voting or application of mind for approving a 'Resolution Plan', as it will be sold at the highest price. One would not need 'Corporate Insolvency Resolution Process', 'Interim Resolution Professional', 'Resolution Professional', interim finance, calm period, essential services, Committee of Creditors or 'Resolution Applicant' and detailed, regulated process for the purpose of sale. It is possible that under a 'Resolution Plan', certain rights in the 'Corporate Debtor', or assets and liabilities of the 'Corporate Debtor' are exchanged, but that is incidental.[70]

Therefore, sale of the business of the CD on a going concern basis has not been permitted through a resolution plan under the Code, instead resolution has only been permitted on an entity level. However, in recent cases related to real estate companies, this restrictive interpretation of the definition of resolution plan has led to roadblocks in maximisation of value. For instance, in *Flat Buyers Association Winter Hills-77, Gurgaon v. Umang Realtech Pvt. Ltd.,*[71] the NCLAT has allowed project-wise CIRP of the CD. This means that CIRP for each project would be conducted separately. The rationale of the NCLAT was that this would be "*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.*"[72] Accordingly, in such cases of real estate insolvency, resolution plans dealing with only specific projects of the CD would made and not those dealing with the CD as a whole.

Notably, the Code does not contain any provisions or bestow any power (explicitly) on the AAs to allow project-wise CIRPs. The NCLAT has read this power from observations of the Supreme Court in the *Swiss Ribbons*[73] case wherein the Court noted that "*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…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.*"[74]

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[68] Clause 31, Notes on Clauses, Insolvency and Bankruptcy Bill, 2015.
[69] Company Appeal (AT) (Insolvency) No. 82 of 2018, Judgement dated 14th November, 2018 of the NCLAT.
[70] *Id.,* para 17, at 15-16.
[71] Company Appeal (AT) (Insolvency) No. 926 of 2019, NCLAT, Order Dated 4 February 2020. An appeal was filed against this order in the Supreme Court, which was however dismissed.
[72] *Id.,* para 25.
[73] (2019) 4 SCC 17.
[74] *Id.,* para 120.

Thus, interpretation of the definition of resolution plan has largely limited the scope of rescue to instances where the entity is preserved as a going concern after a new management has taken over the entity. This interpretation is arguably narrower than originally intended by the BLRC. Further, the interpretation of 'resolution plan' has not been consistent and plans dealing with only parts or projects of the CD are being considered in real estate insolvency cases. Thus, expansion of the scope of resolution plans is left to discretion of the NCLT which is exercised in an *ad hoc* manner instead of being guided by the rule of law. Accordingly, there is a need for amending the IBC to broaden the scope of resolution plans and allow more flexibility to the CoC to rescue different parts of the CD in different ways. For instance, multiple resolution plans may be called for different business units of the CD if it is likely to bring more value than only allowing one plan that deals with all business units of the debtor. To account for its peculiarities, specific amendments regarding insolvency proceedings of real estate companies may also be considered. Similar recommendations for amending the IBC have also been made by the Standing Committee on Finance.[75]

Notably, the regulations governing CIRP have recently been amended to allow the CoC to call for bids that provide for sale of one or more assets of the CD if resolution plans for the whole entity have not been received.[76] This amendment however falls short of fixing the issues with interpretation of the definition of 'resolution plan' as described above.

The Principle of Clean Slate

The principle of the "clean slate" has long stood as a cornerstone principle underlying the intended ramifications of the IBC. This principle denotes that upon the acceptance of a resolution plan by the CoC and its subsequent approval by the AA, no claim, regardless of satisfaction or dissatisfaction, shall survive. Thus, all claims must be submitted to and decided by the resolution professional so that a prospective resolution applicant knows exactly what must be paid in order, that it may then take over and run the business of the CD on a fresh slate. This principle has also been codified in section 31 of the IBC which provides that once a resolution plan has been approved by the AA, the plan shall be "*binding on the corporate debtor and its employees, members, creditors, including the Central Government, any State Government or any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed, guarantors and other stakeholders involved in the resolution plan.*"

Propounded in the case of *Committee of Creditors of Essar Steel Limited v. Satish Kumar Gupta and Ors.*,[77] the principle of 'clean slate' has also been relied on in subsequent judgments. The Supreme Court of India in *Ghanashyam Mishra & Sons (P) Ltd. v. Edelweiss Asset Reconstruction Co. Ltd.*,[78] held that

> The legislative intent behind this is to freeze all the claims so that the resolution applicant starts on a clean slate and is not flung with any surprise claims. If that is permitted, the very

[75] Standing Committee on Finance, *supra* note 64, at 26-27.
[76] Regulation 36B(6A), Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.
[77] (2020) 8 SCC 531.
[78] (2021) 9 SCC 657.

> calculations on the basis of which the resolution applicant submits its plans would go haywire and the plan would be unworkable.

Similarly, in *Indian Oil Corporation Ltd. v. Arcelor Mittal Nippon Steel India Ltd.,*[79] when an OC petitioned for the appointment of an arbitrator to settle its claim against the CD post approval of a resolution plan for the latter, the High Court dismissed the petition and held that the approval of the resolution plan is statutorily recognized as conferring a closure upon all claims that persons or entities may have had against the CD. The claims or liabilities which could have been enforced against the CD are duly considered in the course of the CIRP with the AA undertaking a detailed exercise with respect to identification of the various creditors of the CD, including the classes thereof, the scrutiny of claims received, and the ultimate apportionment of the amounts deposited by the successful resolution applicant amongst the creditors inter se.

In fact, in a recent ruling of *M/S RPS Infrastructure Limited v. Mukul Kumar & Another,*[80] the Supreme Court took a firm stance by disallowing the admission of claims even before the formal approval of the resolution plan by the AA. The case arose from a dispute between the CD and RPS Infrastructure, leading to arbitration proceedings and a subsequent award in favour of the latter. While an appeal against the award was pending before the Supreme Court, a CIRP was initiated against the CD, culminating in the CoC's approval of a resolution plan pending final approval by the AA. During this interim period, RPS Infrastructure asserted its claim arising from the arbitral award to the resolution professional. However, the resolution professional rejected the claim citing two grounds: first, the claim was submitted 287 days beyond the stipulated 90-day period from the initiation of CIRP, and second, a resolution plan had already been approved by the CoC. RPS Infrastructure contested this decision before the NCLT, which ruled in its favour. However, the decision was overturned by the NCLAT.

Upon appeal, the Supreme Court dismissed RPS Infrastructure's plea, emphasizing that IBC is a time-bound process, with limited scope for extending timelines. The Court emphasized the need for vigilance on the part of appellant regarding the ongoing CIRP against CD. The Court held that allowing claims solely because the AA has not yet approved the resolution plan would potentially prolong the CIRP indefinitely, opening the floodgates for numerous similar claims. Such an approach would disrupt the resolution process and may unleash the hydra-headed monster of undecided claims on the resolution applicant.

This view has also been endorsed by the NCLAT in the case of *Anju Industries v. Supervising Agency of Rishi Ganga Power Corporation Ltd.,*[81] wherein the NCLAT ruled that entertaining fresh claims at a belated stage, particularly when the resolution plan is under consideration by the AA, would not be justified. Such an action would essentially introduce a new dimension to the proceedings, akin to adding another head to the hydra, and could potentially disrupt the resolution process.

However, while the principle of clean slate itself has been firmly reaffirmed by various judicial authorities, some decisions have engendered interpretive challenges, potentially paving the

[79] ARB.P. 102/2022; Order dated 10 October 2023.
[80] Civil Appeal No. 5590 of 2021; order dated 11 September 2023.
[81] 2020 SCC OnLine NCLAT 863.

way for creditors to exploit perceived loopholes. A striking deviation from the norm is illustrated in the case of *Fourth Dimension Solutions Ltd. v. Ricoh India Ltd. & Ors.*[82] wherein the continuity of arbitration proceedings between the CD and the creditor was affirmed by the Supreme Court despite the approval of the resolution plan. The resolution professional had published a list of claims wherein the claims of the creditor were denoted as 'Nil', accompanied by a notation stating: "*The claims attributed to FDSL are under dispute and are currently subject to arbitration proceedings/appellate scrutiny. The liability is contingent upon the outcome of these proceedings*." Subsequently, the approval of the resolution plan for the CD ensued, sans a definitive allocation towards the creditor's claim. Notably, the Hon'ble Supreme Court ultimately decreed that, given the prevailing factual circumstances, the appeal required disposal by reaffirming the aforementioned fact, granting the parties the liberty to pursue all available contentions in the proceedings ongoing at the relevant time, if any. Furthermore, it was emphasized that if arbitration proceedings were pending between the parties, all contentions accessible to both sides would be adjudicated within the said proceedings based on their individual merits, in accordance with the established legal framework. Consequently, the civil appeal was disposed of accordingly. Respectfully, the stance adopted by the court gravely distorts resolution dynamics and unfairly burdens the resolution applicant with future liabilities.

Further, while the principle of the clean slate doctrine is unequivocal in its assertion that the failure to lodge claims during the CIRP leads to the nullification of such claims under a resolution plan, this standard is inconsistently applied in certain instances. In the case of *SEL Manufacturing v. Punjab Small Industries & Export Corporation Ltd.*,[83]despite the government creditor's failure to file a claim during the CIRP, the NCLAT contended that the protective shield provided by the IBC should not be stretched to the point where public authorities are compelled to relinquish their assets without receiving full settlement of their dues or without adhering to the stipulations outlined in sale or lease agreements, or their transfer policies. The 'clean slate principle' was deemed inapplicable to the factual context of the case due to the existence of a prior demand from a public sector land authority, which was also not disclosed during the CIRP proceedings to the insolvency resolution professional or the CoC.

Internationally, jurisdictions also apply the clean slate principle to their restructuring laws, though they vary in their application and scope. In the United States, for instance, confirmation of a plan under Chapter 11 of the US Bankruptcy Code leads to the discharge of pre-bankruptcy debts for the debtor, unless explicitly stated otherwise in the plan or confirmation order. This discharge encompasses all claims, regardless of whether proof of claim has been filed or deemed filed, and whether or not the claim is allowed. Furthermore, the discharge terminates the rights and interests of equity security holders and general partners as delineated in the plan. However, the provision allows for exceptions to be made regarding certain specified debts, subject to the terms of the plan or confirmation order.[84] Even the German Insolvency Code's objective is to "*serve the collective satisfaction of a debtor's creditors by means of liquidation of the debtor's assets and distribution of the proceeds or by reaching an arrangement in an insolvency plan, in particular in order to maintain the enterprise. Honest debtors are given the opportunity to*

[82] Civil Appeal 5908/2021; Order dated 21 January 2022.
[83] Company Appeal (AT) (Insolvency) No. 881/2022; Order dated 20 March 2024.
[84] 11 U.S. Code § 1141 - Effect of confirmation.

achieve discharge of residual debt."[85] The Code accordingly provides for insolvency plans that can restructure debts and may involve the compromise or discharge of pre-insolvency claims. As soon as the order approving the insolvency plan become final, the same becomes binding on all parties to the proceedings and the debtors are discharged of the claims of the insolvency creditors.[86]

In India, courts have largely upheld the clean slate principle in insolvency cases, ensuring the integrity of the IBC. However, certain judicial precedents, as discussed earlier, have weakened this robust principle and created vulnerabilities that could be exploited to challenge decisions aligned with the spirit of the IBC. India, as one of the fastest-growing economies globally, stands to gain significantly from unlocking investments in stressed assets and reallocating them towards more productive uses. The enactment of the IBC aimed to foster investments in the Indian distressed assets market. The law has provided a legal framework, defined processes, and set time limits to maximize value for all stakeholders in distressed asset transactions. While the IBC has undoubtedly facilitated opportunities for investors seeking business expansion through acquisitions, mergers, amalgamations, and demergers at competitive prices,[87] it is imperative to note that such opportunities come with the expectation of acquiring assets free from the past liabilities of erstwhile promoters. However, judicial decisions that undermine the clean slate principle risk undermining the efforts of the law. When investors perceive the possibility of acquiring assets burdened with past liabilities and encumbrances due to legal ambiguities, they may become hesitant to invest. These loopholes created by judicial precedents not only discourage domestic investments but also deter international investors from engaging in the Indian market. Thus, it is crucial to address and rectify such loopholes to maintain investor confidence and promote robust investment inflows into the Indian economy.

Treatment of secured creditors under the IBC

The BLRC recommends that a secured FC's security interest, including the nature, quality, and value of such security, is a fundamental consideration and needs to be given credence to both in the CIRP as well as the liquidation process.[88] One of the principles set out by the BLRC for the design of the Code includes the "*recognition of existing creditor rights and establishment of clear rules for ranking priority of claims*".[89] Further, while emphasizing and encouraging collective participation of stakeholders, the BLRC stressed that the "*core principle*" of payout in liquidation is retaining the order of priorities that existed prior to liquidation.[90] Therefore, the legislative intent gathered from the BLRC report makes it clear that the Code does not intend to override or abrogate the security interest owed to secured creditors and its priority.

The principle governing priority in cases of multiple charges on a property is encapsulated by the Latin maxim "*qui prior est tempore potior est jure*," meaning "he who is earlier in time is

[85] German Insolvency Code, § 1, https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p1130.
[86] German Insolvency Code, § 254, https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p1130.
[87] IBC: *Developing a Market for Distressed Assets*, https://ibbi.gov.in/uploads/resources/b7d255fa23b6d70f3dda575e9ec0dfae.pdf.
[88] Bankruptcy Law Reform Committee dated November 2015, Para. 3.4.2, Principle VII; Para. 6.4.2; Box 6.7, Entry 5.
[89] Bankruptcy Law Reform Committee dated November 2015, para. 3.3.1.
[90] *Id.*, para 5.5.8.

stronger in law." This maxim finds its place in section 48 of the Transfer of Property Act, 1882 (TP Act) and is commonly referred to as the rule of priority. According to this rule, when multiple charges are created on an asset, the claim of the first charge holder takes precedence over those of subsequent charge holders, and the debts of the initial charge holder must be settled in full before those of the subsequent charge holders. Section 48 of the TP Act allows for the general rule of priority based on the timing of charge creation to be altered by a special contract among charge-holders, thereby allowing for the establishment of sub-categories of priority, such as senior and junior charges. In the event of the sale of the asset, senior charges are accorded priority and are settled before subordinate charges. This principle governing the ranking of multiple charge holders is known as the doctrine of priority, which stands as a fundamental principle in secured lending.

The case of *Essar Steel* stands out as a pivotal judgment in this regard, particularly due to the ruling by the NCLAT.[91] In this landmark decision, the NCLAT determined that FCs should not be categorized as 'secured' or 'unsecured' when distributing resolution proceeds under a resolution plan. The NCLAT reasoned that the presence of security interest held no significance during the CIRP and consequently, the CoC could not devise a distribution mechanism considering the value and priority of security interest among secured creditors. Instead, the NCLAT asserted that all creditors of the CD must be treated equally for a resolution plan to be deemed 'fair and equitable'. Accordingly, the NCLAT redistributed the resolution proceeds equally among financial and OCs, disregarding the hierarchy and value of security interest. This ruling faced substantial criticism from the credit industry, prompting the government to swiftly amend the IBC in 2019. These amendments, among other things, empowered the CoC to consider security interest, its value, and priority under section 30(4) when determining the distribution of resolution proceeds. Additionally, the amendments introduced provisions mandating a minimum payment of liquidation value to dissenting FCs of a resolution plan under section 30(2)(b).[92]

The decision of the NCLAT was challenged before the Supreme Court of India and certain stakeholders also challenged provisions of the above-mentioned amendments. The Apex Court in the case of *Essar Steel* reaffirmed the traditional rights of secured creditors under the Code and clarified the legal principles applicable to security interest under the law. The Court recognized age-long norms regarding the rights and standing of secured creditors and upheld the distribution mechanism amongst secured creditors that respected the priority and value of their security.

However, despite the unequivocal verdict in *Essar Steel*, numerous judicial rulings under the IBC have diluted the rights of secure creditors in insolvency proceedings in a manner contravening the well-established doctrine of security interest priority. In *India Resurgence ARC Private Limited v. M/S Amit Metaliks Limited*[93] (*India Resurgence*), the Supreme Court, among other findings, determined that it would be appropriate for the CoC to exercise its commercial discretion in ensuring payment to all secured creditors in proportion to their admitted claims, irrespective of the value of their security. The Court emphasized the discretionary nature

[91] Standard Chartered Bank v. Satish Kumar Gupta, 2019 SCC OnLine NCLAT 388.
[92] Insolvency and Bankruptcy (Amendment) Act, 2019.
[93] 2021 SCC online SC 409.

indicated by the use of 'may' instead of 'shall' in section 30(4), implying that these provisions were intended merely as guidelines for the CoC when deliberating on the distribution modalities under a resolution plan. Consequently, the order of priority amongst creditors under section 53(1) of the IBC including the consideration of priority and value of a secured creditor's security interest was not deemed obligatory.

Unfortunately, the *India Resurgence* ruling has been invoked in various cases to rationalize the disbursement of resolution proceeds without regard for the inter-se priority among secured creditors and their security arrangements.[94] Additionally, it has been cited to assert that determining the payment amounts to different classes of creditors falls within the commercial discretion of the CoC and consequently, dissenting secured creditors are precluded from demanding higher payments based on the value of their held security interest.[95]

This disregard for the value and precedence of security interest held by creditors has also been similarly applied to cases of liquidation by the NCLAT. In *Technology Development Board v. Mr. Anil Goel & Ors.*[96] (*TDB*), the NCLAT was tasked with determining whether the inter-se priority among secured creditors would persist once a secured creditor has waived its security interest in accordance with section 52. The NCLAT concluded that secured creditors who relinquish their security interest will be remunerated under section 53(1)(b) regardless of the extent of their charge and noted that "once a secured creditor opts to relinquish its security interest, the distribution of assets would be governed by the provision engrafted in Section 53(1)(b)(ii) whereunder all secured creditors having relinquished security interest rank equally and in the waterfall mechanism are second only to the insolvency resolution process costs and the liquidation costs."

An appeal against the NCLAT's order has been filed in the Supreme Court of India, resulting in a current stay on the judgment.[97] Despite this halt, the NCLAT has maintained a similar stance in subsequent cases. In *Oriental Bank of Commerce v. Anil Anchalia, Liquidator of M/s. Bala Techno Industries Ltd.,*[98] the NCLAT ruled that a secured FC forfeiting its security interest cannot claim precedence over other creditors during the distribution of proceeds in liquidation. Consequently, once a creditor surrenders its security, it stands to receive payment proportionately alongside other secured creditors, disregarding the hierarchy of charges. This decision of the NCLAT is also under appeal before the Supreme Court of India.[99]

To address the concerning interpretations stemming from these judgments, the Insolvency Law Committee (ILC) has issued multiple clarifications in its reports of March 2018 and February 2020. These clarifications emphasized the imperative of honouring inter-creditor

[94] Small Industries Development Bank of India v. Vivek Raheja, RP, M/s. Gupta Exim (India) Pvt. Ltd Company Appeal (AT)(Insolvency) No. 570 of 2022; ICICI Bank Ltd. v. BKM Industries Ltd. and Anr. Company Appeal (AT) (Insolvency) No. 405 of 2023, Decided on 06-Nov-23; Canara Bank v. Sri. Nitin Vishwanath Panchal RP- I.A. No.520/2021 with I.A. No.663/2021 in CP(IB) No.384/7/HDB/2018; Decided on 13 March 2023.

[95] Union Bank of India v. Mr. Rajender Kumar Jain, RP of M/s Kudos Chemie Ltd. & Ors.; Comp. App. (AT) (Ins.) No. 665 of 2022); Paridhi Finvest Pvt. Ltd. v. Value Infracon Buyers Association and Anr. - Company Appeal (AT) (Insolvency) No. 654 of 2022; Decided on 09-Feb-24.

[96] [2021] NCLAT, Company Appeal (AT) Insolvency No. 731 of 2020.

[97] Kotak Mahindra Bank Limited v. Technology Development Board & Ors. [Civil Appeal Diary No(s). 11060/2021].

[98] NCLAT, CA (AT) 547/2022.

[99] Oriental Bank of Commerce v. Anil Anchalia and Anr. Civil Appeal No. 4664/ 2022.

and subordination agreements when distributing proceeds to secured creditors under section 53(1) of the IBC. Subsequently, the IBBI Colloquium Report echoed this sentiment, expressly recommending the insertion of an explanation in section 53(2) to affirm the continued applicability of valid inter-creditor/subordination agreements during liquidation. This proactive step serves to establish the legislative intent of the statute, even in instances where courts overlook such fundamental aspects. Notably, the statement of objects and reasons of the Insolvency and Bankruptcy Code (Amendment) Bill, 2019[100] also mentions that amendments to section 30 were necessary on account on critical gaps in the IBC highlighted by various stakeholders that suggested that equal treatment of creditors with different pre-insolvency entitlements would adversely affect the cost and availability of credit.

The doctrine of priority extends beyond national borders and is universally recognized as a fundamental principle governing security interest. It is well established that an effective insolvency regime should uphold creditor rights established prior to insolvency proceedings, ensuring their precedence throughout the process. This commitment to priority fosters certainty, transparency, and predictability in commercial relationships[101] which in turn reduces the risk premiums associated with extending credit. Such stability is vital for facilitating economic development and growth.[102] Prominent international practices suggest that rights of secured creditors are respected within insolvency proceedings and to the extent that different creditors have struck fundamentally different commercial bargains with the debtor (e.g., through the granting of security), differential treatment of creditors that are not similarly situated may be necessary as a matter of equity.[103]

Accordingly, modern insolvency laws commonly recognize the rights of secured creditors prior to insolvency when borrowers undergo reorganization or liquidation. For instance, in the United States, section 510(a) of Chapter XI of the US Code, which governs bankruptcy, affirms the validity of subordination agreements during bankruptcy proceedings. This provision applies to both reorganization and liquidation proceedings under the US Code. Section 510(a) states that "a subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable non-bankruptcy law." Subordination agreements typically involve the prioritization of payouts and the ability to enforce collateral, and these provisions have been largely upheld by American bankruptcy courts.

Without a corrective action, the dilution of the rule of priority under the Code could result in adverse economic consequences across numerous cases. This scenario would allow a creditor secured by a weak or subordinate security to receive benefits equal to those of a creditor with a strong and valuable security and exclusive rights. In the short term, this dilution of the rule of priority has already caused chaos and unpredictability in the outcomes of CIRP and liquidations under the Code. In the long term, the flawed interpretation of the Code, disregarding the rule of priority, will blur the meaningful distinction between security held by lenders. This would, in turn, deter lenders from financing long-term infrastructure projects.

[100] https://ibbi.gov.in//uploads/legalframwork/630af836c9fbbed047c42dbdfd2aca13.pdf .
[101] World Bank, *Principles for Effective Insolvency and Creditor/Debtor Rights* (2015), https://www.insolindia.com/uploads_insol/resources/files/the-world-bank-principles-for-effective-insolvency-and-creditordebtor-regime-1024.pdf.
[102] UNCITRAL, s*upra* note 30.
[103] International Monetary Fund's Report on Orderly & Effective Insolvency Procedures.

Acknowledging the pre-existing entitlements of secured creditors is essential for maintaining an equitable balance among all stakeholders. Without recognition of the inter-se priority of creditors and the value of security interest, lenders will adopt conservative approaches and undervalue security interest in their commercial decisions. Consequently, the availability and cost of credit in the market will be affected, potentially causing a ripple effect across the economy. Precedents following the *India Resurgence* judgment contravene internationally established legal principles regarding the rights and treatment of secured creditors in insolvency proceedings. This undermines the foundational principles upon which the credit industry operates and could have a detrimental impact on the overall financial stability of the economy.

The ongoing debate surrounding the inter-se rights of secured creditors has been complemented by a significant legal battle over the precedence of crown dues versus dues of secured FCs, catalysed by the Supreme Court's landmark judgment in *State Tax Officer v. Rainbow Papers Limited*[104] (*Rainbow Papers*). The report of the BLRC highlights a pivotal distinction between the IBC and its predecessors. Specifically, the IBC strategically prioritizes government dues below those of secured and unsecured FCs in the hierarchy of claims during liquidation proceedings. This deliberate prioritization aligns with the overarching objectives of the IBC, aimed at fostering entrepreneurship and bolstering credit availability.[105] However, the *Rainbow Papers* judgment is perceived as a notable departure from this policy stance. In this case, the Supreme Court ruled that tax authorities or statutory creditors would be regarded as secured creditors, even in instances where security interest is established by operation of statute. Moreover, it asserted that a resolution plan neglecting statutory demands payable to any State Government or legal authority would inevitably face rejection. Additionally, the CoC, inclusive of FCs, could not prioritize their own dues at the expense of statutory dues owed to the government or any government authority.

This judgment garnered widespread criticism not only for contradicting the policy objectives of the statute but also for being in direct conflict with the definitions of 'security interest' and 'transaction' provided within the IBC. In essence, the IBC stipulates that a security interest must be "created in favour of, or provided for a secured creditor by a transaction".[106] This transaction should involve a written agreement or arrangement for the transfer of assets, funds, goods, or services involving the CD.[107] Consequently, a creditor can be classified as a 'secured creditor' only when both parties have expressly documented their intention to create 'security interest' in favour of such creditor. Clearly, security interest formed through operation of law falls outside the scope of these definitions, and any interpretation to the contrary would have far-reaching effects on the balance of rights and interests of secured creditors, OCs, and even the Central and State Governments.

While the Supreme Court, in a particular instance, declined to consider the precedent of *Rainbow Papers* citing the failure of the judgments to acknowledge the 'waterfall mechanism'

[104] (2023) 9 SCC 545.
[105] Bankruptcy Law Reform Committee dated November 2015.
[106] Insolvency and Bankruptcy Code 2016, § 3(31).
[107] Insolvency and Bankruptcy Code, 2016, § 3(33).

outlined in the IBC,[108] the NCLT in one instance has nonetheless applied the ratio of *Rainbow Papers* which resulted in the classification of the State Tax Department as a secured FCs, citing the existence of a charge or encumbrance on the property of the CD in accordance with the *Rainbow Papers* judgment.[109] However, such interpretation runs counter to the legislative intent, as evident from the preamble to the IBC itself, which highlights that the reordering of the priority of government dues payment was a deliberate legislative policy. Consequently, government dues are intended to be afforded a lower priority than secured dues under section 53 of the IBC.

The challenge with judgments that diverge from established legal norms lies in their inconsistent application across various benches of the NCLT. This inconsistency results in numerous appeals and delays in the resolution process. Rectifying these legal developments through judicial precedents can be a time-consuming process. Meanwhile, the adverse effects of these precedents can reverberate throughout banks, financial institutions, and the broader Indian economy. To pre-empt any detrimental repercussions on the debt market and the economy, the MCA should contemplate proposing urgent amendments to the Code. These amendments would serve to clarify the law, ensuring its effective implementation and alignment with its objectives. By explicitly incorporating the doctrine of priority and providing clarity regarding the treatment of sovereign dues under the Code, these clarifications would mitigate prolonged litigation and foster necessary legal clarity.

Withdrawal of CIRP applications under section 12A

Many contemporary socio-economic laws enacted by legislative bodies delineate overarching principles and policy directives. Due to constraints imposed by time considerations, legislatures often refrain from delving into intricate details. Hence, delegated legislation is established to afford flexibility, adaptability, efficiency, and room for experimentation. Hence, the practice of empowering the executive to enact subordinate legislation within defined parameters has evolved as a pragmatic necessity to meet the demands of modern welfare states.[110]

Most statutes in India provide for the delegation of authority to create rules, regulations, bye-laws, or other statutory instruments, which are implemented by designated subordinate bodies. This form of legislation, termed delegated or subordinate legislation, operates within the parameters set by the legislature's delegated powers. It is well-established that subordinate legislation is supplementary to the statute itself; thus, any rules, regulations, or bye-laws must operate within the legal framework established by the delegation. Subordinate legislation must also remain consistent with the law under which it was authorized and must not exceed the policy and standards outlined within the law. Moreover, if the legislative policy is clearly defined or a standard is set, judicial intervention should be restrained, recognizing that the legislature holds the discretion to determine the extent of delegation required in a specific context.[111]

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[108] Paschimanchal Vidyut Vitran Nigam Ltd. v. Raman Ispat Private Limited & Ors Civil Appeal No. 7976 of 2019, Judgment dated 17 July 2023.

[109] Parag Sheth (Liquidator of Sai Infosystem (India) Limited v. The Collector (Ahmedabad) & Ors. (IA No. 157/AHM/2022 In CP(IB) 164/AHM/2017); order dated 9 November 2022.

[110] Gwalior Rayon Mills Mfg. (Wing.) Co. Ltd. v. Asst. Commissioner of Sales Tax and Others, All India Reporter 1974 SC 1660 (1667).

[111] Rojer Mathew v. South Indian Bank Ltd. and Ors.; 2019 INSC 1236.

The IBC employs the terms 'prescribed' and 'specified' to authorize the making of subordinate legislation. According to section 3(26) of the IBC, 'prescribed' means prescribes by rules established by the Central Government. Conversely, under section 3(32), 'specified' refers to delineations outlined by regulations established by the Board, with the term 'specify' construed accordingly. Notably, certain provisions within the IBC explicitly grant authority to the Central Government, stating, for instance, "the Central Government may, by notification, specify..." This signifies that the power to enact subordinate legislation resides expressly with the Central Government.

The IBBI's authority to create regulations is further explained in section 240 of the IBC. Section 240(1) grants the IBBI broad regulatory discretion, allowing it to make regulations that must meet two essential criteria: the regulations must be consistent with the IBC and its subordinate rules, and the regulations should carry out the provisions of the Code. This provision provides the IBBI with the flexibility to ensure regulatory coherence while adhering strictly to framework of the IBC. Section 240(2) further elaborates on the IBBI's regulatory domain specifying the matters for which IBBI may make regulations.

Section 12A of the IBC allows for the withdrawal of an application admitted under sections 7, 9, or 10 of the IBC, subject to the approval of a 90% voting share of the CoC, in such manner *as specified*. Thus, when interpreted alongside the definition in section 3(32) of the IBC and section 240(1), it distinctly conveys two key points: (i) CIRP applications once admitted, can only be withdrawn with the approval of a 90% voting share of the CoC, and (ii) the authority to enact subordinate legislation under section 12A rests with the IBBI and such legislation cannot exceed the legislative scope of the IBC and the ruled made thereunder.

However, in blatant disregard of this legislative intent, Regulation 30A of the IBBI (Insolvency Resolution Process of Corporate Persons) Regulations, 2016 (CIRP Regulations) outlines the procedure for withdrawal of applications under section 12A without the requisite CoC approval as provided under section 12A of the IBC. Notably, Regulation 30A (1) commences with the phrase "*an application for withdrawal under Section 12A may be made to the Adjudicating Authority*," unmistakably suggesting that the regulation itself exceeds the scope of the law as no provision within the IBC grants the IBBI the authority to enact subordinate legislation pertaining to withdrawals under section 12A *de hors* the approval of 90% voting share of the CoC.

However, despite such assertive exertions of authority, courts have consistently permitted withdrawals prior to the establishment of the CoC. Remarkably, courts have sanctioned withdrawals under the premise that Regulation 30A furnishes a comprehensive framework for entertaining withdrawal applications before the formation of the CoC, and in the absence of a CoC, there exists no obligation to hear other parties[112] or seek the consent of the CoC, as mandated by section 12A of the IBC.[113] The Supreme Court has also affirmed that the statement of objects and reasons of the IBC, in conjunction with Rule 11 of the National Company Law Tribunal Rules, 2016 (NCLT Rules), empowers the NCLT to issue orders in the interest of justice, including orders allowing an applicant to withdraw its application and facilitating

[112] Abhishek Singh v. Huhtamaki PPL Ltd. & Anr, SLP (Civil) No. 6452 of 2021, Order dated 28 March 2023.

[113] Asif Abdullah Dalwai v. Arun Bagaria, IRP of Windals Auto Pvt. Ltd. & Anr; Comp. App. (AT) (Ins.) No. 958 of 2021, order dated 11 January 2022, Punjab National Bank Vs. Mr. Harshad S Deshpande, RP;I.A. 1990 of 2021 & I.A. 2440 of 2021 in C.P. (IB) 2390/MB/2019 , Order dated 1 December 2021.

unimpeded business operations for a corporate entity. [114] Moreover, the exercise of inherent powers has been expanded to conclude that Regulation 30A is designed to give effect to the provisions of the IBC and must be interpreted in harmony with the IBC's provisions. Consequently, the provisions of Regulation 30A must be enforced unless they contravene any provisions of the IBC.[115]

Such judicial precedents are inconsistent with the spirit of the law. The legislative intent behind permitting withdrawals only upon securing the approval of 90% of the CoC by voting share, is encapsulated in the BLRC Report. The report emphasizes that the structure of the IBC ensures that "*all key stakeholders will participate to collectively assess viability.*"[116] The law must guarantee that all creditors capable and willing to restructure their liabilities are part of the negotiation process, and the liabilities of creditors not involved in the negotiation process must also be addressed in any negotiated solution.[117] Consequently, once CIRP commences, it becomes a collective endeavour involving all creditors of the debtor, thereby discouraging individual actions for settlement enforcement to the detriment of the broader interests of all creditors.

Thus, the consequence of section 12A is significant and impacts all stakeholders of the CD. An approval of 90% of the CoC by voting share is essential for this decision, which also helps mitigate future concerns of fraudulent preference. The ILC in its March 2018 report, also elucidates the legislative intent of section 12A and recommends amending Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 (CIRP Rules) to allow withdrawal post-admission only if approved by the CoC with a 90% voting share. It explicitly recommends that Rule 11 of the NCLT Rules should not be applied in this context during the early stages of the CIRP. The legislature's intent regarding the application of Rule 11 of the NCLT Rules to procedures under the IBC can also be gathered on a reading of Rules 10(1)) of the CIRP Rules. Rule 10(1) of the CIRP Rules selectively applies certain NCLT rules to the IBC but conspicuously omits Rule 11. Consequently, these judicial precedents directly allow transgression of the collective nature of a CIRP by permitting individual settlements with the CD.

It is firmly established that inherent powers cannot bypass the mandatory provisions of a law.[118] The inherent powers of the court cannot be exercised when there exists an express provision of law applicable to the case.[119] These powers are intended for exceptional circumstances and are not meant to allow courts to disregard procedural laws or to absolve parties from the consequences of their own errors, nor can they be employed to enable evasion of laws specifically prescribing deadlines for certain actions in support of a case. Consequently, the inherent powers of the court cannot be invoked to circumvent the provisions of law.[120] There are numerous instances under the IBC where courts have declined to exercise

[114] Ashok G. Rajani v. Beacon Trusteeship Ltd. & Ors; Civil Appeal No. 4911 of 2021; Decided on 22 September 2022.
[115] Sintex Plastics Technology Ltd. v. Mahatva Plastic Products and Building Materials Pvt. Ltd. and Ors.; Company Appeal (AT) (Ins.) No. 729 & 730 of 2022; Decided on 3 January 2023.
[116] Bankruptcy Law Reform Committee dated November 2015, para 3.4.2.
[117] *Id.*
[118] Manilal Mohanlal Shah and Ors. v. Sardar Sayed Ahmed Sayed Mahamad and Ors. AIR2010SC53.
[119] GLAS Trust Company LLC v. BYJU Raveendran & Ors. (2024 SCC OnLine SC 3032)
[120] Mcdowell and Company Ltd. v. Wine Link L-1 Licensee, O.M.P. No. 138 in Civil Suit No. 2 of 2003; Decided on 29 October 2004.

their inherent powers when the statute contains explicit provisions either permitting or prohibiting certain actions.[121]

As illustrated in the aforementioned cases, the utilization of such broad discretionary powers increases instances of judicial interference in situations where it may not be warranted, thereby exacerbating delays and fuelling further litigation. This stands in stark contrast to the overarching scheme of the IBC, which envisions a circumscribed role for the AA and specifies circumstances in which the intervention of the AA would be permissible. The IBC aims to streamline insolvency proceedings by establishing clear guidelines and limiting judicial intervention to circumstances deemed essential for the fair and efficient resolution of insolvency cases. However, the expansive interpretation and application of discretionary powers by the courts risk deviating from this intended framework, potentially hindering the expeditious resolution of insolvency matters and undermining the objectives of the IBC.

CONCLUSION

In the realm of insolvency law, comprehensiveness is paramount to effectively address the multifaceted challenges that arise when individuals or entities face financial distress. By facilitating the turnaround of viable businesses, the law can preserve jobs, promote economic stability, and maximise the assets for creditors. While the law should be comprehensive to address a wide range of circumstances judicial innovation should be applied judiciously and limited to scarce circumstances. Courts may play a crucial role in interpreting and applying insolvency law, resolving disputes, and adapting legal principles to new challenges. However excessive judicial innovation can lead to uncertainty and inconsistencies, undermining the effectiveness of the insolvency regime.

Over the last 8 years, the judiciary has played a significant role in the fortification of the IBC. Notably, its intervention has been instrumental in addressing critical challenges due to legislative void. For instance, the collapse of Infrastructure Leasing and Financial Service, a systemically important financial entity demonstrated the judiciary's nimbleness by crafting an ad-hoc framework and respond adeptly to urgent situations. The insolvency resolution of *Jet Airways*[122] illustrated the first instance on cross-border cooperation highlighting the judiciary's role in facilitating effective coordination with conflicting international proceedings. Moreover, the NCLT's adept utilisation of precedents from the United States and United Kingdon to tackle intricate issues like group indebtedness has not only proven effective in the case of *Videocon Industries*[123] but also for numerous other subsequent group companies under the IBC.

However, despite the initiation of these cases years ago, little progress has been made to address the legislative gaps. India has yet to enact a comprehensive law encompassing a complete framework for the insolvency resolution of financial firms critical to economic stability. Moreover, in an era where the global economy is shaped by digital transformation and intricate corporate structures proliferate multiple jurisdictions thereby facilitating borderless businesses

[121] Sarda Mines Pvt. Ltd. v. Shailendra Ajmera Liquidator of Kwality Ltd.; I.A. 5208/2021 in Company Petition No. (IB)-1440 (ND)/2018, Order dated 22 May 2022.
[122] Jet Airways (India) Ltd v. State Bank of India (Company Appeal (AT)(Insolvency) No. 707 of 2019).
[123] State Bank of India v. Videocon Industries Limited (MA 1306/ 2018 in CP No. 02/2018).

transactions, India still lacks legislations on cross-border insolvency and group insolvency. These deficiencies compel the judiciary to resort to ad-hoc frameworks.

Expeditious legislative action in response to erroneous judicial interpretations stemming from gaps in the law is not unprecedented. A notable instance occurred with the amendments to Section 30 of the IBC vide the Insolvency and Bankruptcy (Amendment) Act, 2019 on August 6, 2019. This ensued promptly, a mere 32 days after the NCLAT judgment on July 4, 2019 which posited that security interest was inconsequential during CIRP and proscribed the CoC from considering their value and inter-se priority while deciding the distribution scheme under a resolution plan. The amendment aimed to elucidate that such considerations were indeed germane for the CoC when effectuating distributions under a resolution plan and upheld the exercise of commercial wisdom of the CoC to decide the distribution of resolution proceeds. Thus, the path to instilling predictability in the law necessitates the complementing of judicial innovations and interpretations with suitable legislative amendments. There is pressing need for further amendments to follow a principle- based approach guided by the rule of law. Such an approach will be outcome oriented and quickly adapt to changes.

02

ASSESSING THE BORROWER-LEVEL IMPACT OF THE INSOLVENCY AND BANKRUPTCY CODE: A STUDY OF THE FRESH START PROCESS

Natasha Agnes D'cruze, Dwijaraj Bhattacharya, Shree Harini V and Indradeep Ghosh

ABSTRACT

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) is a landmark legislation with the potential to impact every borrower. This paper focuses on Part III of the IBC, which deals with natural persons, proprietorships, and personal guarantors for corporate debt. Through the paper, the authors attempt to estimate the potential consequences of the Fresh Start Process (FSP) defined under this Part. The IBC lays out economic criteria that can qualify (or disqualify) an applicant for FSP. Under FSP, a borrower must be asset-light, have a low income, and hold minimal outstanding debt to qualify. These thresholds determine the applicability of the process once the IBC is fully notified. Thus, empirical estimates regarding the effects of the provisions on the Indian credit market are crucial to deciphering the impact of the IBC, more specifically, the FSP.

We start by comparing the contemplated processes and outcomes of IBC with other similar legislations, like the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (2002), Provincial Insolvency Act (1920), and Presidency Town's Insolvency Acts (1909). The authors then proceed to estimate how many borrowers are likely to qualify under the FSP. They use the Centre for Monitoring Indian Economy's (CMIE) Consumer Pyramids Household Survey (CPHS) conjoined (using a nearest neighbour model and the Hungarian Algorithm) with the All-India Debts and Investments Survey (AIDIS) for 2019 to estimate how many households qualify under FSP. They perform the analysis for the entire country, except a few states and union territories with relatively sparse population.

Thus, the research is intended as a methodological contribution through which the impact of the IBC across borrower groups can be measured.

INTRODUCTION

The Code was introduced in an environment where formal sector lenders, especially banks, struggled with low asset quality. The IBC was intended "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".[1] It has been almost 8 years, but not all stakeholders are still covered. Currently, the act is operational (i.e., notified by the government) for corporate debtors (CDs) and individuals (natural persons) who are guarantors of corporate debtors. Most natural persons, including non-limited liability entities like partnerships, proprietorships, etc., are still outside the scope of the remedies proposed by the IBC, since Part III of the IBC, which deals with such debtors, is not notified in its entirety.

Though there is no official declaration regarding why some sections of the code are not notified, it is possible to conjecture that they have to do with the rather complex issue of natural persons. In the case of Part III of the IBC, a human subject in distress becomes a key consideration. Policymakers must, therefore, contend not only with how Part III will impact credit markets but also with the ethical question of whether a natural person deserves relief in some form and, if so, why. The three processes outlined in the Code provide us a glimpse into the minds of the policymakers, especially highlighting how they envision answering this ethical question.

The three processes under which a natural person (or her creditor) may seek shelter are: a) The Insolvency Resolution Process (IRP), b) The Bankruptcy Process, and c) The Fresh Start Process (FSP). The first two processes form part of a continuum, whereby any debtor (or their creditor) can file for an IRP and apply for bankruptcy if such an IRP fails. The third process, FSP, is unique. It is targeted towards low-income borrowers who are asset-light and have minimal outstanding debt, i.e., the most vulnerable borrowers. For such qualifying[2] individuals, the FSP proposes a scenario where their debts can be wiped clean, i.e., "discharged". In this paper, the authors situate the FSP in the historical arc of insolvency and bankruptcy regimes and processes, and then present a methodology (and insights therefrom) through which the impact of the FSP can be measured at a borrower level.

SITUATING THE FRESH START PROCESS IN A HISTORICAL CONTEXT

For as long as credit has existed, there have been borrowers unable to repay their monetary debts, and an attempt to recover the debts has always led to acrimony. In classical antiquity, creditors could repossess the debtor's person, i.e., debt slavery was common, and the practice was rooted in customs rather than formal laws (Levinthal, 1918). Between the 1st and 16th century AD, a second phase of insolvency practices developed; debt slavery received formal legal sanction, but certain sections of the society (members of higher political standing) were granted immunity from such a punishment. With the dawn of enlightenment, rational-legal principles began to take centre stage, and by the mid-16th century, formal law offered some protection to the debtor in default but also empowered the state (more precisely, its embodiment, the crown) to impose the death penalty (Carlos, 2019; Bhattacharya & Ghosh, 2022)

Across these three phases, the purpose of the law (or the custom) was to enable the creditor to reclaim their debt. Further, another common feature unites these three phases - the lenders and borrowers were mostly singular entities[3] and natural persons. However, there

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[1] Per the long title of the IBC, 2016

[2] Specific qualification criteria are discussed in the next section.

[3] one person would be lending to another rather than a consortium of persons lending to one or more people

were exceptions to this rule, i.e., some institutions did lend and borrow. After the 10th century, institutions like the church and the crown(s) often received or disbursed credit. The terms of such credit were, however, governed by bilateral agreements between the lender and the borrower rather than a codified national-level law. Starting from the turn of the 19th century, the modern era marks a significant departure from the earlier phases. Natural persons no longer occupy centre stage, neither as creditors[4] nor as borrowers.[5] With the invention of "companies", and with such companies receiving the lion's share of credit (earlier for trade and manufacturing, and later for services), they emerge as the key focus for insolvency and bankruptcy regimes (Bhattacharya & Ghosh, 2022).

Axiomatically, we know that corporations are different from natural persons. The former can be carved into pieces and liquidated. The latter, on the other hand, have inalienable rights. Therefore, modern-day insolvency and bankruptcy regimes have attempted to move beyond the express purpose of enabling creditors to reclaim their debt. Now, they aim to balance the rights of the debtors against the creditors. In India, the Presidency Towns Insolvency Act (1909) and the Provincial Insolvency Act (1920) attempted to do this before Part III of the IBC sought to replace them with new provisions. However, those earlier acts remain in force since the majority of Part III of the IBC is yet to be notified.[6]

Apart from procedural aspects – such as the identification of the forum having jurisdiction over the subject, the presence of a moratorium, the time-bound nature of the processes, the need for an insolvency resolution professional, etc., – the key difference between the British-era statutes and the IBC is the FSP. It is a low-cost quasi-bankruptcy process applicable for low-income, asset-light debtors holding minimal debt. It allows for a complete discharge of their debt provided they satisfy specific economic and procedural criteria. Thus, the FSP process mimics the gate-kept bankruptcy process whereby the debtor may get a complete discharge from their obligations (Bhattacharya & Ananth, 2021).

In the present form, an individual (debtor) applying for FSP under the IBC must satisfy four economic criteria, as specified in sections 80(2)(a) 80(2)(c) and 80(2)(e) of the IBC. These include the income criterion (the debtor must have annual income not exceeding ₹60,000), the asset criterion (the aggregate value of the debtor's assets ought not to exceed ₹20,000), the debt criterion (the eligible debt owed by the individual must not exceed ₹35,000) and an extension of the asset criterion, whereunder for a debtor to be eligible, they must not own a "dwelling unit". Further, the IBC specifies that these criteria should be jointly applied, meaning that a debtor would qualify for the FSP if they satisfied all four (IBC, 2016).

The criteria, however, leave significant scope for interpretation in their definitions. For instance, it is unclear which income streams would be considered income under the income criterion. For an individual operating a proprietorship, all revenues from the business venture are essentially personal income and that aggregate number is very likely to exceed the ceiling, thus making most ineligible for the remedy. Furthermore, it is unclear whether

[4] replaced by banks, and banking institutions

[5] replaced by corporates

[6] since section (243) of the IBC which repeals the Presidency Towns Insolvency Act (1909) and the Provincial Insolvency Act (1920) has not been notified, these laws remain in-force.

direct benefits transfers by the government will be considered income. If they are, that would even further reduce the eligible debtor numbers. The asset criterion and its extension present several dilemmas also. How do we ascertain the value of household goods? Who should be considered the owner if the asset is a common asset? Regarding the ownership of a dwelling, how should structures that are not wholly residential but used for residential purposes be treated (e.g. a hut on agricultural land used as the residence and storage unit for grains)?

Thus, estimating the impact of the IBC, especially the FSP, using an as is interpretation of Part III must be accompanied by a set of assumptions that seek to resolve interpretive concerns such as the ones identified in the previous paragraph. The following section discusses these assumptions and the data sources (and their transformations) in detail.

DATA SOURCES AND METHODS

In India, no pan-national official data source simultaneously captures an individual's income, the assets owned by them and their debts. These data reside in fragmented silos. For income, the official data resides within the income tax department. However, with only 7.4 crore people filing income tax returns in 2022-23 and given the widespread informal economy in the country, the data is neither comprehensive nor adequately representative. For data on debt owed by the individual, the hurdles are similar. Credit Information Companies (CICs) capture the cumulative credit outstanding for individuals and businesses, but the data only represents formal credit, thus reducing representativeness and comprehensiveness. Most importantly, however, neither of the above data sources is public. Finally, capturing the asset ownership of an individual through any consolidated database is virtually impossible. So, official data sources are of little help, and reliance must be placed on nationally representative surveys for estimation efforts.

Currently, two such surveys exist – the All-India Debt and Investment Survey (AIDIS), conducted by the National Sample Survey Organisation (NSSO) and the Consumer Pyramids Household Surveys (CPHS), conducted by the Centre for Monitoring Indian Economy (CMIE). Both surveys have their limitations.

AIDIS is a sample survey that captures quantitative information on assets and liabilities but not income. Further, most of the relevant data for our analysis is captured at a household level and not at the individual level, which ought to be the unit of analysis given the construct of the FSP. The CPHS, on the other hand, provides complementary details, like the quantum of income and ownership of debt, at an individual level. And also, across most asset segments such as household durables, jewellery, vehicles, etc., the CPHS data only indicates whether a particular asset type is owned or not, and not its value (if owned). Thus, from CPHS, we may only learn that a household has jewellery, but not how much it is worth. The qualification criteria for FSP, however, are based on values.

Thus, neither the CPHS dataset nor the AIDIS dataset can be used in isolation to estimate the number of borrowers the FSP will cover. However, together, both datasets complement each other. The CPHS dataset presents select insights at an individual level and captures income. In contrast, the AIDIS dataset captures granular details on asset ownership and debt owed, though at a household level. Thus, a combined analysis of both datasets is critical, necessitating us to adopt an approach to match households from one dataset to another.

Matching the datasets

Matching observations between datasets is a common yet intricate challenge, especially when dealing with sample surveys representing the same universe. This task becomes particularly complex since the AIDIS (for the year 2019) and CPHS (for the year 2019) datasets have a multitude of variables, both categorical and continuous. These variables must be taken into account simultaneously for any accurate matching. This objective can, therefore, be recast as a classification problem. To elucidate, let us consider there are three households, "a_1", "a_2", and "a_3" from the AIDIS dataset and "c_1", "c_2" and "c_3" from the CPHS dataset. Further, let us consider there are three variables common between the two datasets, "V_1", "V_2", and "V_3". The values of each variable for the different households are given below in Tables 1 (A) and 1(B).

Table 1(A): Snippet from AIDIS dataset

Household	V_1	V_2	V_3
a_1	Male	7	15000
a_2	Male	5	30000
a_3	Female	6	45000

Table 1(B): Snippet from CPHS dataset

Household	V_1	V_2	V_3
c_1	Male	7	15000
c_2	Female	12	150000
c_3	Female	6	48000

Datasets like the AIDIS and CPHS often contain variables like the gender of the head of the household, the number of members in the family and the income (at a given frequency). Thus, we can assume V_1, V_2, and V_3 represent these categories. With the presented information, it would appear that households a_1 and c_1 are identical since any and all given variables have identical values. Conversely, households a_2 and c_2 are very different. In the case of a_3 and c_3, however, concluding whether the households are identical (or different) is an arduous task, especially when we consider that data may have been collected at different points in time. Thus, statistical models must be used to systematically calculate similarities between two households using their properties (i.e., variables). One of the most popular methods for solving such classification problems is the *k*-nearest-neighbour (KNN) method (Cover & Hart, 1967).

The KNN method is often used for classification and regression tasks (Fix & Hodges Jr, 1951). Its flexibility and simplicity make it a valuable tool in data-matching exercises. The method operates on the premise that similar instances in the feature (i.e., variable) space tend to share similar labels (Song et al., 2017). In the context of our exercise, it means that households with similar characteristics, such as – the number of members, location, social group, expenditure, etc., are likely to be the same, i.e., they reflect identical characteristics. Thus, the KNN method essentially establishes similarities (Mehta et al., 2018), which can then be inferred to mean that household "a" from AIDIS is identical to household "c" from CPHS.

Before proceeding further, it is important to understand the KNN method's three key aspects. First, how is the distance between the neighbours calculated? Second, how is the value of "K" assigned? Third, how is the assignment decision made (decision rule)?

Table 2: Variables selected for identifying similar households

Variable Description	Variable Type
Region (Urban/Rural)	Categorical
District	Categorical
Social Group	Categorical
Religion	Categorical
Age Groups	Categorical
Gender Groups	Categorical
Household Size Groups	Categorical
Household Expenditure	Continuous
#Similar HHs in the Country	Continuous

Source: Authors' Calculations

On the choice of distance measure, we note first that we are working with two types of variables: categorical ones and continuous ones. A categorical variable can assume a finite number of categories without a natural ordering. For example, the states of India may be coded as numbers, with 1 representing Andhra Pradesh, 2 for Arunachal Pradesh, 28 representing West Bengal, and so on (assignment per alphabetical order).[7] Here, the numbers 1 to 28 have a natural order, where 28 is greater than 27, which in turn is greater than 26, and so on. However, such ordering is meaningless. Just because West Bengal is 28 and Andhra Pradesh is 1, it doesn't mean West Bengal is greater than Andhra Pradesh. Similarly, in our case, the categorical variables discussed in Table-2 do not share a natural order, despite often being coded as numbers.

The second variable type is a quantitative measurement (on the integers or real numbers line). In this case, there is a natural order. Further, the difference between the values are also meaningful. For example, an expense of ₹10 is less than one of ₹100. Similarly, the difference between ₹10 and ₹100 is meaningful since we can now learn that one household consumed more goods valued and we can quantify that difference as ₹90 in value terms.

Several distance functions are available when dealing with all categorical or non-categorical variables (Abu Alfeilat et al., 2019; Van de Velden et al., 2019). However, options are limited for datasets with mixed-type variables, which is common in survey data.

The continuous variables are normalised first so that the values lie between 0 and 1. The normalisation is achieved by subtracting the minimum value of the variable in the dataset from the value to be normalised and dividing this difference by the difference between the maximum and minimum values of the variable in the dataset. Thereafter, we compute the scalar distance for the normalised variable between the two households (from the AIDIS and CPHS datasets). Thus, we obtain 2 distances, one for each variable. To resolve these 2 distances

[7] In this example the values are assigned to a state alphabetically.

into a single measure that combines the distance for all (both) continuous variables, we square each scalar difference, then sum the squares and then take the square root (this is a Euclidean metric). This result is divided by 2 to obtain a continuous distance distribution (between 0 and 1).

For categorical variables, the process is more straightforward. For each of the categorical variables, either there will be a perfect match or not. If there is a perfect match, we calculate that distance as zero. If not, then we calculate that distance as 1. We then sum the 7 distances (for the seven categorical variables) to obtain a combined measure of the distance for all categorical variables. This result is divided by 7 to obtain a step-separated[8] categorical distance (between 0 and 1).

Finally, the two distance measures, one for continuous variables and the other for categorical variables, are resolved into a single distance measure using the modified Gower method (Gower, 1971), and this too produces a number between 0 and 1. This concludes the discussion on the first of the three aspects of the KNN method.

The second and third aspects are the value assigned to "K" and the assignment algorithm for the nearest match. We discuss these together as they relate closely to each other. For our estimation, we assign the value of 5 to 'K', meaning that the KNN method will consider the "5" nearest neighbours (based on the collapsed distance as measured through the modified Gower's distance) before assigning which is the closest match (based on the individual distances across all variables). For our analysis, we can consider that the operation is being carried out for household "a" from AIDIS across all households "c_1" to "c_n" from CMIE. Thus, in the first step, the KNN method will select 5 closest neighbours from the CPHS dataset using only one distance measure, the modified Gower distance. Thus, we obtain 5 possible assignments: household 'a' matched to 'c_1' (denoted as c_1 à a), or c_2 à a, c_3 à a, c_4 à a, and c_5 à a. In a scenario where only one pair has the minimum distance between two households, such a pair is considered to be the final match. To exemplify, if the distance between c_1 à a is 0.1 and the distances between c_2 à a, c_3 à a, etc. are all greater than 0.1, household 'c_1' is assigned to household 'a'. However, if the minimum distance is shared by two (or more) pairs, i.e., the distance between, say, c_1 à a and c_2 à a are identical and the minimum, then there is a tie. In such a scenario, to resolve the tie, the model computes 9 measures of distance for each pair of households, i.e., for the pair (c_1 à a), the model computes the distance using the 'region' variable, then the 'district' variable, and so on, across all variables listed in Table-2. So, instead of comparing just one distance measure, the model now compares nine distance measures to find which pair has the maximum number of minimum distances. It is still theoretically possible not to be able to resolve the tie; however, since we did not face the situation, a discussion of the same is avoided. Through this process, the KNN method chooses which of the five households from CMIE is the closest match to household 'a' of AIDIS.

The KNN method also has a few drawbacks (Guo et al., 2003). Firstly, its computational complexity increases with the size of the dataset (Maillo et al., 2015; Maillo et al., 2017; Deng

[8] The distances are step separated, since it can only assume discrete values of 0/7 (i.e., all the categorical variables match), or 1/7 (i.e., only one categorical variable does not match), and so on.

et al., 2016). Secondly, in high-dimensional spaces where instances tend to be equidistant,[9] a challenge arises, impacting the method's performance, known as the curse of dimensionality. Finally, the KNN method is sensitive to imbalanced datasets, potentially leading to biased predictions (Goyal, 2022). In this estimation exercise, the first two drawbacks, computational complexity and distances in higher dimensional spaces, are mitigated by reducing the total observations and dimensions. Observation reduction was done by selecting one state at a time from both datasets, and dimension reduction was done by selecting only 9 common variables across both AIDIS and CPHS datasets.

The third challenge that arises due to imbalanced datasets, resulting in higher and lower density regions, remains. For example, we expect to find more households earning between ₹10,000 and ₹1,00,000 than between ₹10,00,000 and ₹10,90,000, despite the interval being equal. Thus, when all variables are considered together, regions of overpopulation (and higher densities) and regions of underpopulation (and lower densities) emerge. This prevents us from achieving a 1:1 (unique) match. To mitigate this hurdle, we also use the "Hungarian Algorithm" to find matching households between the two datasets.

The Hungarian method, developed by Hungarian mathematicians Dénes Kõnig and Jenõ Egerváry in the 1930s, has found applications in various fields. It solves the classification problem where the goal is to find the optimal assignment of a set of tasks to a set of agents, minimising the total cost (Hahn et al., 1998). In our context, the goal is to assign households from the CPHS dataset to households in the AIDIS dataset while minimising the total distance.

Operationally, the task is carried out by constructing a table, say 'X'. Each element in the table, 'X_{ac}', represents the distance between household '*a*' from AIDIS and household '*c*' from CPHS datasets. The distance measure used for the Hungarian method is identical to that of the KNN. The lower the distance between the two households, the more similar they are. The Hungarian method then iteratively selects pairs of unique households in a manner such that the sum of all distances (between two matched households) is minimised. We can consider an example to understand this better. Say there are two households, a_1 and a_2 from AIDIS and c_1, c_2, and c_3 from CPHS. Thus, there are six possible assignments: c_1 à a_1, c_2 à a_1, c_3 à a_1, c_1 à a_2, c_2 à a_2, c_3 à a_2. Firstly, the Hungarian method considers the assignment, c_1 à a_1, as a given (say, with a distance of 0.2). At this stage, both c_1 and a_1 are considered assigned, and thus, the model only computes the distance for c_2 à a_2 (say, a distance of 0.3) and c_3 à a_2 (say, a distance of 0.4), i.e., the residual pairs. Thus, in the first iteration, the optimal match is found to be c_1 à a_1 and c_2 à a_2, with a total distance of 0.5. The model then considers the pair c_2 à a_1 as fixed and computes the distance for the residual pairs, which, let us say, results in a minimum total distance of 0.4, with c_2 à a_1 and c_1 à a_2 representing the matches. Finally, in the third iteration of the model, c_3 à a1 will be considered fixed, and the distance of the residual pairs will be computed. Out of these three iterations, let us say the second iteration resulted in the lowest sum of distances. In such a scenario, the resultant pair from the second iteration is considered final.

[9] It can be intuitively understood in the following example: Assume we compare two countries based on one parameter, say "GDP". Then, we are likely to find a difference. As we start adding dimensions, say population, growth rates, gender distribution, life expectancy, majority religion, etc., in some cases, the distances will start increasing (e.g., if we were comparing India and Bangladesh), while in others the distances will start reducing (e.g., if we were comparing Iran and Turkey, which have similar population, life expectancy, and so on). So, as the number of variables (dimensions) increase, the chances that two countries may appear similar increases, especially when we are adding the difference in the variables.

Thus, combining the KNN and the Hungarian methods provides a comprehensive and effective approach to household matching. The former's flexibility in handling mixed variable types and adaptability to complex distributions, combined with the latter's precision in achieving an optimal one-to-one mapping, creates a synergistic effect that addresses the discussed challenges in the matching process.

To generate unique one-to-one mapping, we must match from the smaller dataset to the bigger one – meaning that for the states where AIDIS has the smaller number of households, we will try to find for each AIDIS household a corresponding and unique household from the CMIE dataset that is its closest match. Thus, to combine both models, we start with KNN. Assuming that AIDIS has fewer households for all states compared to the CPHS, the KNN model shall result in some one-to-one matching (one household from the CPHS dataset will be assigned to one from AIDIS), some one-to-many matching (one household from CPHS will be assigned to many households of AIDIS), as well as some residual households (of CPHS who were not assigned to any households in AIDIS).

These unique (one-to-one) matches are considered final matches. For the one-to-many matches, we consider the closest match as the final match. To exemplify, say, household c_1 of CPHS was matched with households a_1, a_2, and a_3 of AIDIS. The distance between each pair c_1-a_1, c_1-a_2, and c_1-a_3 are 0.2, 0.25 and 0.35, respectively. So, despite three matches, we only consider the c_1-a_1 pair since this has the lowest distance. We obtain a set of matched and unmatched households using these one-to-one matches and by resolving the one-to-many matches. These matched households are used for final analysis, whereas the unmatched households are then passed onto the Hungarian method for final matching.

Data transformations

Data cleaning is a crucial step in the pre-processing pipeline, especially when dealing with datasets that include both categorical and continuous variables. Following are the key strategies adopted for data cleaning before employing the K-Nearest Neighbours (KNN) and the Hungarian method.

1. Handling missing values: KNN and the Hungarian methods are sensitive to missing data. Given the negligible occurrence of such missing data across the variables used for matching and estimating the impact of the FSP, imputation methods are avoided since they may introduce bias or distort the original distribution. Instead, such households were dropped.
2. Standardising and scaling: KNN relies on distance metrics, and the Hungarian method involves optimisation, both of which are influenced by the scale of variables. Thus, observations were standardised by subtracting the minimum value and dividing by the range (maximum observed value – minimum observed value of the variable).
3. Recasting categorical variables: Categorical variables, wherever in the form of non-numeric values, were converted into a numerical format.
4. Ensuring compatibility with methods: Finally, since the two methods have specific requirements regarding the input data format, the datasets were reorganised and variables were appropriately pre-processed to ensure compatibility.

Upon completion of the data transformation, the KNN and the Hungarian methods were used to obtain the final data structure based on which estimations were carried out.

Before discussing the final data structure, it is important to discuss one final aspect of the matching procedure: the quantum of data loss. It is evident that whether the matching happens from AIDIS to CPHS or from CPHS to AIDIS, the final results will not differ since the final result will indicate that households "a" and "c" (from AIDIS and CPHS, respectively) are identical. However, the number of households in each state may differ. For example, in Bihar, AIDIS has 7708 households and CPHS has 9236 households, and thus, 1528 households[10] from CPHS do not get any households from AIDIS assigned to them. The data pertaining to these (1528 in case of Bihar) residual households are thus not accounted for in the final dataset. Appendix-A presents the number of households that were residual households for each of the analysed states.

Final data structure

The final dataset contains all the variables used for merging, along with additional variables from the AIDIS and CMIE datasets. Table-3 presents the description of the variables and their source data[11]:

Table 3: Variables present in the final data (used for estimations)

Sl	Variable Name	From AIDIS	From CMIE
1	Region (Urban/Rural)	Yes	Yes
2	District	Yes	Yes
3	Social Group	Yes	Yes
4	Religion	Yes	Yes
5	Age Groups	Yes	Yes
6	Gender Groups	Yes	Yes
7	Household(HH) Size	Yes	Yes
8	HH Expenditure	Yes	Yes
9	#Similar HHs in the State	Yes	Yes
10	Value of assets owned by the HH (across various types of assets)	Yes	-
11	Amount of Debt Outstanding	Yes	-
12	Occupational Sector of the Head of the HH	-	Yes
13	Household Income	-	Yes

Source: Authors' Calculations

[10] 9236 (households in CPHS) - 7708 (households in AIDIS) =1528 Households from CPHS who were not assigned a corresponding household from the AIDIS dataset.

[11] The total number of variables used for the estimation is 156, but between them they contain the data pertaining to the themes discussed in the table. All 156 variables are not reproduced here to enhance ease of understanding.

Estimations were done using these variables for the households across Indian states and union territories. The analysis however excludes Andaman & Nicobar Islands, Arunachal Pradesh, Dadra & Nagar Haveli, Daman & Diu, Lakshadweep, Manipur, Mizoram, and Nagaland as the CMIE CPHS does not report data for those states in 2019.

In addition to sample-level estimations, we also use the weights provided by the two datasets to project the estimations onto the population level. For states where the base dataset is AIDIS, i.e., where all households of AIDIS are assigned a corresponding household from the CPHS dataset, we use the weights in the AIDIS dataset to compute state-population-level results. Similarly, for states where the CPHS dataset is used as a base dataset, CPHS weights are used. For most states, we rely on the AIDIS dataset as the base dataset due to its smaller state-specific sample size.

In case of AIDIS, weights are assigned at the stratum or district level. To compute the total number of FSP-eligible households in the population, we identify qualifying households in the sample, multiply their eligibility by the assigned weight, and sum up these values for a population-level estimate (National Sample Survey Organisation, 2019). However, for Assam, Delhi, Meghalaya, Sikkim, and Tripura, we turn to the CMIE CPHS as the base dataset. When using CMIE CPHS as the base, we apply the dataset's provided weights, utilising state-level weights for households and a non-response factor. The weight of an observation is calculated by scaling the state-level weight with the non-response factor, yielding a measure for each household per month. These constructed weights are averaged to derive a final measure for each household in the year 2019, which is then employed for all population-level estimates (Consumer Pyramids Household Survey, 2019). The estimation results are discussed in the next section.

ESTIMATION RESULTS

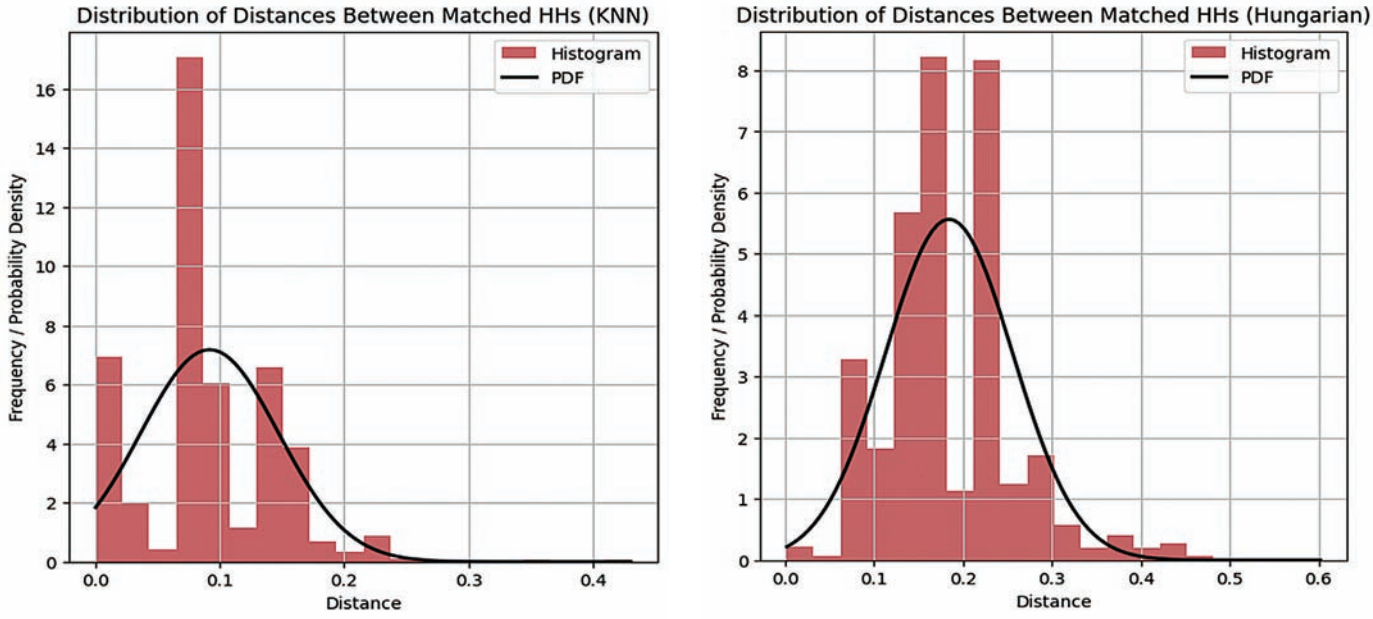
Households were matched using a tiered approach. The first layer of matching was done using KNN, and the second layer using the Hungarian model. The following table, Table-4, presents the total number of households (of AIDIS) matched in each stage and their mean distances.

Table 4: Households matched through each model (and summary statistics of the distances)

	# HH (from AIDIS/ CMIE) Matched	Mean Distance (Modified Gower)	Std. Dev.	Median Distance (Modified Gower)
KNN Method	37323	0.09	0.055	0.08
Hungarian Method	69093	0.18	0.071	0.16

Source: Authors' Calculations

Figure 1: Distribution of distances between matched households using KNN (A) and Hungarian Method (B)



Source: Authors' Calculations

As discussed in the earlier section, any pair of matched households will have two distances—one combined distance for categorical variables and one combined distance for continuous variables. Given that the authors summed the distance of all categorical variables and then divided it by 7, they obtained a stepwise distribution for categorical variables (between 0 and 1). Similarly, they also obtain a continuous distribution (between 0 and 1) for continuous variables. Thus, Figures 1(A) and 1(B) suggest that most of the matched households were fairly close to one another.

Using the merged data, the authors estimate the eligibility of the households for FSP. Table-5 presents the summary statistics of the relevant variables (at the sample level).

Table 5: Summary statistics of the relevant variables for determining eligibility under the FSP

Variable	Count	Mean	Standard Deviation	1st quartile (Q)	2nd Q (Median)	3rd Q
Total Annual Income	1,06,416	2,41,405.7	2,09,040.5	1,21,081.5	1,81,735	2,92,447
Outstanding Debt	50,058	3,19,361.3	10,36,296	34,570	87,000	2,67,659
Value of Assets	1,06,416	23,67,650	85,67,444	2,72,175	8,95,000	23,76,150
Home Ownership[12]	1,06,416	0.83	NA	NA	NA	NA

Source: Authors' Calculations

[12] Home ownership is a categorical value. The mean is represented since it presents the ratio of number of people who own a residential property (from the data it appears that 94% of the sample owns a residential property).

While the summary statistics presented above are for the sample, the estimation results have been calculated for the population level by applying appropriate weights, as described in the previous section. Table-6 presents how many households qualify under each of the four criteria laid out for the FSP.

Table 6: Number of households qualifying for FSP under each of the eligibility criteria

	Qualifying Households (from Matched Dataset)[13]
FSP Criterion-1: Annual Income < ₹60,000	45,02,187
FSP Criterion-2: - Outstanding debt amount < ₹35,000, but >₹0	2,17,58,764
FSP Criterion-3: - Value of Assets < ₹20,000	40,24,937
FSP Criterion-4: No home ownership	92,89,643
Combining all criteria	1,50,408

Source: Authors' Calculations

Combining all four criteria, the authors find that only 1,50,408 out of the 26,56,71,317 households with outstanding debt qualify for FSP. This represents 0.057% of all households. The number of qualifying households across each state is represented in Appendix C. Table-7 presents the number and proportions of qualifying households at the state level.

Table 7: Share of households qualifying for FSP under the income criteria

State	**Count**	**Qualifying HHs (Income criterion)**		**Base weights used**
		Total	**%**	
Andhra Pradesh	14198806	22525.75	0.1586	CMIE CPHS
Assam	12200471	1115	0.0091	AIDIS
Bihar	17748050	554.83	0.0031	CMIE CPHS
Chandigarh	252275.0938	0	0.0000	CMIE CPHS
Chhattisgarh	5672758.5	0	0.0000	CMIE CPHS
Delhi	4922844	0	0.0000	AIDIS
Goa	308249.5	0	0.0000	CMIE CPHS
Gujarat	12531386	12.5	0.0001	CMIE CPHS
Haryana	5414255.5	0	0.0000	CMIE CPHS
Himachal Pradesh	1716132.75	0	0.0000	CMIE CPHS
Jammu & Kashmir	2272021.25	0	0.0000	CMIE CPHS

[13] The following results have been calculated only for households that have reported owing some debt.

Jharkhand	6516384.5	198.5	0.0030	CMIE CPHS
Karnataka	13810240	304.5	0.0022	CMIE CPHS
Kerala	8910524	2663.25	0.0299	CMIE CPHS
Madhya Pradesh	14949053	6806	0.0455	CMIE CPHS
Maharashtra	24223068	3692.5	0.0152	CMIE CPHS
Meghalaya	770592	546	0.0709	AIDIS
Odisha	10015405	63726.63	0.6363	CMIE CPHS
Puducherry	288658	0	0.0000	CMIE CPHS
Punjab	6019335	515.25	0.0086	CMIE CPHS
Rajasthan	13273183	0	0.0000	CMIE CPHS
Sikkim	555504	2175	0.3915	AIDIS
Tamil Nadu	19161852	27230.17	0.1421	CMIE CPHS
Telangana	9276134	0	0.0000	CMIE CPHS
Tripura	1261376	0	0.0000	AIDIS
Uttar Pradesh	35141980	10009.25	0.0285	CMIE CPHS
Uttarakhand	1947767	0	0.0000	CMIE CPHS
West Bengal	22313012	8332.58	0.0373	CMIE CPHS
Total	**265671317.1**	**150407.71**	**0.0566**	

Source: Authors' Calculations

The estimates reveal that Odisha (with 63,727 households), Tamil Nadu (27,230 households), and Andhra Pradesh (22,526 households) are the states with the highest number of households that qualify for FSP. Together, these states account for 75% of the total number of qualifying households per the income criterion. These states also constitute 77% of the total outstanding debt that qualifies for FSP. Further, there are twelve states without any qualifying households. The estimation results thus suggest that there are pockets of concentration where FSP may have a higher uptake, assuming the ratio of qualifying households vis-à-vis households that seek refuge remains constant across regions, states, and cultures.

The authors also explore an alternative estimation approach. Earlier, they had used four criteria (given in Table-8). However, after replacing criterion-1, i.e., "the income of the household must be less than ₹60,000 annually", with "expenditure of the household must be less than ₹60,000 annually", they find that the number of households that qualify for FSP increases from 1,50,408 to 4,42,802. The authors construct this scenario (by replacing income with expenditure) since most measures of poverty focus on the expenditure of the individual or household rather than income. Table-8 provides the number of households that qualify for this revised criteria.

Table 8: Number of households qualifying for FSP under the revised criteria (expenditure-based)

	Qualifying Households (from Matched Dataset)[14]
FSP Revised Criterion-1: Annual Expenditure < ₹60,000	1,04,05,050
FSP Criterion-2: - Outstanding debt amount < ₹35,000, but >₹0	2,17,58,764
FSP Criterion-3: - Value of Assets < ₹20,000	40,24,937
FSP Criterion-4: No home ownership	92,89,643
Combining all criteria (and replacing income with expenditure)	4,42,802

Source: Authors' Calculations

Combining the revised criteria (replacing income with expenditure), they find that only 4,42,802 households out of the 26,56,71,317 households with outstanding debt qualify for FSP, i.e., only 0.166% of households qualify for FSP. Table-9 presents the state-level qualifications.

Under the revised criteria, Odisha still has 1,03,537 qualifying households, which is the highest in the country. It is followed by West Bengal with 96,159 and Uttar Pradesh with 54,641 qualifying households. These three states together account for 57% of the total number of qualifying households and 56% of the total qualifying outstanding debt, considering the expenditure criterion (alongside asset, debt and home ownership criteria). In this scenario, the number of states with zero qualifying households comes down to six. The number of qualifying households across each state is represented in Appendix D. Table-9 presents the number and proportions of qualifying households at the state level.

Table 9: Share of households qualifying for FSP under the expenditure criteria

State	**Count**	**Qualifying HHs (Income criterion)**		**Base weights used**
		Total	**%**	
Andhra Pradesh	14198806	43708	0.3078	CMIE CPHS
Assam	12200471	44566	0.3653	AIDIS
Bihar	17748050	11563	0.0651	CMIE CPHS
Chandigarh	252275	418	0.1657	CMIE CPHS
Chhattisgarh	5672759	69	0.0012	CMIE CPHS
Delhi	4922844	0	0.0000	AIDIS
Goa	308250	137	0.0444	CMIE CPHS
Gujarat	12531386	1755	0.0140	CMIE CPHS

[14] The following results have been calculated only for households that have reported owing some debt.

Haryana	5414256	2266	0.0418	CMIE CPHS
Himachal Pradesh	1716133	0	0.0000	CMIE CPHS
Jammu & Kashmir	2272021	0	0.0000	CMIE CPHS
Jharkhand	6516385	2659	0.0408	CMIE CPHS
Karnataka	13810240	8314	0.0602	CMIE CPHS
Kerala	8910524	1013	0.0114	CMIE CPHS
Madhya Pradesh	14949053	1816	0.0121	CMIE CPHS
Maharashtra	24223068	175167	0.0723	CMIE CPHS
Meghalaya	770592	0	0.0000	AIDIS
Odisha	10015405	103537	1.0338	CMIE CPHS
Puducherry	288658	0	0.0000	CMIE CPHS
Punjab	6019335	5946	0.0988	CMIE CPHS
Rajasthan	13273183	426	0.0032	CMIE CPHS
Sikkim	555504	1262	0.2272	AIDIS
Tamil Nadu	19161852	34779	0.1815	CMIE CPHS
Telangana	9276134	7051	0.0760	CMIE CPHS
Tripura	1261376	0	0.0000	AIDIS
Uttar Pradesh	35141980	54641	0.1555	CMIE CPHS
Uttarakhand	1947767	3201	0.1643	CMIE CPHS
West Bengal	22313012	96159	0.4310	CMIE CPHS
Total	**265671317**	**442802**	**0.1667**	

Source: Authors' Calculations

DISCUSSION

The estimates reveal that only 1.5 lakh out of the 26 crore households with debt qualify under all four criteria laid down by the IBC. The number of qualifying households increases to 4.4 lakhs if the authors replace the income criterion with a similar criterion for expenditure. Thus, as discussed earlier, only 0.05% of the households qualify for the FSP in India. If the expenditure criterion were to be considered, then that would allow 0.16% of the total households to qualify for FSP.

This three-fold increase in the proportion of qualifying households (when considering the expenditure criterion also implies that the debt that must be written off increases from ₹264 crore to ₹705 crore. The ₹705 crore may appear to be a substantial amount in isolation; however, it amounts to a mere 0.86% of the credit outstanding of micro-finance institutions, specifically entities licensed as Non-Banking Financial Companies (NBFC-MFIs) (MFIN, 2023). If they consider the banking sector (RBI, 2023), it amounts to only 0.05% of total unsecured personal loans.

Under the existing criteria (contained in the IBC), Odisha has the highest number of qualifying households, 63,727. This forms a minuscule fraction of the state's total population of households, only 0.63%. For the states with the second and third highest number of qualifying households, Tamil Nadu (27,230) and Andhra Pradesh (22,526), the qualifying households only represent 0.14% and 0.15% of the total populations, respectively. The state with the highest proportion of qualifying households is Sikkim (2,175 households), amounting to 0.39% of the total population. Thus, in a scenario where all qualifying households seek refuge under the FSP (per the current criteria), there are no states where even 1% of the households will be covered under the IBC. Appendices C and E, present the number of qualifying households and the quantum of qualifying debt (that has to be written off in case all qualifying households seek refuge under the FSP) at a state level, respectively.

In the case of the income criteria, the maximum qualifying debt belongs to Odisha, followed by Andhra Pradesh and Tamil Nadu. A closer study of the number of qualifying households and the outstanding debt suggests that the average outstanding debt per household varies significantly across states (See Appendix B for further details). For example, Andhra Pradesh and Tamil Nadu have similar numbers of households qualifying for FSP (22,526 and 27,230 households, respectively). However, the amount of qualifying debt differs significantly. For Andhra Pradesh, the qualifying debt is ₹63.7 crore and for Tamil Nadu (despite having more qualifying households), the qualifying debt is ₹39.9 crore. Thus, the average qualifying debt per household for Andhra Pradesh (₹28.2 thousand) emerges to be almost twice that of Tamil Nadu (₹14.6 thousand). The authors posit that two factors contribute to this disparity. First, some states have a higher degree of credit penetration in the low-income segments. Second, some states have a higher degree of over indebtedness. Thus, it is not necessary that as the number of qualifying households increases, the qualifying debt must increase in similar proportions.

The scenario remains similar, even when considering the constructed expenditure criteria (alongside the asset, debt and home ownership criteria). Using the expenditure criteria, Odisha still has the highest number of qualifying households. According to this criteria, the share of households that qualify for FSP from the state increases to 1.03% of the total population. The constructed criteria lead to West Bengal having the second-highest number of eligible households, constituting 0.43% of its total population. Uttar Pradesh follows as the state with the third-highest number of eligible households, comprising 0.15% of its total population qualifying for the FSP. Appendices D and F present the number of qualifying households and qualifying debts for each state, respectively.

Under the constructed expenditure criteria, we again observe that states like Andhra Pradesh and Tamil Nadu have a similar number of qualifying households, but a sizeable difference in the qualifying debt. West Bengal and Odisha also follow a similar trend. States with lesser populations are also not immune to the differentiated average household debt, as is evidenced by Himachal Pradesh and Uttarakhand.

While the estimates provide an insight into the total number of households that may qualify under different scenarios and the debt that correspondingly must be written off, there are a few limitations of the study that we must acknowledge. The results are at a household level

and not at an individual level. The IBC defines FSP as a process whereunder an individual may seek refuge. However, one key factor inhibits estimations at the individual level. We can leverage the matched dataset to obtain individual-level income and outstanding debt, but we cannot obtain asset ownership (including home ownership) details. This hurdle arises since there is no singular approach through which assets may be apportioned between the household members. The authors consider a household (of four members) that owns a few utensils, a gas stove, a refrigerator, and a bicycle.

The head of the household is a 55-year-old male who works as a casual labourer. His wife, aged 50, works seasonally during harvest, and two adult children are in college. Assuming they don't own a house, how can we decide who owns the household assets? One approach is to consider who are the beneficiaries. In this example, all the members are. Alternatively, we may inquire who purchased the items initially. This approach may work when cases are adjudicated one at a time, but it is hardly implementable during a sample survey. Another is apportioning the assets according to the current or historical income patterns. In this example, it would mean that we take the income ratio of the head of the household and his wife and then apportion the assets in that ratio. It may work if we can trace this ratio for a long enough period, but it does not account for disproportionate gifts. We can consider many alternate approaches, but none truly capture the nuances. Thus, the limitation around apportioning assets is unlikely to be mitigated ex-ante, i.e., before the section is notified and there is enough jurisprudence to guide estimations.

It is also important to recognise that the authors have only estimated the number of households that will qualify under FSP and not the number of households likely to seek refuge under it. It is well documented that households tend to make sacrifices, ranging from skipping festivals to skipping meals and pulling children out of school before they turn delinquent. The stigma and shame associated with being delinquent will likely magnify when they try to seek a formal discharge from their debts. Shaping this belief system is the underlying culture that the individual subscribes to. Thus, even if the number of eligible individuals increases, it does not mean everyone will start seeking refuge under the FSP.

Further, the bankruptcy process, defined under the IBC, presents an interesting alternative to the FSP. In both FSP and bankruptcy, the final outcome is that the debtor is discharged from their repayment obligation, though the process of achieving this differs. In the case of the bankruptcy process, the debtor's assets are attached to an estate administered by a bankruptcy trustee. The trustee is responsible for selling such assets to recover the dues from the borrower and repay her creditors. Thus, in case of bankruptcy, an alienation of assets is posited to occur. However, such alienation of assets is not absolute, as specific assets are excluded from being attached to the bankruptcy estate. Section 79(14) of the IBC lists these excluded assets; however, it does not assign any value to most.

The first two sub-sections read as under:

> ...unencumbered tools, books, vehicles and other equipment as are necessary to the debtor or bankrupt for his personal use or for the purpose of his employment, business or vocation and unencumbered furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his immediate family.

Thus, all assets essential for the debtor's vocation will likely be protected, irrespective of their value. The third exclusion on personal ornaments allows the competent authority to set a value beyond which assets will not be excluded. The sub-section reads 'any unencumbered personal ornaments of such value, as may be prescribed, of the debtor or his immediate family which cannot be parted with, in accordance with religious usage'. Under the Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Rules, 2019, personal jewellery worth up to ₹1,00,000 is excluded. Similarly, unencumbered single dwelling units having a value of up to ₹20,00,000 in urban areas are excluded. In rural areas, single dwelling units having a value of up to ₹10,00,000 are excluded. Thus, the quantum of asset protection under the bankruptcy process is significantly greater than that of the FSP. This suggests that households that do not meet the current thresholds present in the FSP may file for the IRP and later bankruptcy and reap similar benefits as prescribed under the FSP. Thus, the incentive structures poise such households to not act in good faith during the IRP so that they can reap similar benefits (as the FSP) during the bankruptcy process.

This possibility that some may reap the benefits of FSP, despite not qualifying for it, begs the question: are the current FSP thresholds appropriate? To answer, the motive of the parliament when enacting the law must be deciphered. Though there is no stated motive for the FSP, a closer reading of the Code may provide some insights. Since the fundamental objective of the Code is to balance the rights of creditors and debtors, higher thresholds for FSP may erode significant creditor value (which in turn can impact the credit market, but such a discussion is beyond the scope of this paper). Conversely, the low thresholds may indicate an intent to cover the poorest of the poor. This can be discussed in two contexts: minimum wages and minimum per capita consumption expenditure. In India, Nagaland has the lowest minimum wage. At ₹5280 per month, it corresponds to ₹62,760 annually (Dezan Shira & Associates, 2023). In Delhi, the minimum wage is ₹17,494 (monthly) or approximately ₹2,10,000 annually (The Mint, 2023). Setting the FSP thresholds lower than the minimum wage suggests an intent to protect the most vulnerable. The question, however, remains. Does the code adequately protect all that needs protection?

One approach that the parliament may consider is replacing the income criterion with an expenditure-based criterion. If there is only one earning member in a household of four, the member must consume items worth ₹74,463 annually to ensure that the household stays above India's poverty line (Bhattacharya & Ananth, 2021). For the alternate estimate, the authors assumed household expenditure thresholds to be ₹60,000 and found that only 17 out of 7708 households in the sample qualify for FSP.

CONCLUSION

The inclusion of FSP suggests that the framers of the IBC envisioned it to embody the evolving moral standard of insolvency regimes. The Code makes a visible effort to distinguish and protect natural persons. Despite this intent, the fact that majority of the Part III of the code is still not notified underscores that resolving the tussle between moral hazard and debtor protection is an arduous task. The methodology suggested in this paper allows policymakers to estimate the impact of the FSP, aiding in the process of resolving the tussle.

Appendix A: State-wise number of residual households

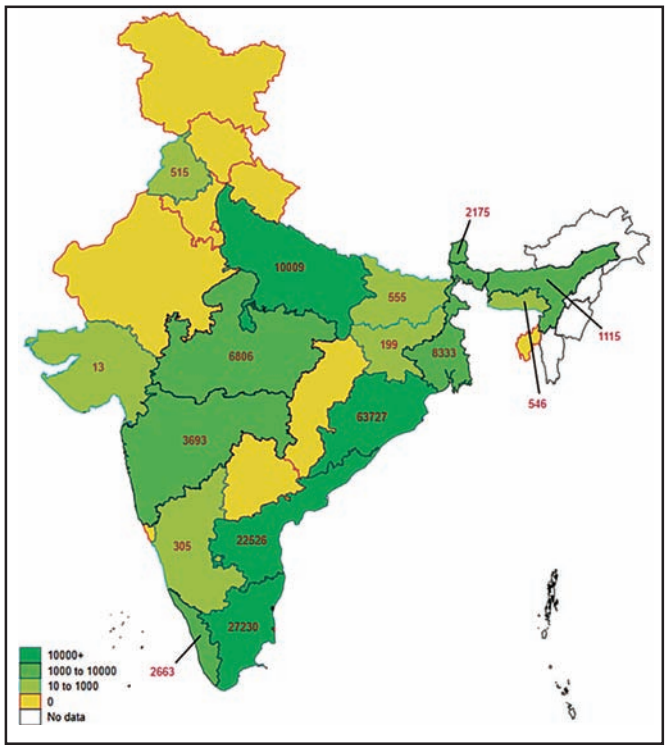
State	AIDIS sample size	CMIE CPHS sample size	Residual	Residual dataset
Andhra Pradesh	4710	8080	3370	CMIE CPHS
Assam	3577	1755	1822	AIDIS
Bihar	7708	9382	1674	CMIE CPHS
Chandigarh	190	456	266	CMIE CPHS
Chhattisgarh	2281	4799	2518	CMIE CPHS
Delhi	1650	1375	275	AIDIS
Goa	235	1064	829	CMIE CPHS
Gujarat	5095	9066	3971	CMIE CPHS
Haryana	2181	5538	3357	CMIE CPHS
Himachal Pradesh	1054	1280	226	CMIE CPHS
Jammu & Kashmir	1603	2588	985	CMIE CPHS
Jharkhand	2830	4710	1880	CMIE CPHS
Karnataka	5750	9717	3967	CMIE CPHS
Kerala	3610	4786	1176	CMIE CPHS
Madhya Pradesh	6164	9200	3036	CMIE CPHS
Maharashtra	10181	19834	9653	CMIE CPHS
Meghalaya	1368	1040	328	AIDIS
Odisha	4080	6761	2681	CMIE CPHS
Puducherry	359	1140	781	CMIE CPHS
Punjab	2691	6760	4069	CMIE CPHS
Rajasthan	5978	10886	4908	CMIE CPHS
Sikkim	858	816	42	AIDIS
Tamil Nadu	7075	10938	3863	CMIE CPHS
Telangana	2999	5830	2831	CMIE CPHS
Tripura	2304	1192	1112	AIDIS
Uttar Pradesh	13769	22868	9099	CMIE CPHS
Uttarakhand	1136	2042	906	CMIE CPHS
West Bengal	8559	10502	1943	CMIE CPHS
Total	**109995**	**174405**		

Appendix B: Detailed table (non-rounded) on the share of qualifying households under FSP (income and expenditure criteria)

State	Count	Home ownership		Total Expenditure		Total Income		Asset Value		Debt	Qualifying HHs (Income cirteria)			Qualifying HHs (Expenditure criteria)		
		Debt=0	*Debt>0*	*Debt=0*	*Debt>0*	*Debt=0*	*Debt>0*	*Debt=0*	*Debt>0*		*Total*	*%*	*Outstanding Debt*	*Total*	*%*	*Outstanding Debt*
Andhra Pradesh	14198806	635071.1	2055244	300570.2	933535.9	123232.1	418175.3	303645	1038540	1121078	22525.75	0.15865	637073344	43708.01	0.307829	637009920
Assam	12200471	218533	211512	324608	378199	754423	708745	80608	67845	1630800	1115	0.00914	27643080	44566	0.365281	716585920
Bihar	17748050	62322.27	178552.3	191464.4	628172.3	130923.6	303135.4	22422.55	51908.9	2250797	554.83	0.00313	8152780	11562.83	0.06515	109707776
Chandigarh	252275.0938	2957.35	8092.56	0	418	0	0	1179.1	447.33	4302.18	0	0.00000	0	418	0.165692	6270000
Chhattisgarh	5672758.5	38101.92	53087.14	188878.2	249048.1	54171.54	67487.82	11377.5	32097.5	475626.5	0	0.00000	0	69	0.001216	759000
Delhi	4922844	279297	218586	0	0	0	0	152355	91644	121473	0	0.00000	0	0	0	0
Goa	308249.5	2481.16	3191.6	171.5	137	0	978.5	921.33	960	3642	0	0.00000	0	137	0.044445	2740000
Gujarat	12531386	106929.1	160018.2	39374.67	101095.8	20334.68	54626.35	53752.35	36691.82	516420.1	12.5	0.00010	125000	1754.5	0.014001	20250950
Haryana	5414255.5	52494.37	130411.2	5066.22	17507.8	0	489	28060.26	34045.22	242019.9	0	0.00000	0	2265.5	0.041843	21726300
Himachal Pradesh	1716132.75	9061.75	36834.5	1286.83	28279.85	0	941	6870.5	5089.23	62388.11	0	0.00000	0	0	0	0
Jammu & Kashmir	2272021.25	1644.33	6278.71	1212.5	32003.25	2713.5	41685.15	475	934.75	96731.64	0	0.00000	0	0	0	0
Jharkhand	6516384.5	46793.54	72585.01	158298.4	252192.7	48890.92	49006.32	31440.52	18491.62	723043.1	198.5	0.00305	459700	2658.5	0.040797	59063076
Karnataka	13810240	130869.6	620216.6	142331.1	615740.6	25612.3	107278	51237.65	203080.7	873674.8	304.5	0.00220	3093750	8314.06	0.060202	139030528
Kerala	8910524	193367.7	581543.7	47264.92	111829.3	36633.58	117894	82075.43	191504.9	528871.1	2663.25	0.02989	49662676	1013.25	0.011371	29803676
Madhya Pradesh	14949053	96381.99	279502	213969.3	1095408	12866.93	95783.74	39889.98	97341.1	1298148	6806	0.04553	162286512	1816.14	0.012149	41296864
Maharashtra	24223068	284476.4	658418.5	256065.5	878256.1	93447.33	331163.8	145866.5	222628.5	1251901	3692.5	0.01524	57615000	17516.92	0.072315	443746880
Meghalaya	770592	8508	43800	546	3048	1092	2472	6324	17244	108090	546	0.07085	7985250	0	0	0
Odisha	10015405	217898.5	500311.8	637429	1372801	265615.1	740722.8	113689.6	257125.5	1900215	63726.63	0.63629	992387584	103536.9	1.033776	1688397952
Puducherry	288658	7653.21	27079.67	324	2672.88	0	195.5	0	7060.29	20554.13	0	0.00000	0	0	0	0
Punjab	6019335	67820.64	162778.6	29740.5	9158.84	3225.75	4726.46	25173.71	83828.5	415468.9	515.25	0.00856	8914340	5946	0.098782	72510000
Rajasthan	13273183	159006.7	213954.1	126264.2	201695.7	34057.81	89070.67	42575.74	92092.61	954387.3	0	0.00000	0	426	0.003209	10692000
Sikkim	555504	26312	32326	11707	10311	58136	101262	20513	15518	50508	2175	0.39154	47166752	1262	0.227181	24341750
Tamil Nadu	19161852	675535.1	1272215	179500.7	549265.9	87498.69	272428.7	272762.7	503439.9	1243834	27230.17	0.14211	398806944	34779.09	0.181502	530335648
Telangana	9276134	186490	662977.9	119193.9	716122.8	16969.08	189609.9	69181.71	242215.1	746335.8	0	0.00000	0	7051.25	0.076015	190397104
Tripura	1261376	15349	19518	12121	27443	5460	3798	9224	3899	154021	0	0.00000	0	0	0	0
Uttar Pradesh	35141980	189551.9	539266.4	279559.4	1411141	72191.38	427222.5	114561.1	313916.2	2632484	10009.25	0.02848	155658848	54641.19	0.155487	538766080
Uttarakhand	1947767	13561.16	63116.09	2849.17	17136.5	2118.67	3870.5	3716.33	14550.58	110704.2	0	0.00000	0	3201	0.164342	67219416
West Bengal	22313012	483270.4	478225.4	691942	762429.4	314548.3	369419	335395.3	380796.8	2221245	8332.58	0.03734	87452976	96159.3	0.430956	1704838784
Total	**265671317.1**	**4211739**	**9289643**	**3961739**	**10405049.72**	**2164162**	**4502187**	**2025294**	**4024937**	**21758764**	**150407.7**	**0.05661**	**2644484536**	**442802.4**	**0.166673**	**7055489624**

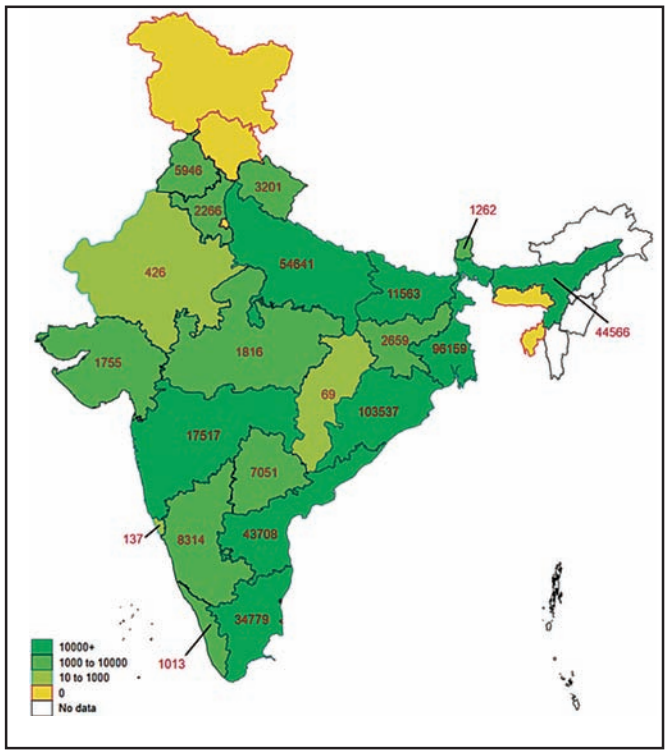
Note: The figures presented in the table above are for the population-level. It lays out the number of households that qualify for FSP for every criterion, namely, home ownership, total income, asset value, and outstanding debt. We also do a similar calculation for total expenditure. We then calculate the final number of households that would qualify if all the criteria were to be applied. Although the calculations under outstanding debt and final income and expenditure criteria only account for households that owe some debt, for the other calculations we present the figures for households that currently do not owe any debt as there is a chance that they may become indebted in the future

Appendix C: State-wise number of qualifying HHs (Income criterion)



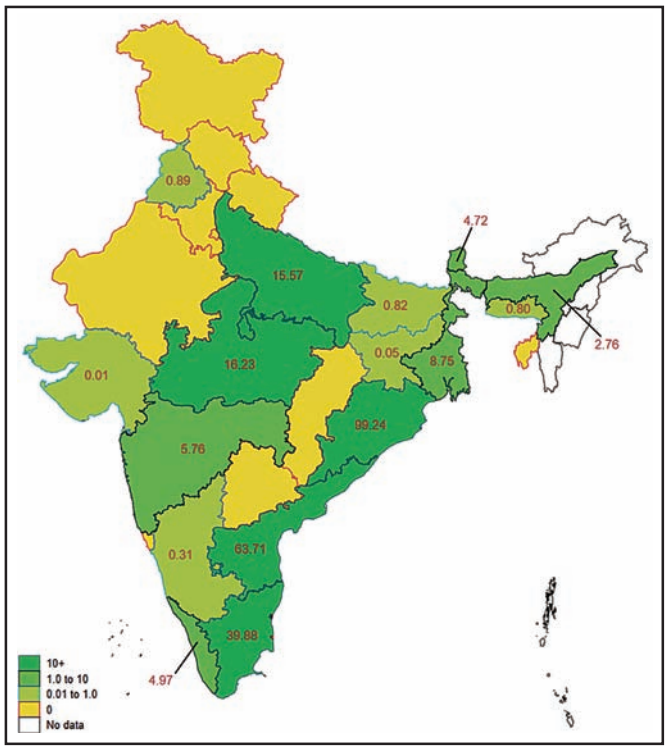
Source: Authors' Calculations

Appendix D: State-wise number of qualifying HHs (Expenditure criterion)



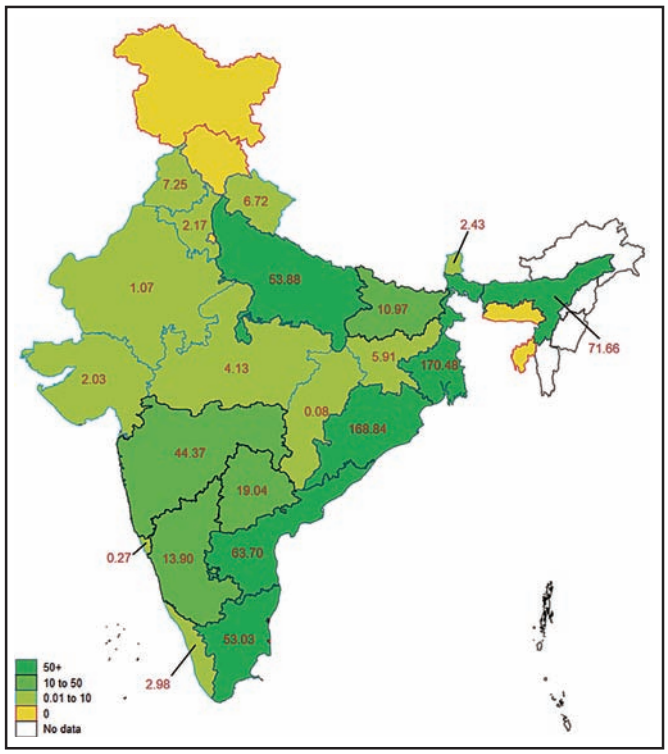
Source: Authors' Calculations

Appendix E: State-wise amount of qualifying debt in INR Crores (Income criteria)



Source: Authors' Calculations

Appendix F: State-wise amount of qualifying debt (Expenditure criteria)



Source: Authors' Calculations

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03

EVALUATING THE EFFECTIVENESS OF IBC IN BALANCING RECOVERY RATES BY MINIMISING THE AMBIT OF HAIRCUT METHOD

Rakesh Kaidala and Chennu Bhargavi

ABSTRACT

This research delves into the intricate workings of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) in India, scrutinizing its efficacy in achieving the delicate balance envisioned for substantial recovery rates. Recent insolvency cases have raised concerns as substantial reductions, known as "haircuts," impact outstanding debts, particularly affecting banks relying on public funds.

The study highlights the persistent challenge of a growing ratio of non-performing loans and disappointingly low recovery rates within the context of public-funded banks. The lack of clear signs of successful settlement, restructuring, or recovery exacerbates the issue, prompting a call for a more robust resolution framework. The broader implications on the interests of the public underscore the urgency for an effective system.

The IBC adopts the "haircut" methodology to determine debt recovery for creditors during resolution. This reduction in outstanding debt value is based on an assessment of the insolvent company's resolution plan feasibility. Acknowledging the financial distress of the insolvent company, creditors agree to a reduction in debt value by accepting haircuts. The impact on creditors hinges on variables like the company's financial health, asset value, and the efficacy of the resolution plan. Notable cases, such as Bhushan Steel and Amtek Auto, illustrate instances where creditors willingly accept haircuts to facilitate company revitalization and optimize overall recovery.

According to CRISIL Ratings, the recovery rates under the Code experienced a decline, dropping from 43% to 32% between March 2019 and September 2023. Concurrently, the average resolution time has seen an escalation from 324 to 653 days, surpassing the stipulated timeframe of 330 days.

While the haircut approach is designed with the intention of ensuring fairness for all involved parties, it falls short of guaranteeing uniform sharing of losses. Certain stakeholders may bear a disproportionate impact based on specific circumstances, potentially leading to conflicts and objections regarding the fairness of the process. There exists the risk that the haircut approach might incentivize moral hazard. Creditors, foreseeing substantial debt reduction through insolvency proceedings, may engage in riskier lending practices, banking on the expectation that their losses will be mitigated through haircuts. This introduces a potential threat to the overall stability of the financial system.

Another potential concern is the likely increase in ambiguity and difficulty in valuation due to the haircut procedure. The determination of the appropriate haircut hinges on factors such as the financial condition of the bankrupt company, the valuation of its assets, and the feasibility of the resolution plan. These assessments can be intricate, and divergent perspectives among stakeholders may lead to delays and even legal disputes.

This research aims to uncover factors contributing to higher haircuts, exploring their legal connections with relevant sections of the IBC and their effects on financial institutions. By examining the intricacies of the IBC, legal nuances, and the practical implications of haircuts, the study aspires to provide insights into enhancing the recovery process and fortifying the financial stability of institutions involved.

The interdisciplinary approach of this research involves an in-depth analysis of legal provisions, case studies, and financial data. It seeks to shed light on the intricacies of the insolvency resolution process, emphasizing the need for a nuanced understanding of the factors influencing the determination of haircuts. Ultimately, the research aspires to contribute valuable insights that can inform policy decisions, foster improvements in the insolvency framework, and promote financial stability in the Indian context.

RESEARCH PROBLEM

This research addresses the potential impact of the Haircut Method on the banking system within the framework of the IBC. It seeks to understand the factors influencing the rate of haircut and examine the interconnections between various sections of the IBC that indirectly affect haircuts, potentially influencing the broader economy. The Haircut Method has the potential to result in substantial losses for banks, potentially leading to a credit crunch and impacting overall financial stability. Conversely, it may also serve as a mechanism to balance firm resolution and credit repayment. Therefore, it's crucial to comprehend the challenges banks face in implementing the Haircut Method and explore possible solutions to effectively manage insolvent companies. By delving into these issues, this research aims to contribute valuable insights to the existing literature concerning the Haircut Method's impact on the banking system and the factors influencing haircut rates.

RESEARCH OBJECTIVES

1. What are the key factors that influence the *"haircut rate"* in corporate insolvency resolution process (CIRP) under the IBC?

2. How does the use of the haircut method under the IBC impact the financial institutions?

METHODOLOGY

The research will utilize an analytical research methodology, primarily employing a case analysis approach. The study aims to examine the Conglomerates which have undergone the resolution process under the IBC and have experienced a substantial haircut, either exceptionally high or exceptionally low. The case analysis will entail a thorough examination of the companies' financial statements, resolution plans, public documents and other pertinent documents. The results will be conveyed through a descriptive analysis of the case studies.

LITERATURE REVIEW

The enactment of the IBC in India in 2016 stands as a pivotal milestone in the nation's legal landscape, addressing critical issues surrounding insolvency and bankruptcy with a comprehensive framework. Designed to streamline the resolution process, safeguard creditor rights, and foster transparency and efficiency, the IBC has sparked widespread academic and professional discourse, prompting in-depth analyses of its implementation, impact, and future trajectory.

Scholars have delved into various facets of the IBC, scrutinizing its legislative structure, core provisions, objectives, and underlying principles. Through comparative studies and assessments against international best practices, researchers have identified areas for refinement and enhancement within the code.

Central to academic inquiry is the examination of the insolvency resolution procedure outlined in the IBC, encompassing the roles of Insolvency Professionals (IPs), resolution timelines, and implications for stakeholders. Evaluations of the process's efficacy and efficiency have yielded insights into its successes and challenges, informing ongoing refinements and reforms.

A key focus of the literature is the emphasis placed by the IBC on preserving creditor rights and their active participation in the resolution process. Mechanisms such as the committee of creditors (CoC) have come under scrutiny, with researchers evaluating their decision-making authority and safeguards for creditor interests. Judicial interpretations of the IBC through landmark court decisions provide further insights into its evolving jurisprudence and implications for future insolvency cases.

Furthermore, scholars have explored the potential of the IBC to address critical issues such as delays in resolution, cross-border insolvency, and stakeholder coordination. These explorations offer valuable perspectives on the code's future evolution and its role in fostering a resilient and dynamic business environment.

In the realm of banking, publications such as "The Corporate Insolvency Regime and Its Implications for the Indian Banking System" by former Reserve Bank of India Chief General Manager Shri Ajay Kumar Chowdary have shed light on how insolvency laws impact financial institutions. The analysis underscores the critical interplay between insolvency frameworks, financial stability, and the resolution of distressed businesses.

Moreover, the literature underscores the imperative of efficient corporate insolvency frameworks in addressing non-performing assets (NPAs) and ensuring stable financial markets. Scholars have examined how the IBC has accelerated the resolution process, providing a structured approach to addressing troubled businesses within defined timelines.

Studies also highlight the pivotal role of banks in the insolvency resolution process, examining their financial implications and challenges in assisting distressed businesses. Furthermore, the literature evaluates the broader financial stability implications of India's corporate insolvency legislation, assessing its efficacy in mitigating systemic risks and preserving market integrity.

Additionally, researchers delve into mechanisms for conflict resolution and the existing institutional framework, including the role of institutions such as the National Company Law Tribunal (NCLT) and the Insolvency and Bankruptcy Board of India (IBBI). These discussions offer valuable insights into the operational dynamics of the insolvency resolution process and avenues for institutional strengthening.

Case studies of successful resolutions under the IBC provide nuanced insights into the factors contributing to their efficacy. Scholars analyze factors such as effective financial restructuring, management response, cooperative negotiations, and the pivotal role of IPs and the CoC in facilitating successful outcomes.

Moreover, discussions on regulatory and legal frameworks, including the role of regulatory bodies such as the IBBI and the NCLT, shed light on the efficacy and effectiveness of the insolvency regime. Industry-specific case studies further enrich the discourse, offering insights into sector-specific challenges and opportunities in resolving distressed businesses.

In conclusion, the literature surrounding the IBC provides a rich tapestry of insights into its implementation, impact, and future directions. Through rigorous analysis and empirical studies, scholars continue to contribute to the ongoing evolution of India's insolvency landscape, fostering a more resilient and dynamic business environment.

HAIRCUT METHOD AND IBC 2016

What are Hair Cuts under IBC?

Lenders often undergo "haircuts" as part of resolution plans approved under the Code, indicating a shortfall in creditor recovery compared to their initial claims submitted during the borrower's insolvency resolution procedure. While the extent of these haircuts may seem substantial in certain cases, it's important to note that many of these insolvency proceedings were initiated after the asset had already been classified as a non-performing asset (NPA) on the lender's books. An NPA designation implies that the asset no longer yields interest.

In the context of the IBC, a "haircut" denotes a decrease in the value of an asset, representing the variance between the loan amount and the actual value of the collateral utilized by lenders or creditors in such scenarios. This discrepancy places the burden on lenders or creditors and reflects their assessment of the risk associated with a potential decline in the asset's value. Conversely, loan recovery signifies the disparity between the borrower's actual debt and the amount eventually resolved with the bank.[1]

Alternatively, the lender calculates notional interest on the NPA account and incorporates it into the claims once insolvency proceedings commence.[2] This tactic is justified as NPAs necessitate funding from obligations incurring expenses rather than generating interest. While creditors' recovery is estimated as a percentage of their claims, even if these claims are not acknowledged on the lender's balance sheet, this factor must be considered when determining the "haircut." While concerns regarding haircuts are valid, there should also be

[1] "Haircut" under Insolvency Laws – Mirza & Associates, Advocates & Attorneys, (2022), https://www.mirzaandassociates.com/haircut-under-insolvency-laws/

[2] https://ibbi.gov.in/uploads/resources/cf9e3f8a658e837ba704fc8594670a68.pdf.

alignment with the company's intrinsic value. A company's valuation hinges on various factors such as market reputation, client base size, workforce quality, proprietary software, and operational processes. Employee departures due to loan defaults, client defections to competitors, goodwill erosion—all contribute to a gradual decline in a company's worth.

According to the Financial Stability Report by the Reserve Bank of India (RBI), detailed analysis of CIRPs in India as of March 31, 2023, under the IBC. Here are the key insights:

1. Closure of CIRPs by Stakeholder and Outcome

- Among CIRPs initiated by operational creditors (OCs), 53% were closed due to appeal, review, settlement, or withdrawal, accounting for 72% of all closures.
- A significant number of CIRPs ended in resolution (678), with financial creditors (FCs) realizing 169% of the liquidation value under resolution plans, compared to only 32% of their claims.
- Out of the 678 resolved cases, 249 corporate debtors (CDs) were either pending before the erstwhile Board for Industrial and Financial Reconstruction (BIFR) or were defunct.

2. Outcome of CIRPs

- 45% of closed CIRPs resulted in liquidation orders, 15% in resolution plans, and the remaining 40% were settled. The economic value of many CDs had been eroded significantly before admission to CIRP, with assets valued at only about 7% of the outstanding debt amount

By March 2023, a total of 6,571 CIRPs had been initiated, out of which 4,515, or approximately 69%, were concluded. Among the closed CIRPs, 21% were terminated through appeals, reviews, or settlements, while 19% were withdrawn. Notably, 45% culminated in liquidation orders, while only 15% resulted in the approval of resolution plans.

Given that OCs are not part of the CoC, which evaluates resolution plans, it falls upon FCs within the CoC to ensure OCs receive their due share of claims to maintain financial stability. Oversight by FCs, solely focused on maximizing their recovery from resolution applicants, may have an adverse effect on the viability of OC's businesses, thereby impacting the long-term prospects of the CD.

PROS AND CONS OF HAIRCUT METHOD

Haircut method benefits

The implementation of the haircut approach presents an opportunity to swiftly and efficiently address distressed debt situations. By accepting a reduction in the principal owed to them, creditors can expedite the recovery process, allowing them to recoup at least a portion of their funds. This proactive measure not only facilitates the more effective utilization of available resources but also alleviates strain on the economy.

Moreover, the haircut approach fosters viability and feasibility by mandating realistic and attainable resolution plans from potential buyers or investors. This strategic move contributes to the financial restructuring of insolvent companies, thereby reducing the burden of debt and enhancing the prospects of their revival. Such initiatives hold promising implications for the future growth and sustainable development of these companies.

Furthermore, the interests of stakeholders are safeguarded through the implementation of the haircut approach, which strives to strike a balance between the claims of creditors and shareholders. By acknowledging the imperative need for debt recovery while also recognizing the financial challenges faced by the company, this strategy aims to mitigate the impact on any single group. By distributing the losses equitably through a reduction in the debt's value, the approach seeks to minimize adverse effects and promote a more harmonious resolution process.

The problems with the haircut approach

One significant drawback of implementing the haircut approach is its potential to halve creditors' recovery, significantly impacting their financial stability. For creditors, especially smaller ones or those heavily reliant on the retrieved funds, this shortfall can pose significant challenges.

While the haircut method aims for fairness among all parties involved, its execution may not ensure uniform loss sharing. Depending on the circumstances, certain stakeholders might bear a disproportionate burden, leading to conflicts and objections regarding the process' equity. Additionally, there's a risk that the haircut approach could inadvertently foster moral hazard. Creditors might adopt riskier lending practices in anticipation of substantial debt reductions through insolvency proceedings, potentially destabilizing the overall financial system.

Moreover, the haircut procedure might exacerbate ambiguity and complexity in valuation processes. Determining the appropriate haircut necessitates a thorough assessment of the bankrupt company's financial status, asset valuation, and the feasibility of the resolution plan. These assessments can be intricate, and disagreements among stakeholders may result in delays or even legal disputes.

Despite potential drawbacks, the haircut approach offers various benefits within insolvency and bankruptcy proceedings, including expeditious debt resolution and the promotion of viability. Striking a balance between debt recovery and the rehabilitation of insolvent companies is crucial for effectively employing the haircut approach. Mitigating the potential negatives of this technique requires meticulous case evaluation and transparency throughout the resolution process.

Case analysis

The resolution of Essar Steel India Limited (ESIL) in June 2017 marked a watershed moment in India's financial landscape. As the largest among the initial 12 accounts referred to insolvency under the Code by the RBI, ESIL's resolution has reverberated across various dimensions of the financial ecosystem. Beyond being the single largest resolution under the IBC, it yielded banks their highest-ever return on a stressed asset, both in terms of the dollar amount and the percentage of money recovered by creditors.

On August 2, 2017, ESIL commenced its journey into the CIRP, with Satish Kumar Gupta

assuming the role of Interim Resolution Professional (IRP), later affirmed as the Resolution Professional by the CoC. The resolution process subjected the IBC, as a stressed asset resolution mechanism, to rigorous testing, navigating the complexities of ESIL's large and intricate account. Two rounds of litigation culminated in the Supreme Court, affirming the legitimacy, efficacy, and transparency of the CIRP. Moreover, the journey saw the establishment of legal precedents and the clarification of crucial IBC-related matters, enriching the insolvency regime.

Amidst occasional competing goals, the ESIL case provides invaluable insights for the IBC ecosystem, showcasing the positive roles played by various stakeholders in maximizing asset value. The narrative of the case is replete with both moments of clarity and challenges, reflecting the dynamic nature of insolvency resolution.

The genesis of ESIL's financial distress can be traced to several factors, including debt-fueled expansion of plant facilities and reliance on natural gas for production. However, fluctuations in petrol production in India disrupted ESIL's fuel supply chain, forcing it to procure petrol at inflated spot prices. Additionally, increased input costs, particularly gas, compounded ESIL's financial woes. The company's strategic shift towards reducing reliance on natural gas through Corex production modules at Hazira and transitioning to coal-based electricity further strained its finances. Overleveraging, compounded by incomplete capital expenditure projects due to liquidity issues, exacerbated ESIL's financial predicament.[3]

Resolving creditor claims during the CIRP presented its own set of challenges. Of the Rs 82,541 crore in claims made, Rs 54,565 crore were verified and accepted. The complexity of creditor claims, including disputes and procedural issues, underscored the intricacies of insolvency resolution under the IBC. International distressed investors and asset reconstruction companies played a significant role in the resolution process, further adding to its complexity.

In conclusion, the ESIL case serves as a compelling narrative of resilience and adaptation in the face of financial adversity. It highlights the importance of stakeholder cooperation, judicial clarity, and procedural efficiency in navigating complex insolvency scenarios. As the IBC continues to evolve, the ESIL case stands as a testament to the efficacy and transformative potential of India's insolvency framework.

During the CIRP of Essar Steel India Limited (ESIL), an intriguing trend emerged where more than 15% of FC's claims were transferred to international distressed investors and Edelweiss Asset Reconstruction Company (EARC), as reported in a DNA article dated July 19, 2018, titled "Foreign money lapped up Essar Steel Loans from Banks." Additionally, HDFC Bank and Axis Bank opted to allocate their claims to SC Lowy, Bank of Baroda, Laxmi Vilas Bank, and others, whereas Bank of Baroda and IDBI Bank transferred theirs to Deutsche Bank. This redistribution of claims reflected a strategic maneuver to optimize the resolution process.

Moreover, after the CoC greenlit the resolution plan and filed it in the NCLT, State Bank of India (SBI) embarked on a strategy to expedite insolvency resolution by initiating the sale of its financial assets in January 2019.

[3] CASE-STUDY-of-Successfull-Resolutions-Under-IBC.pdf, https://www.iiipicai.in/wp- content/uploads/2021/11/CASE-STUDY-of-Successfull-Resolutions-Under-IBC.pdf (last visited Apr 29, 2023).

However, this proactive move was eventually abandoned, underscoring the complexity and fluidity of the resolution process.

Despite efforts to streamline creditor claims, a significant proportion were rejected due to disputes or non-compliance with the IBC's requirements, prompting disgruntled creditors to resort to litigation. Notably, HDFC Bank secured a foreign judgment against ESIL in a London Court regarding its External Commercial Borrowings (ECB), leading to a subsequent re-filing of a higher claim amount with the Resolution Professional. However, this amended claim was rejected for non-compliance with IBC regulations, triggering further legal actions.

Particularly, claims assigned to third parties necessitated proper stamping in accordance with sections 5 (7) and 5 (20) of the Code, highlighting the importance of adherence to procedural requirements. A related party creditor, failing to appropriately stamp its claim for Rs 5,325 crore with ESIL as both a financial and operational creditor, later rectified the oversight by agreeing to cover the difference in stamp duty paid and providing duly stamped documents to the Resolution Professional.

This intricate stance of creditor claims, and legal intricacies underscores the complexity of the insolvency resolution process and the importance of adherence to regulatory frameworks.

THE JUDGEMENT ANALYSIS

In the comprehensive analysis of the Supreme Court's judgment, it becomes evident that the apex court meticulously upheld the supremacy of financial creditors in decisions concerning the assets, liabilities, and operations of the corporate debtor. By delineating the limited circumstances under which judicial intervention may occur, the court ensured a balanced approach to resolution proceedings. Moreover, by discerning between operational and financial creditors, as well as secured and unsecured creditors, the Supreme Court aptly applied the principle of "equality among equals," thereby ensuring fair treatment for all stakeholders.

The potential ramifications of the National Company Law Appellate Tribunal (NCLAT) Order were highlighted, with the court warning of dire consequences for the Indian banking industry, including an influx of stressed assets into liquidation rather than resolution through the CIRP. The Supreme Court's decision to extinguish all past claims, including undecided claims, provided a sense of relief to resolution applicants who had been hesitant to invest in insolvent companies due to the specter of prolonged litigation proceedings. Additionally, the emphasis on timely resolution, typically within 330 days, addressed concerns that had plagued earlier regulations governing the resolution of stressed assets.[4]

The authors of the judgment believe that the Supreme Court's decision offers an effective mechanism for settlement through the CIRP under the IBC, aligning with the economic and financial principles of the banking industry. However, the court refrained from offering a definitive opinion on the acceptability of invoking guarantees against a corporate bankrupt's former promoters' post-acquisition by a successful resolution applicant, leaving room for further legal interpretation.

[4] Case Note: Judgement Of The Supreme Court In The Essar Steel Case - Insolvency/Bankruptcy - India, https://www.mondaq.com/india/insolvencybankruptcy/1058270/case-note-judgement-of-the-supreme-court-in- the-essar-steel-case (last visited May 1, 2023).

With the Supreme Court's approval of the sale of Essar Steel, it is anticipated that banks will recover over 90% of their dues, amounting to over ₹40,000 crore, significantly bolstering the financial position of weak public sector banks. OCs are also expected to receive a substantial portion of their dues, estimated at close to ₹1,200 crore. This development underscores the success of the CIRP in minimizing the haircut for creditors, despite the corporate debtor being sold. It serves as a testament to the effectiveness of the resolution process and highlights the importance of exploring alternatives to insolvency resolution when feasible.

How this case shows the key factors that affect the rate of Haircuts?

Upon careful examination of this case, it becomes apparent that it holds the distinction of being the inaugural instance under the IBC to undergo the insolvency procedure. Furthermore, it demonstrates a remarkably low percentage of haircut, estimated to be approximately 8-10%, which starkly contrasts with the average haircut rate of around 55%.

Several pivotal factors have contributed significantly to this minimal haircut, thereby underscoring a path of success amidst challenging circumstances:

The proactive approach adopted by Essar Steel's creditors emerges as a critical factor. Rather than awaiting the transition of stressed assets into NPAs, they initiated insolvency proceedings and expedited the approval of a resolution plan. This strategic maneuver not only averted potential losses but also secured a substantial recovery of ₹40,000 crore. Had Essar Steel not taken this proactive stance, the resulting haircut would likely have been considerably higher, given the inherent risks associated with NPAs.

The presence of multiple bidders, including industry giants like ArcelorMittal and Numetal, injected a sense of competition into the process. This heightened competition led to an increase in the valuation of Essar Steel's assets, consequently driving down the haircut rate for creditors. The robust bidding environment facilitated by these interested parties significantly contributed to the favorable outcome for creditors.

Essar Steel's stature as a large, well-established steel producer with substantial assets, notably including a 10-million-tonne-per-year steel facility in Gujarat, played a pivotal role in mitigating the haircut. The considerable value of these assets served as a protective shield for creditors, thereby reducing potential losses and enhancing recovery prospects.

The resolution procedure for Essar Steel was characterized by its relative efficiency, with the Supreme Court actively intervening to resolve disputes and ensure a timely resolution. This proactive judicial involvement streamlined the process, thereby minimizing the costs and delays typically associated with protracted insolvency proceedings. The expeditious resolution facilitated by the judiciary significantly contributed to reducing creditor haircuts.

Effective management of liquidity issues by experienced professionals further bolstered the resolution process. By proactively addressing liquidity concerns and implementing strategic measures to manage cash flow effectively, Essar Steel successfully navigated through challenging financial terrain, safeguarding creditor interests and minimizing haircut rates.

In essence, the success of Essar Steel's insolvency resolution can be attributed to a combination of proactive creditor engagement, competitive bidding dynamics, substantial asset value,

efficient judicial intervention, and adept liquidity management strategies. This case serves as a guiding beacon within the IBC landscape, illustrating the potential for favorable outcomes even amidst complex financial distress scenarios.

CIRP OF AMTEK AUTO

Facts of the case

Navigating the intricate corporate structure of Amtek Auto, the Corporate Debtor (CD), presented the foremost challenge in ensuring its operational continuity as a Going Concern (GC). With direct holdings in numerous global subsidiaries across Japan, Thailand, Spain, Germany, and various states in India, the CD operated as a network of autonomous entities, largely beyond central control. Absence of a standardized Management Information System (MIS) compounded the issue, as each unit maintained its own reporting format, resulting in over 15 disparate excel sheets for daily performance evaluation. Consequently, this decentralized approach fostered isolated operations among units, leading to organizational inconsistency.

Moreover, the CoC, comprising over 90 major lenders, exerted significant influence. The COVID-19-induced lockdown from March to May 2020 further exacerbated challenges, causing a sharp decline in sales during the first quarter of fiscal year 2021. Despite this, subsequent to the lockdown, a rapid revenue recovery resembling a V-shaped rebound was observed.

Dinkar Venkata Subramanian, supported by colleagues Mukul Dalmia and Riya Goel, elucidates the journey of Amtek Auto Ltd.'s CIRP in collaboration with IIIPI. Initiated by the NCLT on July 24, 2017, under section 7 of the Code, Mr. Subramanian was appointed as the IRP, later confirmed as the Resolution Professional.

Beyond the domestic footprint encompassing 15 plants across Haryana, Himachal Pradesh, Maharashtra, Madhya Pradesh, and Tamil Nadu, Amtek's global operations in Japan, Thailand, Spain, Germany, and elsewhere added complexity to the CIRP initiation. This case study is structured into three phases: pre-CIRP performance, CIRP performance, and post-CIRP performance, each posing distinctive hurdles necessitating innovative solutions. Through a descriptive analysis, the study outlines the evolution of Amtek Auto's resolution process, highlighting the challenges surmounted to achieve a successful conclusion in July 2020.

Process for Corporate Insolvency Resolution (CIRP)

Appointment of IRP/ RP:

The initiation of the CIRP for Amtek Auto Limited was set in motion by the NCLT through an order dated July 24, 2017, under section 7 of the IBC. Following this, on July 27, 2017, the Adjudicating Authority (AA) appointed Mr. Dinkar T. Venkata Subramanian as the IRP for the CD. In line with the statutory requirements, Mr. Subramanian was subsequently ratified as the Resolution Professional by the CoC during its meeting on August 22, 2017.

Initial Assessment:

Upon receipt of the NCLT order, the IRP, along with authorized representatives from EY (providing support services to the IRP), engaged with the existing management team of the CD to assume control over its assets. This collaborative effort involved discussions with top

executives to gather insights into current business operations and the organizational framework. Alongside familiarizing the management with the IBC provisions, the IRP presented a strategic plan aimed at sustaining business viability throughout the CIRP and outlined expectations for future collaboration with the incumbent management.

This meeting facilitated the identification of key personnel for essential functions and facilitated the establishment of shadow teams within the IRP's domain. These specialized teams were tasked with overseeing critical functions such as treasury management, human resources, plant operations, sales, and marketing, thereby ensuring comprehensive monitoring and ownership of key operational areas.

The successful resolution of the Amtek Auto bankruptcy stands out as a beacon of hope amidst challenging financial circumstances. Here's a breakdown of why it's considered a triumph:

1. **Improved Recovery Rate**: The final resolution plan offered creditors a significantly higher recovery rate of around 71%, surpassing previous proposals. This means creditors were able to recoup a substantial portion of their outstanding debts, mitigating their losses.

2. **Avoidance of Liquidation**: By steering clear of liquidation, the resolution process safeguarded creditors from facing complete loss. Instead, the acquisition by Deccan Value Investors ensured the continuation of operations, preserving jobs and economic activity associated with Amtek Auto.

3. **Competitive Bidding Process**: The inclusion of multiple rounds of competitive bidding ensured that the assets of Amtek Auto were sold at the highest possible price. This maximized the value for creditors and stakeholders, contributing to the overall success of the resolution.

4. **Commitment to Corporate Governance**: Deccan Value Investors' commitment to enhancing corporate governance practices within Amtek Auto signals a dedication to preventing future defaults and insolvency cases. This proactive approach strengthens the foundation of the company, fostering sustainable growth and stability.

5. **Economic Boost**: The resolution of the Amtek Auto insolvency case has broader positive implications for the Indian economy and the auto component industry. By preserving operations and employment, it injects confidence and stability into the market, bolstering economic resilience.

Overall, the successful resolution of the Amtek Auto bankruptcy serves as a testament to effective restructuring efforts, strategic decision-making, and collaborative engagement among stakeholders.

CIRP OF BHUSHAN STEEL

The resolution of Bhushan Steel's insolvency case under the Code marked a significant milestone in India's corporate restructuring landscape. Here's a breakdown of why Tata Steel's resolution plan was instrumental in achieving a favorable outcome:

Financial Strength of Tata Steel: Tata Steel's robust financial position, characterized by high

profitability, low debt levels, and strong cash flows, empowered the company to submit a competitive bid for Bhushan Steel. This financial stability enabled Tata Steel to provide the necessary capital and support required for the turnaround of Bhushan Steel.

Strategic Fit: The acquisition of Bhushan Steel was strategically aligned with Tata Steel's existing operations in India. This synergy facilitated operational efficiencies and generated strategic advantages for the combined entity, ultimately enhancing competitiveness and profitability.

Capital Infusion: Tata Steel's resolution plan included a significant capital infusion of approximately ₹9,000 crores ($1.4 billion) into Bhushan Steel. This injection of funds strengthened Bhushan Steel's financial position, reduced its debt burden, and contributed to improving operational performance.

Debt Assumption: Tata Steel assumed approximately ₹30,000 crores ($4.6 billion) of Bhushan Steel's debt as part of the resolution plan. By alleviating Bhushan Steel's debt burden, this measure allowed the company to focus on enhancing operational performance and profitability.

Support from Key Stakeholders: The successful resolution of Bhushan Steel's insolvency case was facilitated by the collaboration and support of key stakeholders, including creditors, resolution professionals, and the National Company Law Tribunal (NCLT). This cooperative effort ensured a smooth and effective resolution process.

Favorable Market Conditions: The resolution of Bhushan Steel occurred against the backdrop of favorable market conditions, characterized by strong demand for steel products both domestically and globally. These conducive market conditions contributed to Bhushan Steel's improved financial performance and asset valuation, thereby enhancing creditors' recovery rates.

In essence, Tata Steel's resolution plan for Bhushan Steel demonstrated a combination of financial strength, strategic alignment, capital infusion, debt management, and stakeholder cooperation, which collectively led to a successful resolution of the insolvency case with a relatively low haircut for creditors.

CIRP OF BINANI CEMENT LIMITED

Facts of the case

The implementation of the IBC in India has indeed brought about a transformative change in the corporate rescue system, providing businesses with a structured and efficient mechanism for reorganization. It has significantly altered the credit culture by offering businesses a hassle-free exit option and maximizing the worth of distressed companies. Binani Cement Limited's resolution under the IBC serves as a compelling case study showcasing the effectiveness of the code in resolving complex insolvency issues. Here's a summary of the key points highlighted in the article:

Introduction of IBC: The IBC, enacted in 2016, has revolutionized the corporate rescue system in India by providing a time-bound and efficient framework for restructuring distressed businesses while safeguarding the rights of creditors and balancing the interests of stakeholders.

Role of Resolution Professional : The Resolution Professional serves as a crucial entity in the insolvency resolution process, with the outcome significantly influenced by their capabilities,

expertise, and dedication. They play a central role in managing the resolution process and maximizing value for all parties involved.

Binani Cement's Insolvency Journey: Binani Cement entered the CIRP in July 2017 due to financial distress stemming from various factors, including the global economic crisis, operational challenges, and regulatory issues.

Competitive Bidding Process: Several companies participated in the competitive bidding process for Binani Cement during the CIRP, with UltraTech Cement emerging as the eventual winner after a series of auctions and legal battles.

Acquisition by UltraTech Cement: UltraTech Cement, a subsidiary of the Aditya Birla Group, acquired Binani Cement, renaming it Ultratech Nathdwara Cement Limited. The acquisition involved a significant investment and restructuring of operations.

Financial Recovery for Creditors: The successful resolution of Binani Cement's insolvency case resulted in full recovery for financial creditors and a substantial recovery for operational creditors, totaling approximately 86.44% of their claims.

Future Prospects: While the acquisition by UltraTech Cement is hailed as a fruitful resolution under the IBC, the future growth trajectory of Binani Cement, now Ultratech Nathdwara Cement Limited, remains uncertain but potentially promising, especially with plans for capacity expansion.

In conclusion, the case of Binani Cement under the IBC exemplifies how the code has provided a structured framework for resolving insolvency issues, maximizing value for creditors, and facilitating the revival of distressed businesses, ultimately contributing to the overall efficiency and effectiveness of India's corporate rescue system.

CIRP OF ALOK INDUSTRIES

Facts of the case

The case of Alok Industries provides a vivid illustration of the complexities involved in the insolvency resolution process under the Code. Here's a summary of the key events and developments:

Initiation of Insolvency Proceedings: The NCLT accepted an insolvency petition filed by State Bank of India (SBI) against Alok Industries, which owed SBI close to ₹4,000 crore. Ajay Joshi was appointed as the IRP to oversee the insolvency proceedings.

Acquisition Consideration by Reliance Industries: Reliance Industries Ltd was speculated to be considering the acquisition of Alok Industries, particularly its polyester yarn manufacturing facility, following the company's nomination by the RBI for bankruptcy proceedings due to credit defaults.[5]

Efforts to Attract Bidders: The IRP overseeing Alok Industries' bankruptcy process requested new bids to attract additional potential buyers for the textile company, as initial attempts to solicit expressions of interest (EoIs) did not yield any interested parties.

[5] https://www.businesstoday.in/latest/corporate/story/reliance-acquires-377-stake-alok-industries-rs-250-crore-251054-2020-02-29.

Acquisition by Reliance Industries and JM Financial: Reliance Industries and JM Financial Asset Reconstruction Company acquired Alok Industries through a debt resolution process overseen by the NCLT. However, the CoC rejected their resolution proposal despite the majority of lenders approving it.

Appeal by Workers' Group: A group representing Alok Industries' debt-ridden workers urged banks to reconsider their rejection of the resolution plan put forth by Reliance Industries-led consortium. The workers emphasized the benefits of the proposed settlement plan for both workers and lenders.

Reconsideration by Committee of Creditors: In response to concerns raised by the NCLT, the Committee of Creditors requested the resolution professional to resubmit the resolution plan originally proposed by JM Financial Asset Reconstruction and Reliance Industries. The NCLT ordered the resolution professional to present the approved resolution plan for further consideration.

Company	**Hair cut***	**Resolution Applicant**	**Resolution Professional**	**Time Taken**	**Remarks**
ESSAR STEEL	08%	ArcelorMittal and Japan Nippon steel corporation	Satish Kumar Gupta	800	Wealth maximization and resolut ion of the company with very lo w haircut and did not choose liqu idation.
BHUSHAN STE EL	27%	Tata Steel Limited	Vijay Kumar V. Iyer	294	Within the Maximum Time limit and giving 12.6% shareholdingsto the financial creditors
BINANI CEMENT	20%	UltraTech Cement	VijayKumar V. Iyer	450	It has a strong Asset base and we re not Declared NPAs. The comp etition between the bidders helped in low haircut.
AMTEK AUTO	80%	Deccan Value inve stors LP	Dinkar Venkata Subramaniam	1073	More Appeals and very long peri od. Backing off by the applicants and no competent bidders.
ALOK INDUST RIES	87%	Reliance – JM cons ortium	Ajay joshi	650	Timelines not followed and reali zed at a value very close to liqui dation and no equity allocation to the creditor and very late intervention in financial distress

*Approximate Values

The case of Alok Industries underscores the challenges and negotiations involved in the insolvency resolution process, particularly concerning creditor interests, worker protection, and the approval of resolution plans by relevant authorities.

FACTORS RESPONSIBLE FOR HAIRCUTS – WITH REFERENCE TO THE FIVE CASE STUDIES

In the context of the IBC in India, the magnitude of haircuts can be influenced by several factors, each playing a significant role in the determination process. These factors encompass the overarching goal of wealth maximization, the timeframe allocated for the resolution process, the level of competitiveness observed during the bidding phase, the asset portfolio of the distressed company, the imperative to prevent liquidation, the equitable distribution of equity among creditors, interventions during financial distress, and adherence to prescribed timelines. Although the IBC does not offer a specific definition of haircuts, their size can be influenced by the interplay of these key factors as:

Objective of Wealth Maximization

At the core of the Code in India lies the paramount objective of maximizing the value of the assets owned by the CD. The resolution process embedded within the framework of the IBC is designed to discern and implement strategies that not only optimize value but also ensure equitable distribution of such value among all stakeholders, particularly creditors. The extent of haircuts, or reductions in creditor claims, may be contingent upon the proficiency and ingenuity of resolution applicants in formulating and executing plans that capitalize on the assets of the distressed company, thereby maximizing their overall value and potentially mitigating the need for significant concessions from creditor

Resolution Process Timeline

An integral facet of the IBC is the imposition of stringent deadlines governing the resolution process, aimed at ensuring its efficacy and expeditiousness. The expeditious resolution of insolvency cases is paramount as it curtails the erosion of asset value, fosters market confidence, and enhances the prospects of a successful resolution. Delays in the resolution process can exacerbate the financial distress of the company, resulting in more pronounced reductions in creditor claims as the situation deteriorates over time.

Competitiveness of Bidding Process

The presence of a robust and competitive bidding environment, characterized by the participation of multiple qualified bidders, can significantly influence the extent of haircuts for creditors. Heightened competition among resolution applicants enhances the likelihood of receiving superior offers and proposals, ultimately leading to more favorable outcomes and smaller concessions for creditors. A competitive bidding process not only facilitates the realization of maximum value from the distressed company's assets but also fosters transparency and accountability throughout the resolution process.

Asset Base of Distressed Company

The strength and composition of the distressed company's asset base, coupled with transparent disclosure of NPAs, play a pivotal role in determining the magnitude of haircuts. A resilient

and diversified asset portfolio enhances the prospects of recovery and may attract more viable resolution plans, thereby mitigating the need for substantial concessions from creditors. Moreover, transparent disclosure of NPAs enables resolution applicants to make informed decisions, thereby minimizing uncertainties and fostering confidence among stakeholders.

Avoiding Liquidation

The IBC underscores the primacy of resolution over liquidation, emphasizing the preservation of value and continuity of operations for distressed companies. Viable resolution plans offer creditors greater recovery prospects compared to liquidation, as they enable the company to continue its operations, leverage its existing assets, and generate future value. Successful resolution plans not only mitigate the need for significant concessions from creditors but also contribute to the preservation of jobs, promotion of economic stability, and enhancement of overall stakeholder welfare.

Allocation of Equity to Creditors

The allocation of equity shares to FCs as part of the resolution plan can have profound implications for the magnitude of haircuts. Equity allocation provisions in the plan may serve to partially compensate creditors for their losses, thereby reducing the extent of concessions required in terms of creditor claims. Moreover, the inclusion of equity participation provides creditors with a stake in the future performance and success of the restructured entity, aligning their interests with long-term value creation and sustainability.

Early intervention in financial distress plays a pivotal role in enhancing the likelihood of a successful resolution and reducing the necessity for drastic concessions. The timely identification and mitigation of financial distress enable swift action, thereby preserving the intrinsic value of the company and facilitating more effective resolution strategies.

Adherence to prescribed deadlines, as mandated by the IBC, is imperative for maintaining the efficiency and efficacy of the resolution process. Stricter adherence to these deadlines not only safeguards against value erosion but also minimizes disruptions and uncertainties. Conversely, deviations from these timelines can lead to delays, escalated costs, and heightened reductions in creditor claims, ultimately impeding the resolution process's progress.

It's noteworthy that while these factors significantly influence the magnitude of haircuts, the precise determination of haircuts remains a strategic decision entrusted to the CoC and the resolution applicant. While the IBC provides the legal framework and procedural guidelines for the resolution process, the specifics regarding haircuts, including negotiations and agreements, are intricately tailored to each unique case.

Furthermore, it's important to recognize that the factors discussed are not explicitly tethered to specific sections of the IBC. Rather, they underscore the fundamental principles and considerations that underpin the resolution process. Sections such as 30, 31, and 32 of the IBC delineate the legal framework for the approval and execution of the resolution plan, encompassing provisions that may address haircut-related matters and other pertinent aspects of the resolution process.

RECENT CASE LAW ON HAIRCUT IN RESOLUTION PLAN

The Hon'ble NCLAT in the case of *Mr. Ankur Narang & Ors. v. Mr. Nilesh Sharma RP & Ors*[6] held that a haircut in resolution plan cannot be construed as being violative of section 30(2)(e) of the Code and the minority homebuyers have to necessarily sail with the majority within the class.

This judgement indicates that merely because there is a reduction in the claim of any creditor does not make the resolution plan fall foul of law. "resolution plan providing a lesser amount than admitted does not make it illegal". Any clause in the resolution plan which requires creditors to take a hair-cut cannot be construed as being violative of Section 30(2)(e) of the IBC.

Revival of the company is of utmost importance to the AA which is the primary objective of IBC, *Aircel Ltd v. UOI, CP (IB) No.298/MB.II/2018* is a classic example of resolution plan is comprehensive, aiming to not only maximize asset value but also protect the interests of stakeholders, retain employees, and ensure the continuity of operations.

Background of the case

Background: Aircel Limited, along with its group entities, accumulated significant debt while operating in the telecom sector in India. Despite initially paying a substantial amount for its telecom license, the company faced financial difficulties and filed for insolvency under Section 10 of the IBC.

Insolvency Proceedings: The National Company Law Tribunal (NCLT) admitted Aircel Limited's application for insolvency and appointed an IP to oversee the CIRP. As part of this process, a moratorium was declared under section 14 of the IBC, which provides temporary relief to the company from any legal actions by creditors.

Default on License Fee: Aircel Limited had been paying annual license fees to the Department of Telecommunications (DoT) of the Government of India (GOI) for its telecom license. However, following the initiation of the CIRP, the company defaulted on these payments, leading to DoT issuing a notice for recovery.

Maximizing Recovery for Financial Creditors: The resolution plan seeks to generate approximately [1] 6,630 crore in total, which would serve as a substantial recovery for the FCs of Aircel Limited and its group entities. This amount is significantly higher than what would be expected in a liquidation scenario, indicating a more favorable outcome for creditors.

Protection of Stakeholder Interests: The Resolution Plan takes into consideration the interests of all stakeholders involved, not just the FCs. This holistic approach ensures that the resolution process benefits all parties to the extent possible.

Retention of Employees: One of the significant aspects of the Resolution Plan is the retention of employees. The plan ensures that the workmen and employees currently employed by Aircel Limited and its group entities will not lose their jobs. Instead, they will be retained to

[6] Company Appeal (AT) (Insolvency) No. 1240 of 2023.

carry out the scaled-down operations outlined in the resolution plans. This provision safeguards the livelihoods of employees and promotes continuity in business operations.

Acquisition on "As Is Where Is" Basis: The Resolution Applicant proposes to take over Aircel Limited and its group entities on an "as is where is" basis. This means that the acquiring entity will assume ownership of the companies in their current condition, without any significant alterations or restructuring before the transfer of ownership. This approach could streamline the transition process and expedite the implementation of the Resolution Plan.

CONCLUSION

The IBC stands as a watershed moment in India's legal framework, ushering in a transformative era in the realm of insolvency regulations. At its core, the CIRP introduced by the IBC serves as a mechanism for rehabilitating financially distressed corporate debtors, aiming to mitigate delinquent debts and restore financial stability. With a primary objective of rejuvenating viable enterprises and facilitating the orderly exit of nonviable ones, the IBC embodies a multifaceted approach aimed at bolstering economic resilience and fostering a conducive business environment conducive to growth and sustainability.

Within the expansive framework of the IBC, the haircut method emerges as a pivotal mechanism for resolving financial distress and restructuring debts of companies. This method, which entails a strategic reduction in the value of a creditor's claim or the amount owed by the debtor, presents itself with a plethora of both positive and negative implications for the financial ecosystem at large.

First and foremost, the haircut method seeks to safeguard the value of troubled companies while optimizing creditor recoveries. By embracing haircuts, creditors can expedite the resolution process, thereby circumventing the arduous and protracted liquidation proceedings that would otherwise ensue. Consequently, creditors can recoup a portion of their claims in a timely manner, thus mitigating the financial losses incurred and preserving a semblance of financial stability amidst the turbulence of insolvency.

Furthermore, the haircut method serves to enhance liquidity within the banking sector, enabling financial institutions to extract value from distressed assets and alleviate liquidity constraints. By facilitating the conversion of illiquid assets into liquid capital, the haircut method empowers banks to extend credit more freely, thereby stimulating economic activity and fostering growth across various sectors of the economy.

In addition, the implementation of haircuts incentivizes banks to adopt more prudent lending practices, necessitating comprehensive due diligence and risk assessment before extending credit. By instilling a culture of risk awareness and accountability, the haircut method serves as a catalyst for improving risk management practices within the banking sector, thereby fortifying the resilience of financial institutions and safeguarding against future crises.

However, notwithstanding its merits, the haircut method is not without its challenges and limitations. Reductions in the value of outstanding loans can potentially erode a bank's capital base, thereby impeding its ability to extend credit and comply with regulatory capital

requirements. Additionally, incurred losses may necessitate provisions that can dent profitability and capital adequacy ratios, posing risks to financial stability and investor confidence.

Moreover, contagion effects may ensue if multiple banks are exposed to the same troubled entities, potentially exacerbating systemic risks and undermining overall financial stability. Consequently, the successful implementation of haircuts necessitates effective risk management, prudent provisioning, and robust regulatory supervision to mitigate adverse effects and preserve the stability of the banking system.

In conclusion, while the haircut method represents a pragmatic approach to debt resolution within the ambit of the IBC, ongoing efforts are imperative to address its challenges and optimize its effectiveness in revitalizing distressed companies and preserving financial stability. Through continued research, refinement of processes, and collaborative efforts among stakeholders, the IBC can serve as a powerful instrument for promoting economic resilience and fostering sustainable growth in India's corporate landscape.

One potential suggestion to reduce haircuts under the Code is to enhance the efficiency and transparency of the resolution process. This could involve:

1. **Streamlining Procedures**: Simplify and expedite the resolution process to minimize delays and associated costs. Clear, standardized procedures can help prevent erosion of asset value during prolonged resolution periods.

2. **Effective Asset Valuation**: Ensure accurate and fair valuation of assets to prevent undervaluation, which may lead to higher haircuts. Utilizing independent valuation experts and establishing clear valuation methodologies can enhance transparency and trust in the process.

3. **Promoting Stakeholder Collaboration**: Encourage collaboration among stakeholders, including creditors, debtors, and resolution professionals, to reach consensus-driven solutions. This may involve incentivizing cooperative behavior through appropriate mechanisms such as time-bound resolution plans and creditor committees.

4. **Enhanced Monitoring and Oversight**: Implement robust monitoring and oversight mechanisms to ensure compliance with resolution plans and prevent asset stripping or value erosion. Regular audits and reporting requirements can help detect and address potential issues early on.

5. **Capacity Building and Awareness**: Invest in capacity building initiatives to enhance the skills and knowledge of all stakeholders involved in the resolution process. Additionally, raising awareness about the benefits of timely resolution and the adverse effects of excessive haircuts can foster a more conducive environment for successful outcomes.

6. **Avoiding collusive petitions**: By implementing these measures, the efficiency, fairness, and effectiveness of the resolution process under the IBC can be improved, ultimately leading to reduced haircuts for creditors and a more resilient banking system.

In conclusion, it is evident that haircuts under the IBC represent a double-edged sword, capable of yielding both positive and negative outcomes. On one hand, the haircut method can serve as a crucial tool for balancing the resolution of insolvent firms with the repayment of credits, thereby promoting financial stability and maintaining the integrity of the banking system. However, on the other hand, excessive haircuts can lead to significant losses for banks, potentially resulting in a credit crunch and undermining overall economic health. Therefore, while recognizing the potential benefits of haircuts in facilitating effective resolution processes, it is imperative to implement measures to mitigate the adverse impacts, such as enhancing transparency, promoting stakeholder collaboration, and streamlining procedures. By striking the right balance and adopting a holistic approach, it is possible to harness the potential of haircuts under the IBC while safeguarding the interests of all stakeholders and ensuring the resilience of the financial ecosystem.

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04

WHETHER RESOLVING INSOLVENCY FACTORS OR ECONOMIC FACTORS ARE RESPONSIBLE FOR ENHANCING ENTREPRENEURIAL ACTIVITY IN ASIA WITH SPECIAL FOCUS ON NEW INDIAN INSOLVENCY AND BANKRUPTCY CODE

NVV Satyanarayana Puchakayala and Ramanujam Veluchamy

ABSTRACT

Purpose of present study is to establish an impact of resolving insolvency factors and economic factors on entrepreneurial activity in Asia and India in a probabilistic manner. The present study is also aimed at establishing the impact of the new Indian Insolvency and Bankruptcy Code, 2016 (IBC/Code) on entrepreneurship development in India. Hence, the study is carried out in two parts. The study is of empirical in nature uses secondary source of data obtained from the World Bank Reports, Insolvency and Bankruptcy Board of India (IBBI) Reports, GEM Reports, RBI Reports, etc. A representative sample of five countries namely India, Singapore, Japan, Turkey, and Uzbekistan were drawn from the Asian region for part one. India was considered as one unit of sample for part two. The study addresses research questions: 1) Whether resolving insolvency factors (RIF) have an impact on entrepreneurial activity? 2) Whether economic factors (EF) have an impact on entrepreneurial activity? 3) Whether both RIF and EF have an impact on entrepreneurial activity (EA)? and 4) Whether IBC has an impact on entrepreneurship development in the country? A Tri-Factor Model (RIF–Model 1; EF-Model 2; and RIF & EF together-Model 3) was used for part one. Whereas, a Single-Factor (IBC Factors) model was used for part two. Inferential statistical measures such as multiple correlation, regression analysis, and trend analysis were used for data analysis. The Akaike information criterion (AIC), adjusted R^2, and t-test were also used for testing purpose. The study found an enhanced EA led by RIFs and EFs together in Asian and India as well. The study concludes that the impact of RIFs and EFs together (Model 3) is more on EA as compared to the impact of RIFs (Model 1) and EFs (Model 2) when applied individually on EA. On the other hand, the IBC has also an impact on entrepreneurship development in India.

Key Words: Resolving Insolvency Factors, Economic Factors, Entrepreneurial Activity, IBC, Correlation, and Regression.

INTRODUCTION

Economic development of a nation largely depends on innovation and entrepreneurship that are taking place in that nation (Hodgson, 2019). However, both formal and informal institutions are very much required for innovation and entrepreneurship to occur in the nation (Chowdhury et al., 2018; Dickson and Weaver, 2008; Phelps, 2013; Rodríguez-Pose and Crescenzi, 2008; Urbano et al 2020). Formal institutions are the laws i.e., bankruptcy regime that regulate the treatment of funds at the time of bankruptcy. Informal institutions include social norms and conventions that enforce the communities towards entrepreneurship. Improving the insolvency procedures has become as an important aspect for many Asian economies against the backdrop of financial and economic crisis in Asia in 1997-1998. The strategies and achievements varied significantly among the Asian economies reflecting various legal, economic, cultural and historical circumstances. Still, the main concentration has been instituting and improving the rescue processes, both formal and informal, giving little attention to improving the liquidation process (Forum for Asian Insolvency Reform-FAIR, 2001). India, through the IBC, has been doing well in resolving insolvency in South Asia and standing in the better position in terms of recovery rate, time taken to resolve, and cost of resolving as compared to the average for OECD high-income economies. The creditors' overall recovery rate has been improved from 26.5 cents on the dollar to 71.6 cents, and reduced significantly the time taken to resolve insolvency from 4.3 years to 1.6 years (IBBI).

There were studies measured the entrepreneurship in terms of the EA viz., total businesses, new businesses, and closed businesses. Studies on entrepreneurship also revealed that the entrepreneurial entry was caused by several factors like desire for latent opportunity, looking for self-sufficiency or substitute employability (Taylor, 1999; Shane and Venkataraman, 2000; and Carter et al, 2003). Similarly, entrepreneurial exit was also caused by several factors (Storey et al, 2005). Majority of the previous studies considered the exit as a symptom of non-fulfilment of objectives, while the existence as a measure of fulfilment of objectives (Bruderl et al, 1992; Pennings et al, 1998). It is also not necessary to assume that the existing businesses are successfully running at margins (Van Wittellostuijn, 1998), the exit businesses are not successful (Bates, 2005; McGrath, 2006). It is not possible to link the exit with that of either success or un-success (Gimeno et al, 1997). There was also a mentioning about the entrepreneurial exit both in times of financially viable and unviable (Karl Wennberg et al, 2010). Hence, it can be understood that both entrepreneurial entry and exit are of multifaceted phenomenon. Both entry and exit may impact the individual undertaking the EA, the firm involving in it, the market where it is operated, the society and the economy in which it is held by the individuals through distribution and redistribution of wealth (DeTienne, D., 2010). Here it is worth noting the statement given by magazine The Economist (2010):

> Making it easier to close a business may not sound as inviting as announcing yet another Enterprise fund or Innovation initiative, but it is more vital to reviving the world's moribund economy. In the short run, enlightened bankruptcy laws reduce unemployment by keeping viable companies alive. In the long run they boost rates of entrepreneurship. The best way to get more people to start businesses is to make it easier to wind them up.

Studies, conducted by Wood (1995a, b), Hussain and Wihlborg (1999), Berglöf et al. (2001), Bliss (2003), Falke (2003), Recasens (2004), Franken (2004), and López-Gutiérrez et al. (2005) have distinguished a lot between debtor-friendly bankruptcy systems and creditor-friendly bankruptcy systems. Acharya and Subramanian (2009), through their study, concluded that creditor-friendly bankruptcy regimes lead to more number of liquidations which in turn leads to a lesser number of innovations as compared to debtor-friendly regimes, which support the businesses to continue business activity as going concerns. Some economic, strategic and/or emotional aspects would not permit the insolvent firms to way out pending due to resourceful distribution of inadequate resources of the economy. This is a hurdle for technological progress which prevents the businesses from replacing the old one with the new one. Easy exit procedures are very important for the encouragement of the entrepreneurship. Laws that entrap business houses in too lengthy court dealings or penalising on bankruptcy prevents the individuals or firms from risk taking entrepreneurship (Porter, 1976). However, too much lenient insolvency laws enable the business houses to wind up easily but may not be advantageous to societies at all. Because creditors can take advantage of such lenience in raising the costs of interest which in turn affects negatively the access to credit for small firms. On the other hand, insolvency legislation that is growth-friendly regularly tries to trade-off between un-favouring "small entrepreneurs" (Gratzer and Sjogren, 1999) and discouraging "surplus entry" from the entrepreneurs not doing well (Camerer and Lovallo, 1999).

Studies also have established several legal and institutional environments robustly affect the occurrence of entrepreneurial activity. The corporate debtors (CDs) are going to be treated vividly by different insolvency regimes depending up on the degree of severity of the law. Accordingly, it will also influence the credit available to the small firms. In fact, many countries have different insolvency practices for individual debtors and CDs. Insolvency or bankruptcy regime, as one of the important elements of legal environment, usually comes into picture to arrive at optimal solution on problem between creditors and insolent firms when there are incomplete contracts and poorly enforced laws. Hence, the efficiency of bankruptcy procedure is paramount issue for both government and corporate policy (Yurly Andreev Andreev, 2010). It is a jointly administered practice whereby the creditors' claims are settled against the realisations of debtors' assets. The state of bankruptcy regime is considered to be as one of the factors that determine the causes of failure of business. A more debtor friendly bankruptcy regime can be regarded as a safeguard against the causes of failure of business (Jackson, 1985; Adler, Polack, and Schwartz, 2000; Lee et al., 2007). It further encourages the entrepreneurs to come up with their projects without much concern about quality aspect. However, it may impose a threat on financial creditors who in turn must have to bear the consequences of lending and financing the poor quality projects to the extent possible by continuous monitoring and credit rationing wherever necessary (Stiglitz and Weiss, 1981).

The provision for "fresh start" which has a significant impact on EA is a paramount aspect to be discussed specifically here (White, 2005). A more debtor friendly bankruptcy regime allows the infra-marginal entrepreneurs even from the prior bankruptcy debt position to come back with fresh start quickly as against a business failure (Georgakopoulos, 2002; Landier, 2004; Ayotte, 2007). However, this restarting is allowed in only those jurisdictions where a fresh

come back is accepted (Baird and Morrison, 2005; Stam et al., 2006). On the other hand, the bankruptcy law which doesn't free the debtor from prior bankruptcy debt position will automatically take him away from the entrepreneurial activity as he should have to use his most of his future revenue just to clear his past dues. On top of this, it is not easy for the entrepreneurs entering again second time to find the credit and finance facility. Considering this viewpoint, it can be said that the bankruptcy regime that permits fresh start may enhance marginally the entrepreneurial activity in terms of entry and re-entry.

Insolvency and Bankruptcy Code, 2016

In India, all the previous insolvency regimes like SICA, Lok Adalats, DRTs, CDR, and SARFAESI did not give good results as expected. The non-performing assets (NPAs) are increasing year after year and they are more than 10 lakh crores by the end of 2018. During 2008-20014, banks lend indiscriminately to both existing and new corporations. This led to prompt action by the government appointing an expert committee which in its report in 2015 recommended the Insolvency and Bankruptcy Code. The IBC came into effect on December 1, 2016. It was already six years since the Act came into effect and now it is the time to evaluate the Act whether it is fulfilling its objectives or not and what are the other problems that are confronted with. Hence, the present study is aimed at evaluating the performance of IBC against its one of the stated objectives i.e. promoting entrepreneurship.

The IBC has been demonstrated as a paradigm shift in the way of doing business by enabling other corporate to take over the business of distressed companies referred to NCLT for expansion of their businesses against the closure of default businesses. The IBC is a speedy insolvency resolution mechanism as compared to previous regimes where it took years for the lenders to resolve the unpaid credit extended by them (Nishank, 2019). The insolvency and bankruptcy framework can impact a host of several economic indicators like credit growth, preservation of jobs, creation of employment and entrepreneurship, and in turn the economic growth (M. S. Sahoo and Anuradha Guru, 2020).The IBC has impacted largely on the corporate governance culture where in the interests of all stakeholders are protected while achieving the maximum realisation of claims of creditors simultaneously encouraging the number of corporate insolvency resolution process (CIRPs) (Saket Hishikar et al, 2020).The IBC has brought structural changes for all stakeholders in terms of new incentives leading to their interactions; and the new institutions that influence these interactions (Sreyan Chatterjee et al, 2017).

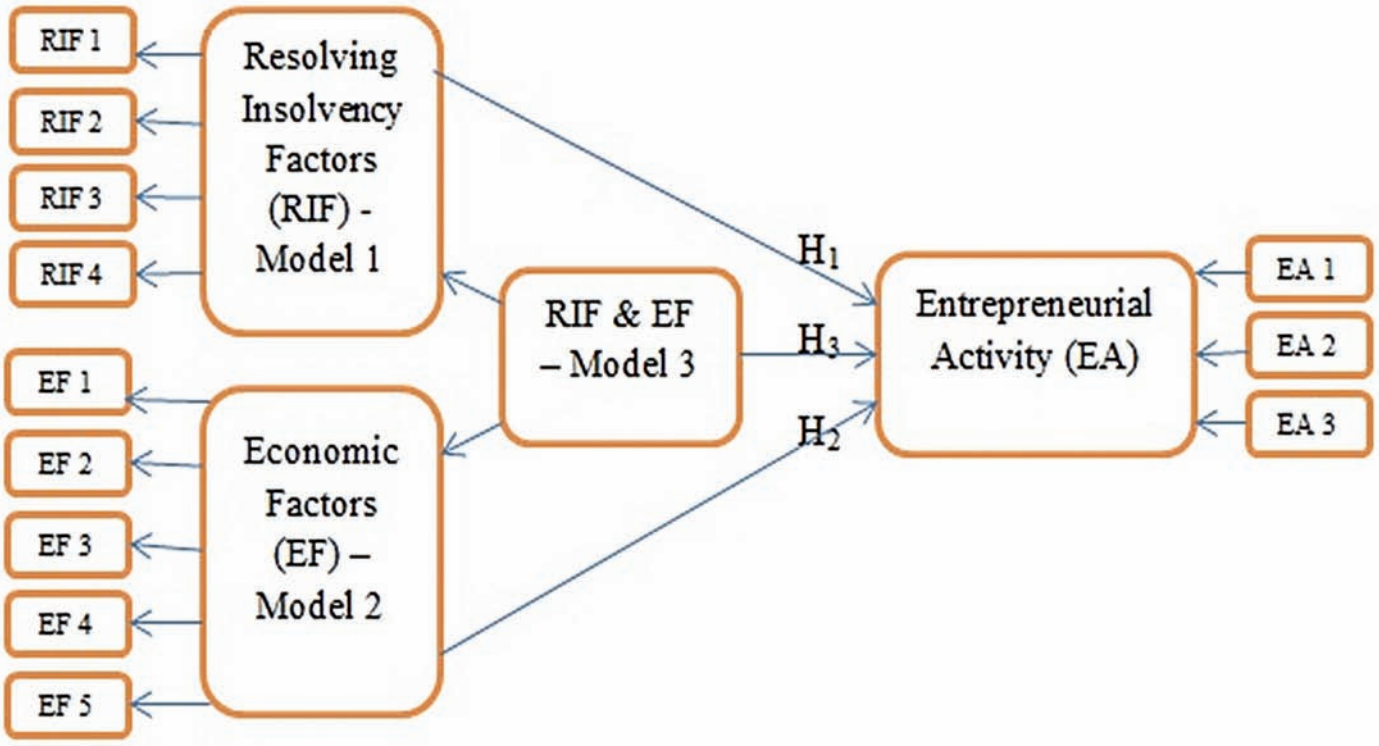
Hence, the present study is mainly aimed at establishing a significant impact of RIFs and EFs on entrepreneurship development (here after referred it as EA) in probabilistic manner in Asian Region with a special reference to India. The present study is further aimed at establishing the impact of the new Code on entrepreneurship development in India.

RESEARCH MODEL AND METHODOLOGY

The available literature review reveals that all the previous studies signify the impact of either RIF or EF on EA. But none of them considered both the factors simultaneously to signify the impact on EA. Moreover, there was very insignificant number of studies in this area especially in Asian context. That is where the present study finds the gap and led by the

research questions: 1) Whether RIFs have an impact on EA? 2) Whether EFs have an impact on EA? and 3) Whether both RIFs and EFs have an impact on EA? A Tri- Factor Model was used to address the research questions (Figure 1).

Figure 1: Resolving Insolvency Factors Vs Economic Factors in Enhancing Entrepreneurial Activity– A Research Model



Source: Authors' Contribution

The EA is measured in terms of total businesses density (total businesses), new businesses density (new businesses), and closed businesses density (closed businesses). RIFs such as time for resolving insolvency (time), cost of resolving insolvency (cost), recovery of creditors' claims (recovery), and strength of insolvency framework (SIF) are considered as part of Model 1. Similarly, economic factors such as paying taxes, getting credit, minimum capital requirements (minimum capital), starting business cost, and ease of doing business score (EDB) are considered as part of Model 2. Likewise, RIFs and EFs together considered as part of Model 3. Hence, the present research model tries to find significant impact of RIFs, EFs, and both RIFs and EFs together on EA in a probabilistic manner.

Based on the main purpose of the study and addressable research questions, the following hypotheses were formulated:

H_1: RIFs have an impact on EA.

Shorter the time the bankruptcy procedure involves, higher the rate of bankruptcy filings and higher the rate of entrepreneurship. Lesser the insolvency cost, higher the bankruptcy filings and higher the rate of entrepreneurship (Hall, 1992). Insolvency regimes themselves become barrier to both entry and exit. Insolvency law that minimizes the cost of entrepreneurial exit

may enhance the level of entrepreneurship in the country (Lee et al. 2007, 2011; Wennberg et al. 2010). Effective insolvency reforms of creditor rights are related with lesser borrowing costs, enhanced access to loan facility, increased recovery of creditor claims and reinforced safeguarding of present employment (Klapper and Claessens et al., 2002; Neira, 2019).

H_2: EFs have an impact on EA.

Taxation is one amongst them. A higher rate of tax on income of employees and a lower rate of tax on capital gains of entrepreneurs are strongly associated with a greater occurrence of entrepreneurial activity in standalone country studies (Poterba, 1989; Gompers and Lerner, 1998; Poutziouris et al., 2000) and cross-country studies (Folster, 2002; Parker and Robson, 2003). In the present scenario, most of the entrepreneurs are going for incorporating their businesses as a limited liability company in the light of the very advantageous characteristic of limited liability. However, the process of incorporating the business as a limited liability company involves costs and minimum capital requirements at varying degrees in different countries. The incorporation costs and the minimum capital requirements have been witnessed a negative association with the occurrence of entrepreneurial activity (Klapper et al., 2006; Klapper et al., 2007; Van Stel et al., 2007). Several studies have also been considered the credit available to small businesses as one of the determining factor for EA (Freear and Wetzel, 1990; Carpenter and Petersen, 2002; Van Praag et al., 2005).

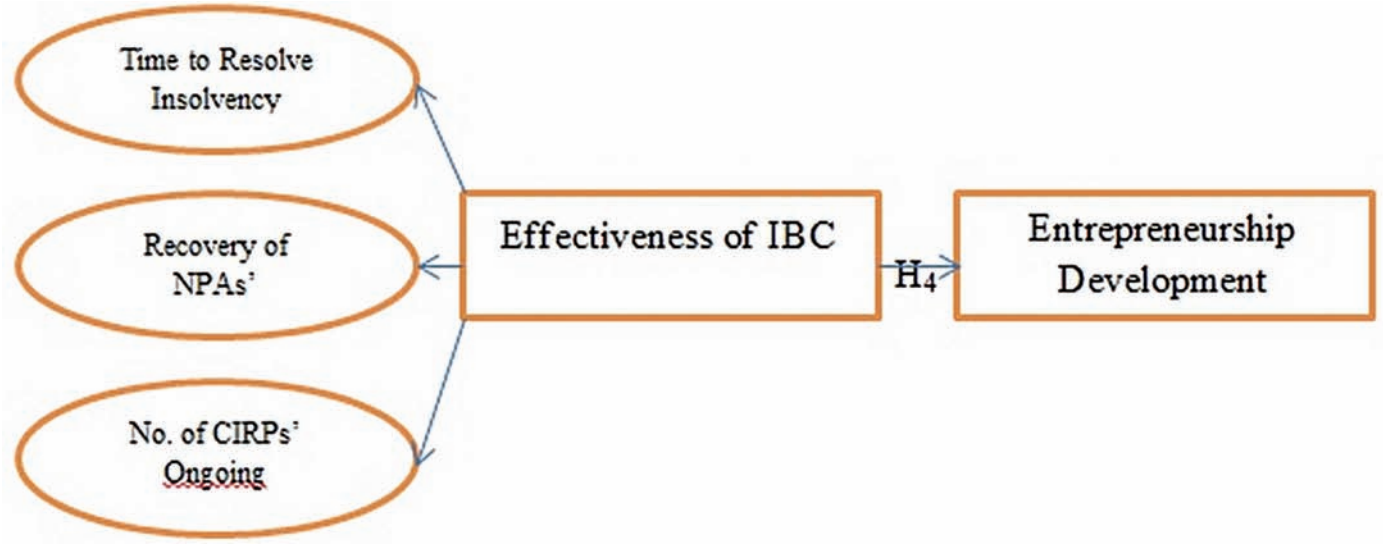
H_3: Both RIFs and EFs together have an impact on EA.

A model with increased number of factors generally may have a significant effect on the dependent variable as compared to models having lesser number of factors. Hence, a combined model with both RIF and EF may have a significant effect on EA.

The study is purely empirical in nature uses secondary source of data obtained from the World Bank Reports for a period of 10 years from 2010 to 2019. A representative sample of five countries namely India, Singapore, Japan, Turkey, and Uzbekistan are drawn from the Asian region for study purpose. Inferential statistical measures such as multiple correlation and regression models were used for analysing the data to know the impact of RIFs on EA (Model 1); EFs on EA (Model 2); and RIFs and EFs together on EA (Model 3) in Asia as a whole and India as well. The data analysis done was classified into two panels viz., panel A and panel B. The panel A was concerned with Asia and the panel B was concerned with India. AIC and adjusted R^2 was used for testing the relative quality of each model. Eviews software was used for the data analysis purpose.

The study also evaluates the present performance of IBC and its impact on entrepreneurship development in India. Hence, the study further addresses research question 4) Whether IBC has an impact on entrepreneurship development? For this purpose, a proposed sub-research model with Single Factor (IBC's Resolving Insolvency Factors) was built (Figure 2). The proposed sub-research model considers the effective performance of IBC as an explanatory variable (X), and entrepreneurship development as a dependent variable (Y). The effective performance of IBC was measured in terms of time to resolve insolvency, recovery of claims of creditors, and number of CIRPs on going under IBC, while the entrepreneurship development was measured in terms of total entrepreneurial activity in India.

Figure 2: Impact of IBC on Entrepreneurship Development - A Sub-Research Model



Source: Authors' Contribution

Based on the purpose of the study, the following hypothesis was formulated:

H_4: The effective performance of IBC enhances the total entrepreneurial activity in the country.

A transparent time-bound resolution process led by IBC leads to quick decision-making enabling financial creditors to reallocate the resources efficiently. It further enables the entrepreneurs to take calculated risks (Daizy Chawla and Jatin Kapoor, 2023).

Research Methodology followed for this part of study was of quantitative research design using secondary source of data from RBI, IBBI, World Bank, IMF, GEM and other published material from prominent data bases for a period of five years from 2017-2018 to 2021-2022. For this purpose, inferential statistical techniques like Carl Pearson's correlation coefficient, regression analysis, trend analysis, and t-test were used.

Based on the past observations of the given variables both IBC factors (X) and Entrepreneurship Development (Y), the following trend lines were constructed for predicting the likely trend of both IBC factors and Entrepreneurship Development:

Likely future trend of IBC factors and Entrepreneurship Development i.e.,

X_c (or) $Y_c = a + bx$——— (1)

Where, 'a' is average of the observations of the given variable, 'b' is annual change in the observations of the given variable, and 'x' is the time deviation taken from the origin i.e, the middle of the past period.

Based on the future trend of IBC factors (X), the following regression line for Entrepreneurship Development was constructed for predicting the impact of IBC.

The regression of Entrepreneurship Development on trend of IBC factorsie.,

$Y - \overline{Y} = byx\ (Xc - \overline{X})$ ——— (2)

Where Y is the expected or estimated value of Entrepreneurship Development in the country for the projected future period of 5 years, Xc is the future trend of IBC factors for the same period, $\bar{Y}$ is the average of Y during the past 5 years, $\bar{X}$ is the average of X during the past period, byx is the regression coefficient of Y on X as measured by the product of correlation coefficient between Y and X, and the ratio of standard deviation of Y and X during the past 5 years period [i.e., $r_{yx}(\sigma_y / \sigma_x)$]. The data sets and workings are available in Appendix for reference.

RESULTS AND DISCUSSION

Based on the objectives of the study, this section is divided into two parts. Part one focuses on the impact of resolving insolvency factors and economic factors on entrepreneurial activity in Asia and India. Part two focuses on the impact of IBC on total entrepreneurial activity in India. For this, inferential statistical techniques like multiple correlation and regression have been used.

Part One: Resolving insolvency factors vs economic factors in enhancing entrepreneurial activity in Asia with special reference to India

This part one initially found correlation between RIF, EF, and EA, and then found regression of EA on RIF and EF in Asia and in India respectively.

Correlation between RIF, EF, and EA- Asia

This section examines whether high degree of correlation exists between RIF and EA or EF and EA in Asia (Table 1 – Panel A).

Between RIF and EA

From the Panel A of Table 1, it can be seen that there was a positive correlation of very small nature at 0.060 between time and total businesses density. It was a negative correlation of very small nature at (-) 0.227 between time and new businesses density, while it was a positive correlation of very small nature at 0.252 between time and closed businesses density. It revealed that the total businesses density decreased at a very low rate, new businesses density increased at a very low rate, and closed businesses density decreased at a very low rate for the decrease in the time to resolve insolvency and vice-versa in Asia during the study period. There was a negative correlation of small nature at (-) 0.385 between recovery of creditors' claims and total businesses density. It was a positive correlation of a very small nature at 0.005 between recovery and new businesses density, while a negative correlation of a very small nature at (-) 0.229 between recovery and closed businesses density. It revealed that total businesses density decreased at low rate, closed businesses density decreased at a very low rate, and new businesses density increased at a very low rate for an increase in the recovery of creditors' claims and vice-versa in Asia during the study period. And there was a positive correlation of very high nature at 0.853 between cost of resolving insolvency and total businesses density. It was a positive correlation of small nature at 0.494 between cost and new businesses density, while a positive correlation of small nature at 0.323 between cost and closed businesses density. It revealed that the total businesses density decreased at a high rate while both the new businesses density and closed businesses density also

decreased at a low rate respectively for a decrease in the cost of resolving insolvency and vice-versa in Asia during the study period. Finally, there was a positive correlation of high nature at 0.723 between SIF index and total businesses density. It was a positive correlation of high nature at 0.859 between SIF index and new businesses density, while a positive correlation of small nature at 0.441 between SIF index and closed businesses density. It revealed that all the three factors of EA increased but at a high rate, a high rate and a low rate respectively for an increase in SIF index and vice-versa in Asia during the study period.

Between EF and EA

From the Panel A of Table 1, it can further be seen that positive correlations were found between the factors of EF and the factors of EA in Asia during the study period. It was a high nature at 0.868 between paying taxes and total businesses density. It was a moderate nature at 0.568 between paying taxes and new businesses density, while it was a very small nature at 0.210 between paying taxes and closed businesses density. It revealed that all the three factors of EA increased but at a high rate, a moderate rate, and a very low rate respectively for an increase in paying taxes and vice-versa in Asia during the study period. There was a high nature at 0.799 between getting credit and total businesses density. It was a moderate nature at 0.595 between getting credit and new businesses density, while it was a very small nature at 0.271 between getting credit and closed businesses density. It revealed that all the three factors of EA increased but at a high rate, a moderate rate, and a very low rate respectively for an increase in getting credit and vice-versa in Asia during the study period. And there was a high nature at 0.889 between minimum capital required and total businesses density. It was a moderate nature at 0.577 between minimum capital required and new businesses density, while a small nature at 0.377 between minimum capital required and closed businesses density. It revealed that all the three factors of EA increased at a high rate, a moderate rate, and a low rate respectively for an increase in the minimum capital required and vice-versa in Asia during the study period. There was a very high nature at 0.964 between starting business cost and total businesses density. It was a high nature at 0.793 between starting business cost and new businesses density, while a small nature at 0.359 between starting business cost and closed businesses density. It revealed that all the three factors of EA increased but at a very high rate, a high rate and a low rate respectively for an increase in starting business cost and vice-versa in Asia during the study period. There was a very high nature at 0.991 between EDB and total businesses density.

It was a high nature at 0.874 between EDB and new businesses density, while a small nature at 0.421 between EDB and closed businesses density. It revealed that all the three factors of EA increased but at a very high rate, a high rate and a low rate respectively for an increase in EDB and vice-versa in Asia during the study period.

Table 1: Correlation between RIF, EF, and EA in Asia and India

Vari-able	Panel A: Asia											
	RIF				EF					EA		
	Time (RIF1)	Recovery (RIF2)	Cost (RIF3)	Strength of Insolvency Framework (RIF4)	Paying Taxes (EF1)	Getting Credit (EF2)	Mini. Capital (EF3)	Starting Business Cost (EF4)	Ease of Doing Business (EF5)	Total Businesses Density (EA1)	New Businesses Density (EA2)	Closed Businesses Density (EA3)
RIF1	1											
RIF2	-0.858	1										
RIF3	0.426	-0.749	1									
RIF4	0.091	-0.150	0.414	1								
EF1	0.345	-0.720	0.962	0.435	1							
EF2	-0.081	-0.350	0.737	0.321	0.771	1						
EF3	0.270	-0.626	0.963	0.437	0.923	0.873	1					
EF4	0.072	-0.426	0.874	0.604	0.905	0.853	0.913	1				
EF5	0..096	-0.394	0.836	0.791	0.838	0.740	0.869	0.941	1			
EA1	0.060	-0.385	0.853	0.723	0.868	0.779	0.889	0.964	0.991	1		
EA2	-0.227	0.005	0.494	0.859	0.568	0.595	0.577	0.793	0.874	0.869	1	
EA3	0.252	-0.229	0.323	0.441	0.210	0.271	0.377	0.359	0.421	0.356	0.255	1
Panel B : India												
RIF1	1											
RIF2	-0.998	1										
RIF3	NA	NA	NA									
RIF4	-0.276	0.295	NA	1								
EF1	-0.780	0.791	NA	0.581	1							
EF2	-0.272	0.284	NA	0.517	0.572	1						
EF3	-0.322	0.342	NA	0.613	0.627	0.877	1					
EF4	-0.424	0.443	NA	0.538	0.692	0.974	0.914	1				
EF5	-0.690	0.706	NA	0.829	0.916	0.615	0.724	0.714	1			
EA1	-0.015	0.022	NA	-0.021	0.241	0.690	0.689	0.688	0.150	1		
EA2	-0.533	0.551	NA	0.576	0.486	-0.125	0.181	0.025	0.649	-0.393	1	
EA3	-0.131	0.152	NA	0.922	0.293	0.402	0.484	0.399	0.617	-0.118	0.484	1

Data Source: World Bank (Refer Table 1A & 1F in Appendix); Calculations contributed by authors using Eviews Software

Correlations between RIF, EF, and EA – India

This section examines whether high degree of correlation exists between RIF and EA or EF and EA in India (Table 1 – Panel B).

Between RIF and EA

From the Panel B of Table 1, it can be seen that there was a negative correlation of very small nature at (-) 0.015 between time and total businesses density. It was a positive correlation of moderate nature at (-) 0.533 between time and new businesses density, while it was a positive correlation of very small nature at (-) 0.131 between time and closed businesses density. It revealed that the total businesses density increased at a very low rate, new businesses density increased at a moderate rate, and closed businesses density increased at a very low rate for a decrease in the time to resolve insolvency and vice-versa in India during the study period. There was a positive correlation of very small nature at 0.022 between recovery of creditors' claims and total businesses density. It was a positive correlation of moderate nature at 0.551 between recovery and new businesses density, while a positive correlation of a very small nature at 0.152 between recovery and closed businesses density. It revealed that all the EA factors increased but at very low rate, moderate rate, and very low rate respectively for an increase in the recovery of creditors' claims and vice-versa in India during the study period. And there was a negative correlation of very small nature at (-) 0.021 between SIF index and total businesses density. It was a positive correlation of moderate nature at 0.576 between SIF index and new businesses density, while a positive correlation of very high nature at 0.922 between SIF index and closed businesses density. It revealed that the total businesses density decreased at a very low rate while both the new businesses density and closed businesses density increased at moderate rate and very higher rate respectively for an increase in the SIF index and vice-versa in India during the study period. It was not found any correlation between cost of resolving insolvency and the factors of EA as the cost was constant throughout the study period.

Between EF and EA

From the Panel B of Table 1, it can further be seen that positive correlations were found between the factors of EF and the factors of EA, except between getting credit and new business density, in India too during the study period. It was a very small nature at 0.241 between paying taxes and total businesses density. It was a small nature at 0.486 between paying taxes and new businesses density, while it was a very small nature at 0.293 between paying taxes and closed businesses density. It revealed that all the three factors of EA increased but at a very low rate, a low rate, and a very low rate respectively for an increase in paying taxes and vice-versa in Asia during the study period. There was a moderate nature at 0.690 between getting credit and total businesses density. It was a negative and a very small nature at (-) 0.125 between getting credit and new businesses density, while it was a small nature at 0.402 between getting credit and closed businesses density. It revealed that the total business density and the closed business density increased but at a moderate rate and at a low rate respectively, while the new business density decreased at a very low rate for an increase in getting credit and vice-versa in Asia during the study period. And there was a moderate nature at 0.689 between minimum capital required and total businesses

density. It was a very low nature at 0.181 between minimum capital required and new businesses density, while a small nature at 0.484 between minimum capital required and closed businesses density. It revealed that all the three factors of EA increased at a moderate rate, a very low rate, and a low rate respectively for an increase in the minimum capital required and vice-versa in Asia during the study period. There was a moderate nature at 0.688 between starting business cost and total businesses density. It was a very small nature at 0.025 between starting business cost and new businesses density, while a small nature at 0.399 between starting business cost and closed businesses density. It revealed that all the three factors of EA increased but at a moderate rate, a very small rate, and a low rate respectively for an increase in starting business cost and vice-versa in Asia during the study period.

There was a very small nature at 0.150 between EDB and total businesses density. It was a moderate nature at 0.649 between EDB and new businesses density, while a moderate nature at 0.617 between EDB and closed businesses density. It revealed that all the three factors of EA increased but at a very small rate, a moderate rate, and a moderate rate respectively for an increase in EDB and vice-versa in Asia during the study period.

Regressions of EA on RIF and EF in Asia and India

This section examines whether RIFs or EFs or RIFs and EFs together have significant impact on EA under three different models for Asia and India separately using multiple regression analysis. The impact of RIFs on EA is measured under Model 1, the impact of EFs on EA is measured under Model 2, and the impact of RIFs and EFs together on EA is measured under Model 3.

Model 1

Impact of RIF on EA - Asia

As part of Model 1, an attempt was made to find the impact of RIFs on EA in Asia (Table 2, Panel A). It can be seen that the total businesses density decreases by 7.832 for one unit change in the time to resolve insolvency, while it decreases by 0.411 for one unit change in the recovery of creditors' claims. It is further found that it increases by 4.529 for one unit increase in the cost of resolving insolvency, while increases by 0.548 for one unit change in the SFI index. All the four RIFs, the explanatory variables, are statistically significant in affecting the total businesses density (one of the dependent variables of EA) in Asia as their p-values 0.002, 0.001, 0.008, and 0.001 are respectively less than the normal significance level i.e., 0.05. In this case, the adjusted R^2 is found to be 0.898 which means about 90% variation in the total businesses density is explained positively by the RIFs' in Asia. AIC is 2.75. It can also be seen that the new businesses density decreases by 1.022 for one unit change in the time to resolve insolvency, while it decreases by 0.040 for one unit change in the recovery of creditors' claims. It is further found that it increases by 0.097 for one unit change in the cost of resolving insolvency, while increases by 0.114 for one unit increase in the SFI index. Here time, cost, and SIF index are statistically significant in affecting the new businesses density in Asia as their p-values 0.003, 0.006, and 0.002 are respectively less than the normal significance level of 0.05. While, recovery is not significant in affecting the

new businesses density in Asia as its p-value 0.596 is greater than the normal significance level. In this case, the adjusted R^2 is found to be 0.848 which means about 85% variation in the new businesses density is explained positively by the RIFs in Asia. AIC is (-) 1.032. It can further be seen that the closed businesses density increases by 0.050 for one unit change in the time to resolve insolvency, while it decreases by 0.008 for one unit change in the recovery of creditors' claims. It is further found that it decreases by 0.035 for one unit change in the cost of resolving insolvency, while increases by 0.032 for one unit change in the SFI index. Here, all the four RIFs, the explanatory variables, are not statistically significant or insignificant in affecting the closed businesses density (one of the dependent variables of entrepreneurial activity) in Asia as their p-values 0.890; 0.628; 0.906 and 0.399are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be (-) 0.167 which means about 17% variation in the closed businesses density is explained negatively by the RIFs in Asia. AIC is (-) 0.069. Hence, hypothesis H1 is accepted.

Table 2: Regression of EA on RIF in Asia and India – Model 1

Panel A: Asia												
Independent Variables – RIFs	**Dependent Variables – EA**											
	Total Business Density Rate				New Business Density Rate				Closed Business Density Rate			
	Coef.	Std. Er.	t-stat.	Prob.	Coef.	Std. Er.	t-stat.	Prob.	Coef.	Std. Er.	t-stat.	Prob.
Time	-7.832	1.425	-5.498	0.002	-1.022	0.215	-4.754	0.003	0.050	0.348	0.145	0.890
Recovery	-0.411	0.064	-6.458	0.001	-0.040	0.010	-4.193	0.006	-0.008	0.016	-0.511	0.628
Cost	4.529	1.155	3.923	0.008	0.097	0.174	0.559	0.596	-0.035	0.282	-0.124	0.906
SIF Index	0.548	0.146	3.758	0.001	0.114	0.022	5.199	0.002	0.032	0.036	0.907	0.399
Number of observations				10				10				10
Adjusted R-squared				0.897				0.848				-0.167
Log likelihood				-9.752				9.159				4.341
Durbin Watson Stat				2.478				2.725				2.163
Akike Info. Criterion				2.750				-1.032				-0.068
Panel B: India												
Time	0.264	0.877	0.301	0.773	0.054	0.103	0.529	0.616	0.090	0.249	0.363	0.729
Recovery	0.014	0.048	0.304	0.771	0.003	0.006	0.610	0.564	0.004	0.014	0.313	0.765
Cost	-0.019	0.559	-0.034	0.974	-0.029	0.066	-0.444	0.673	-0.100	0.158	-0.630	0.552
SIF Index	-0.001	0.007	-0.164	0.875	0.001	0.001	1.269	0.251	0.011	0.002	5.737	0.001
Number of observations				10				10				10
Adjusted R-squared				-0.475				0.271				0.802
Log likelihood				9.065				30.443				21.677
Durbin Watson Stat				0.516				1.162				2.694
Akike Info. Criterion				-1.013				-5.288				-3.535

Data Source: World Bank Report on Resolving Insolvency-Doing Business, 2019 & World Bank Database on Entrepreneurship

(Refer Tables 1A & 1F in Appendix); Calculations contributed by authors using Eviews Software

Impact of RIF on EA - India

As part of Model 1, an attempt was to find the impact of RIFs on EA in India (Table 2, Panel B). It can be seen that the total businesses density increases by 0.264 for one unit change in the time to resolve insolvency, while it increases by 0.014 for one unit change in the recovery of creditors' claims. It is further found that it decreases by 0.019 for one unit change in the cost of resolving insolvency, while decreasing by 0.001 for one unit change in the SFI index. All the four RIFs, the explanatory variables, are not statistically significant or insignificant in affecting the total businesses density (one of the dependent variables of EA) in India as their p-values 0.773, 0.771, 0.974, and 0.875 are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be (-) 0.475 which means about 48% variation in the total businesses density is explained inversely by the RIFs in India. AIC is (-) 1.013. It can also be seen that the new businesses density increases by 0.054 for one unit change in the time to resolve insolvency, while it increases by 0.003 for one unit change in the recovery of creditors' claims. It is further found that it decreases by 0.029 for one unit change in the cost of resolving insolvency, while increasing by 0.001 for one unit change in the SFI index. Here also, all the four RIFs are not statistically significant or insignificant in affecting the new businesses density (one of the dependent variables of EA) in India as their p-values 0.616, 0.564, 0.673; and 0.251 are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.271 which means about 27% variation in the new businesses density is explained positively by the RIFs in India. AIC is (-) 5.288. It can further be seen that the closed businesses density increases by 0.090 for one unit change in the time to resolve insolvency, while it increases by 0.004 for one unit change in the recovery of creditors' claims. It was further found that it decreases by 0.100 for one unit change in the cost of resolving insolvency, while increasing by 0.011 for one unit change in the SFI index. Here also, all the resolving insolvency factors except SIF index, the explanatory variables, are not statistically significant or insignificant in affecting the closed businesses density (one of the dependent variables of entrepreneurial activity) in India as their p-values 0.729, 0.765, and 0.552 are respectively greater than the normal significance level of 0.05. The SIF index is statistically significant as its p-value 0.001 is less than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.802 which means about 80% variation in the closed businesses density is explained positively by the RIFs in India. Hypothesis H1 is accepted. AIC is (-) 3.535. Hence, hypothesis H2 is accepted.

Model 2

Impact of EF on EA – Asia

As part of Model 2, an attempt was made to find the impact of EFs on EA in Asia (Table 3, Panel A). It can be seen that the total businesses density increases by 0.053 for one unit change in paying taxes, while it increases by 0.051 for one unit change in getting credit. It is further found that it decreases by 0.083 for one unit change in the minimum capital required, while decreases by 0.290 for one unit change in the starting business cost. However, it increases at a maximum of 0.657 for one unit change in EDB. Out of five EFs, the explanatory variables, starting business cost and EDB are statistically significant in affecting the total businesses density in Asia as their p-values 0.013 and0.001 are respectively less than the

normal significance level i.e., 0.05. Remaining three EFs viz., paying taxes, getting credit and minimum capital required are not statistically significant or insignificant in affecting the total businesses density in Asia as their p-values 0.151, 0.161 and 0.440 are respectively greater than the normal significance level i.e., 0.05. In this case, the adjusted R^2 is found to be 0.970 which means 97% variation in the total businesses density is explained positively by the EFs' in Asia. AIC is 1.556. It can also be seen that the new businesses density increases by 0.001 for one unit increase in paying taxes, while it increases by 0.009 for one unit change in getting credit. It is further found that it decreases by 0.074 for one unit increase in minimum capital required while decreases by 0.015 for one unit change in starting business cost. However, it increases by 0.133 for one unit change in EDB. Here getting credit, minimum capital required, and EDB are statistically significant in affecting the new businesses density in Asia as their p-values 0.024, 0.010, and 0.001 are respectively less than the normal significance level of 0.05. Paying taxes and starting business cost are not significant in affecting the new businesses density in Asia as their p-values 0.872 and 0.359 are greater than the normal significance level. In this case, the adjusted R^2 is found to be 0.931 which means 93% variation in the new businesses density is explained positively by the EFs' in Asia. AIC is (-)1.798.It can further be seen that the closed businesses density decreases by 0.015 for one unit change in paying taxes, while it decreases by 0.004 for one unit change in getting credit. It is further found that it increases by 0.039 for one unit change in the minimum capital required, while decreases by 0.036 for one unit change in the starting business cost. However, it increases by 0.033 for one unit increase in EDB. Here, all the five EFs, the explanatory variables, are not statistically significant or insignificant in affecting the closed businesses density in Asia as their p-values 0.330; 0.778; 0.426, 0.350and 0.433 are respectively greater than the normal significance level of 0.05. In this case, the adjusted $R^2$is found to be (-) 0.182 which means about 18% variation in the closed businesses density is explained negatively by the EFs' in Asia. AIC is (-) 0.037. Hence, hypothesis H2 is accepted.

Table 3: Regression of EA on EF in Asia and India – Model 2

Panel A: Asia												
Independent Variables – EFs	**Dependent Variables – EA**											
	Total Business Density Rate				New Business Density Rate				Closed Business Density Rate			
	Coef.	Std. Er.	t-stat.	Prob.	Coef.	Std. Er.	t-stat.	Prob.	Coef.	Std. Er.	t-stat.	Prob.
Paying Taxes	0.053	0.031	1.696	0.151	0.001	0.006	0.170	0.872	-0.015	0.014	-1.071	0.333
Getting Credit	0.051	0.031	1.643	0.161	0.019	0.006	3.193	0.024	-0.004	0.014	-0.300	0.778
Minimum Capital	-0.083	0.099	-0.837	0.440	-0.074	0.018	-4.053	0.010	0.039	0.044	0.866	0.426
Starting Business Cost	-0.290	0.077	-3.758	0.013	-0.015	0.014	-1.009	0.359	-0.036	0.035	-1.032	0.350
Ease of Doing Business	0.657	0.087	7.544	0.001	0.133	0.016	8.151	0.001	0.033	0.039	0.852	0.433
Number of observations				10				10				10
Adjusted R-squared				0.970				0.931				-0.182
Log likelihood				-2.778				13.990				5.186
Durbin Watson Stat				2.319				2.747				2.287
Akike info. Criterion				1.556				-1.798				-0.037
Panel B: India												
Economic Factors (EFs)												
Paying Taxes	0.024	0.011	2.093	0.091	-0.001	0.002	-0.421	0.691	-0.037	0.009	-4.005	0.010
Getting Credit	0.010	0.006	1.768	0.137	0.002	0.001	2.180	0.081	0.008	0.005	1.681	0.154
Minimum Capital	0.006	0.002	2.399	0.006	0.0002	0.000	0.454	0.669	-0.001	0.002	-0.701	0.515
Starting Business Cost	0.0002	0.007	0.026	0.981	-0.003	0.001	-2.200	0.079	0.001	0.006	0.193	0.855
Ease of Doing Business	-0.024	0.007	-3.397	0.019	0.004	0.001	2.647	0.046	0.027	0.006	4.692	0.005
Number of observations				10				10				10
Adjusted R-squared				0.772				0.674				0.749
Log likelihood				19.324				35.389				21.413
Durbin Watson Stat				2.178				1.976				2.865
Akike info. Criterion				-2.865				-6.078				-3.283

Data Source: World Bank Report on Resolving Insolvency-Doing Business, 2019 & World Bank Database on Entrepreneurship

(Refer Tables 1A & 1F in Appendix); Calculations contributed by authors using Eviews Software

Impact of EF on EA – India

As part of Model 2, an attempt was made to find the impact of EFs' on EA in India (Table 3, Panel B). It can be seen that the total businesses density increases by 0.024 for one unit change in paying taxes, while it increases by 0.010 for one unit change in getting credit. It is further found that it increases by 0.006 for one unit increase in the minimum capital required, while increases marginally by 0.0002 for one unit change in the starting business cost. However, it decreases by 0.024 for one unit change in EDB. Out of five EFs, minimum capital required and EDB are statistically significant in affecting the total businesses density in India as their p-values 0.006 and 0.019 are respectively less than the normal significance level i.e., 0.05. Remaining three EFs viz., paying taxes, getting credit and starting business cost are not statistically significant or insignificant in affecting the total businesses density in India as their p-values 0.091, 0.137 and 0.981 are respectively greater than the normal significance level i.e., 0.05. In this case, the adjusted R^2 is found to be 0.772 which means about 77% variation in the total businesses density is explained positively by the EFs' in India. AIC is (-) 2.865. It can also be seen that the new businesses density decreases by 0.001 for one unit change in paying taxes, while it increases by 0.002 for one unit change in getting credit. It also increases marginally by 0.0002 for one unit change in minimum capital required. While, it decreases by 0.003 for one unit change in starting business cost and increases by 0.004 for one unit change in EDB. Here all the five EFs are not statistically significant in affecting the new businesses density in Asia as their p-values 0.691, 0.081, 0.669, 0.079, and 0.046 are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.674 which means about 67% variation in the new businesses density is explained positively by the EFs' in India. AIC is (-)6.078. It can further be seen that the closed businesses density decreases by 0.037 for one unit change in paying taxes, while it increases by 0.008 for one unit change in getting credit. It is further found that it decreases by 0.001 for one unit change in the minimum capital required, while increases by 0.001 for one unit change in the starting business cost. However, it increases by 0.027 for one unit increase in EDB. Here, out five EFs, paying taxes and EDB are statistically significant in affecting the closed businesses density in India as their p-values 0.010 and 0.005 are respectively less than the normal significance level of 0.05. Whereas, the remaining EFs' such as getting credit, minimum capital requirement, and starting business cost are not statistically significant as their p-values 0.154, 0.515, and 0.855 are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.749 which means about 75% variation in the closed businesses density is explained positively by the EFs in India. AIC is (-) 3.283. Hence, hypothesis H2 is accepted.

Model 3

Impact of RIF and EF together on EA – Asia

As part of Model 3, an attempt was made to find the impact of RIFs and EFs together on EA in Asia (Table 4, Panel A). It can be seen that there is an increase of 0.577, an increase of 0.110, a decrease of 13.288, a decrease of 0.147, an increase of 0.167, a decrease of 0.136, an increase of 0.578, an increase of 0.151, and an increase of 0.536 in the total businesses density for one unit change in time, recovery, cost, SIF, paying taxes, getting credit, minimum

capital, starting business cost, and EDB respectively in Asia. Here, the RIFs and EFs together are not statistically significant in affecting the total businesses density in Asia as their p-values 0.959, 0.843, 0.707, 0.906, 0.537, 0.828, 0.811, 0.928, and 0.785 are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.992 which means that about 99% variation in the total businesses density is explained positively by the RIFs and EFs together in Asia. AIC is (-) 0.595. It can also be seen that there is an increase of 1.228, an increase of 0.128, a decrease of 0.372, an increase of 0.031, an increase of 0.044, an increase of 0.025, a decrease of 0.039, a decrease of 0.157, and an increase of 0.086 in the new businesses density for one unit change in time, recovery, cost, SIF, paying taxes, getting credit, minimum capital, starting business cost, and EDB respectively in Asia. Here, the RIFs and EFs together are not statistically significant in affecting the new businesses density in Asia as their p-values 0.434, 0.231, 0.921, 0.827, 0.282, 0.731, 0.882, 0.482, and 0.702 are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.994 which means that about 99% variation in the new businesses density is explained positively by the RIFs and EFs together in Asia. AIC is (-) 4.984. It can further be seen that there is an increase of 2.607, a decrease of 0.134, an increase of 7.538, a decrease of 0.771, a decrease of 0.198, an increase of 0.176, a decrease of 0.816, an increase of 0.003, and an increase of 1.057 in the closed businesses density for one unit change in time, recovery, cost, SIF, paying taxes, getting credit, minimum capital, starting business cost, and EDB respectively in Asia. Here, the RIFs and EFs together are not statistically significant in affecting the closed businesses density in Asia as their p-values 0.675,0.661, 0.686, 0.374, 0.294, 0.618, 0.558, 0.997, and 0.411 are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.586 which means that about 59% variation in the closed businesses density is explained positively by the RIFs and EFs together in Asia. AIC is (-) 1.896. Hence, hypothesis H3 is accepted.

Table 4: Regression of EA on RIF and EF Together in Asia and India – Model 3

Panel A: Asia												
Independent Variables – RIFs and EFs	**Dependent Variables – EA**											
	Total Business Density Rate				New Business Density Rate				Closed Business Density Rate			
	Coef.	Std. Er.	t-stat.	Prob.	Coef.	Std. Er.	t-stat.	Prob.	Coef.	Std. Er.	t-stat.	Prob.
Time	0.577	8.934	0.065	0.959	1.228	0.995	1.234	0.434	2.607	4.661	0.559	0.675
Recovery	0.110	0.436	0.251	0.843	0.128	0.049	2.638	0.231	-0.134	0.227	-0.590	0.661
Cost	-13.288	26.835	-0.495	0.707	-0.372	2.990	-0.124	0.921	7.538	13.100	0.539	0.686
SIF	-0.147	0.984	-0.149	0.906	0.031	0.110	0.279	0.827	-0.771	0.513	-1.502	0.374
Paying Taxes	0.167	0.188	0.889	0.537	0.044	0.021	2.112	0.282	-0.198	0.098	-2.011	0.294
Getting Credit	-0.136	0.493	-0.276	0.828	0.025	0.055	0.449	0.731	0.176	0.257	0.684	0.618
Minimum Capital	0.578	1.882	0.307	0.811	-0.039	0.210	-0.187	0.882	-0.816	0.982	-0.831	0.558
Starting Business Cost	0.151	1.330	0.113	0.928	-0.157	0.148	-1.058	0.482	0.003	0.694	0.005	0.997
Ease of Doing Business	0.536	1.527	0.351	0.785	0.086	0.170	0.505	0.702	1.057	0.797	1.326	0.411
Number of observations				10				10				10
Adjusted R-squared				0.992				0.994				0.586
Log likelihood				11.976				33.920				18.482
Durbin Watson Stat				3.474				3.474				3.474
Akike info. Criterion				-0.595				-4.984				-1.896

Table 4: Regression of EA on RIF and EF Together in Asia and India – Model 3

Panel B: India												
Independent Variables – RIFs and EFs	**Dependent Variables – EA**											
	Total Business Density Rate				New Business Density Rate				Closed Business Density Rate			
	Coef.	Std. Er.	t-stat.	Prob.	Coef.	Std. Er.	t-stat.	Prob.	Coef.	Std. Er.	t-stat.	Prob.
Time	-1.701	1.231	-1.382	0.399	-0.053	0.021	-2.592	0.234	0.390	0.074	5.276	0.119
Recovery	-0.101	0.073	-1.386	0.398	-0.003	0.001	-2.814	0.217	0.025	0.004	5.790	0.109
Cost	2.919	2.025	1.442	0.386	0.213	0.034	6.301	0.100	-0.512	0.121	-4.214	0.148
SIF	-0.001	0.014	-0.068	0.957	-0.002	0.000	-7.786	0.081	0.019	0.001	22.653	0.028
Paying Taxes	-0.004	0.033	-0.128	0.919	-0.007	0.001	-13.409	0.047	-0.003	0.002	-1.489	0.377
Getting Credit	-0.264	0.191	-1.386	0.398	-0.022	0.003	-6.998	0.090	0.041	0.011	3.567	0.174
Minimum Capital	-0.001	0.006	-0.090	0.943	-0.0003	0.005	-3.435	0.180	0.001	0.0003	4.171	0.150
Starting Business Cost	0.099	0.069	1.429	0.389	0.006	0.001	4.795	0.131	-0.014	0.004	-3.350	0.185
Ease of Doing Business	-0.005	0.033	-0.147	0.907	0.008	0.001	15.469	0.041	-0.014	0.002	-7.104	0.089
Number of observations				10				10				10
Adjusted R-squared				0.632				0.996				0.998
Log likelihood				24.962				65.874				53.101
Durbin Watson Stat				2.973				2.973				2.973
Akike info. Criterion				-3.192				-11.375				-8.820

Data Source: World Bank Report on Resolving Insolvency-Doing Business, 2019 & World Bank Database on Entrepreneurship (Refer Tables 1A & 1F in Appendix); Calculations contributed by authors using Eviews Software

Impact of RIF and EF together on EA – India

As part of Model 3, an attempt was made to find the impact of RIFs and EFs on EA in India (Table 4, Panel B). It can be seen that there is a decrease of 1.701, a decrease of 0.101, an increase of 2.919, a decrease of 0.001, a decrease of 0.004, a decrease of 0.264, a decrease of 0.001, an increase of 0.099, and a decrease of 0.005 in the total businesses density for one unit change in time, recovery, cost, SIF, paying taxes, getting credit, minimum capital, starting business cost, and EDB respectively in India. Here, the RIFs and EFs together are not statistically significant in affecting the total businesses density in India as their p-values 0.399, 0.398, 0.386, 0.957, 0.919, 0.398, 0.943, 0.389, and 0.907 are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.632 which means that about 63% variation in the total businesses density is explained positively by the RIFs and EFs together in India. AIC is (-) 3.192. It can also be seen that there is a decrease of 0.053, a decrease of 0.003, an increase of 0.213, a decrease of 0.002, a decrease of 0.007, a decrease of 0.022, a decrease of 0.0003, an increase of 0.006, and an increase of 0.008 in the new businesses density for one unit change in time, recovery, cost, SIF, paying taxes, getting credit, minimum capital, starting business cost, and EDB respectively in India. Here, the RIFs and EFs together are not statistically significant in affecting the new businesses density in Asia as their p-values 0.234, 0.217, 0.100, 0.081, 0.047, 0.090, 0.180, 0.131, and 0.041 are respectively greater than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.996 which means that about 99% variation in the new businesses density is explained positively by the RIFs and EFs together in India. AIC is (-) 11.375. It can further be seen that there is an increase of 0.390, an decrease of 0.025, a decrease of 0.512, an increase of 0.019, a decrease of 0.003, an increase of 0.041, an increase of 0.001, a decrease of 0.014, and a decrease of 0.014 in the closed businesses density for one unit change in time, recovery, cost, SIF, paying taxes, getting credit, minimum capital, starting business cost, and EDB respectively in India. Here, except SIF, all the RIFs and EFs together are not statistically significant in affecting the closed businesses density in Asia as their p-values 0.675,0.661, 0.686, 0.294, 0.618, 0.558, 0.997, and 0.411 are respectively greater than the normal significance level of 0.05. The SIF, one of the RIFs, is statistically significant in affecting the closed businesses density as its p-value 0.028 is less than the normal significance level of 0.05. In this case, the adjusted R^2 is found to be 0.998 which means that about 100% variation in the closed businesses density is explained positively by the RIFs and EFs together in India. AIC is (-) 8.820. Hence, hypothesis H3 is accepted.

Part Two: Impact of IBC on total entrepreneurial activity in India

This part two initially found correlation between IBC factors in terms of its RIF and Total Entrepreneurial Activity (TEA), further found trend values for both IBC factors and TEA for a projected period of 5 years from 2023-2027, and then regressed TEA on trend of IBC factors for a projected period of 5 years from 2023-2027 in India.

Correlation between IBC factors and TEA

This section examines the degree and the nature of correlation between the IBC factors and TEA in India (Table 5).

Table 5: Correlation between IBC and TEA

Variables & Measures	IBC Factors in terms of RIF		
	Time to Resolve Insolvency by IBC	Recovery of NPAs of SCBs by IBC	CIRPs ongoing under IBC
	(1)	(2)	(3)
TEA			
Correlation	0.233	0.274	0.371
Degree & Nature of Correlation	Low & Positive	Moderate & Positive	Moderate & Positive
Calculated t-value	0.526	0.654	1.022
Significance	No	No	No
Table t-value @ 5% l.o.s with 4 d.o.f.	2.132	2.132	2.132
Observations	5	5	5

Source: IBBI, RBI, and GEM (Refer Table 2A in Appendix); Calculations – Authors Contribution

From Table 5, it can apparently be seen that there is a positive correlation between time to resolve insolvency and TEA of low order at 0.233, positive correlation between recovery of NPAs and TEA of moderate order at 0.274, and positive correlation between CIRPs and TEA of moderate order at 0.371. All correlations are insignificant as their calculated t-statistic is less than table value i.e., 2.132 at 5% l.o.s with 4 d.o.f.

Trend of IBC factors and TEA

This section examines the trend of both IBC factors in terms of its RIF and TEA in India for a projected period of 5 years from 2023-2027 (Table 6).

Table 6 Trend Values for Five Years during 2022-23 to 2026-27

Year	Time to Resolve Insolvency by IBC –(X_{c1})	Recovery of NPAs of SCBsby IBC(X_{c2})	CIRPson-going under IBC(X_{c3})	Total Entrepreneurial Activity in India (Y_c)
2022-23	636	13.83	2253	12.61
2023-24	717	6.12	2551	13.08
2024-25	797	-1.59	2849	13.55
2025-26	877	-9.30	3147	14.02
2026-27	957	-17.01	3444	14.49

Source: Authors contribution

From Table 6, it can be apparently seen that the trend of time to resolve insolvency under IBC is likely to increase to 957 days on an average for the number of cases to be settled during 2026-2027. The recovery of NPAs will tend to decline to about (-) 17%, while the trend of CIRPs will tend to increase to 3,444 during the same period. However, the trend of TEA will tend increase to 14.49% during the same period.

Regression of TEA on IBC Factors

This section examines the impact of the projected trend of IBC factors such as time to resolve insolvency, recovery of NPAs, and on-going CIRPs under IBC on TEA in India for a projected period of 5 years from 2023-2024.

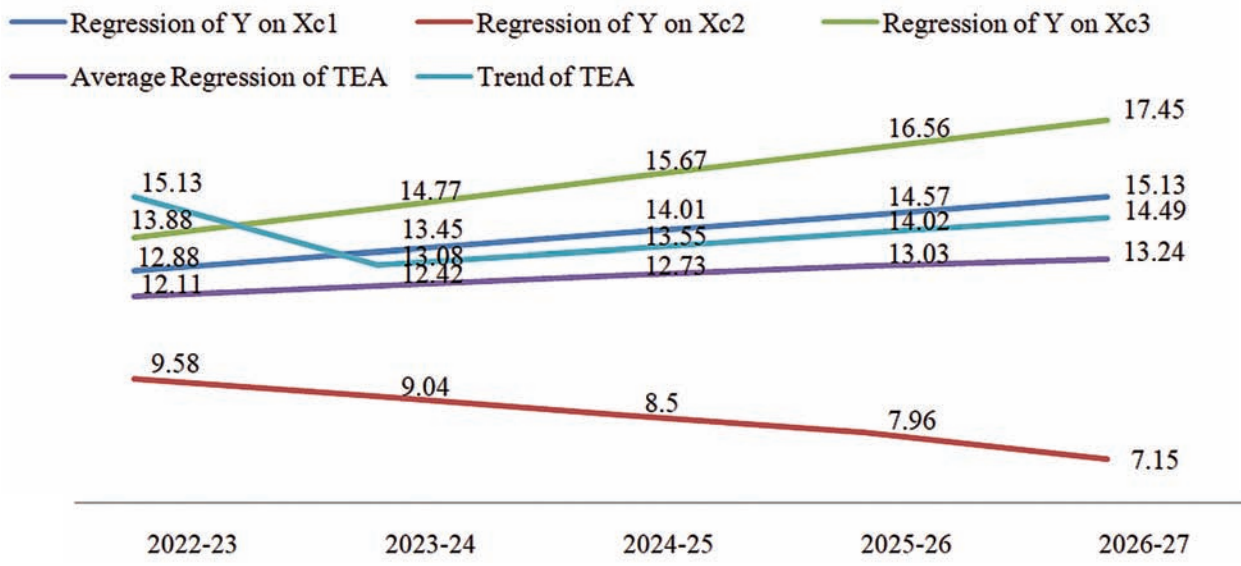
From the Table 6 and Figure 3, it can be apparently seen that the regression of TEA on the trend of time to resolve insolvency would be at 12.88% during 2022-2023 and at 15.13% during 2026-2027. Similarly, when it regressed on recovery of NPAs, it would be at 9.58% and 7.15% during the same periods. Likewise, when it regressed on CIRPs, it would be at 13.88% and 17.45% during the same periods.

Table 5: Regression of TEA (Y)on Trend of IBC Factors (Xc) during 2022-23 to 2026-27

Year	2022-23	2023-24	2024-25	2025-26	2026-27
Regression of Yon Xc_1	12.88	13.45	14.01	14.57	15.13
Regression of Yon Xc_2	9.58	9.04	8.50	7.96	7.15
Regression of Yon Xc_3	13.88	14.77	15.67	16.56	17.45
Average Regression of TEA (Y)	12.11	12.42	12.73	13.03	13.24
Trend of TEA	15.13	13.08	13.55	14.02	14.49

Source: Authors' contribution (Refer Tables 2B, 2C, & 2D in Appendix)

Figure 3: Regression of TEA on IBC & Trend of TEA



Source: Authors' contribution

It further reveals, in all the three cases, that the TEA in the country would tend to increase to 13.24% on an average during 2026-2027 which is slightly below the projected trend of TEA i.e. 14.49% during the same period. Hence, hypothesis H_4 is accepted.

FINDINGS, IMPLICATIONS AND CONCLUSION

The study found that the RIFs in India have been improved a lot in terms of time to resolve insolvency, recovery and SIF at (-) 6.98, 20.06, and 3.32 on an average respectively as a percent year on year decrease or increase basis when compared to Asia as a whole. The reason behind this improvement is the new IBC that has been brought in by the Indian Government in 2016 with the objective of maximum recovery of creditors' claims in a time bound manner. After the IBC has been introduced, India has witnessed a maximum recovery of 77% and a minimum time period of 1.6 years to resolve insolvency. But, when it comes to the mean performance, Asia as a whole stood in the good position in terms of mean time to resolve insolvency, recovery of creditors' claims, cost of resolving insolvency and SIF at 2.29 years, 60.67, 6.65, and 56.25 as a percent respectively on an average. The study further found that the EFs in Asia are ahead of India in terms of the mean distance to frontier (viz., Paying Taxes at 69.10, Business Cost at 94.41, Minimum Capital at 94.93, and EDB Score at 69.40) except the dimension of getting credit which was ahead of Asia at 85.83. However, in India, the minimum capital required dimension has been improved in terms its distance to frontier at 7.97 per cent year on year basis. The EA in Asia as a whole seems to be good as compared to the EA in India in terms of the mean total businesses density at 18.11, new businesses density at 2.30, and closed businesses density at 1.22 per 1000 audit populations. The year on year increase of new businesses density in Asia as a whole is at 5.02, while in India is at 3.07. The year on year increase of closed businesses density in India is at 128.63 which reflect the poor performance of RIFs and EFs. However, after IBC came into force in India, the scenario has been changed drastically. India has improved its EDB score by 23 positions against its 100th rank in 2017 reaching now at a rank of 77 among the World Bank (2019) assessed 190 countries. It has further improved its corporate insolvency resolution processes - CIRPs through which the the creditors are able to realise 177.55% of the liquidation value and 84.00% of the fair value of assets (IBBI, 2022). It was further stated that the IBC is successful not only in achieving one of its objectives i.e., maximizing the value of assets and realising maximum of creditors' claims, but also in enabling the financially distressed businesses to continue as going concerns (Puchakayala and Veluchamy, 2023). The rules governing the best distribution of returns for creditors will extend the credit facility (World Bank, 2014). This, in turn, has pushed the EA in terms of new businesses density in India. It was argued that the effective implementation of insolvency regime could enhance the entrepreneurship development in a country. Further, concluded that the resolving insolvency has an insignificant positive impact on entrepreneurial activity in India in the short run (Puchakayala and Veluchamy, 2023).

The correlations between RIFs (time, recovery, cost, and SIF) and new businesses density in Asia as a whole were found to be at (-) 0.227, 0.005, 0.494, and 0.859 respectively, while they were at (-) 0.533, 0.551, NA, and 0.576 respectively in India. It reveals that the correlations between RIFs and new businesses density one of the important dimensions of EA is high in India as compared to Asia as a whole. But, the correlations between EFs (paying taxes,

getting credit, minimum capital, starting business cost, and EDB) and new businesses density in Asia as a whole were found to be at 0.568, 0.595, 0.577, 0.793, and 0.874 respectively, while they were at 0.486, (-) 0.125, 0.181, 0.025, and 0.649 respectively in India. It reveals that the correlations between EFs and new businesses density one of the important dimensions of EA is high in Asia as a whole as compared to India. It can be understood that the new businesses density in Asia as a whole was more influenced by EFs rather than by RIFs, while the same was opposite in case of India (i.e., the new businesses density was more influenced by RIFs' rather than by EFs' in India).

In regression, based on adjusted R^2, model 3 was found to be good fit as about 99% variation in the new businesses density (one of the important dimensions of EA) was explained by RIFs and EFs together in Asia as a whole and India as well. This figure 99% in model 3 was considered to be more as compared to the figures (i.e., 85% in Asia as a whole and 27% in India) in model 1 and the figures (i.e., 93% in Asia as a whole and 67% in India) in model 2. The AIC also reveals the same thing that the model 3 is good fit as its score was minimum i.e., (-) 4.984 in Asia as a whole and (-) 11.375 in India when the new businesses density (one of the important dimensions of EA) was regressed on RIFs and EFs together. The AIC of model 1 (i.e., when the new businesses density was regressed on RIFs) was (-) 1.032 in Asia as a whole, while (-) 5.288 in India. And the AIC of model 2 (i.e., when the new businesses density was regressed on EFs) was (-) 1.798 in Asia as a whole and (-) 6.078 in India.

There are some theoretical and social implications of the study. *Firstly*, the study was carried out on the basis of the data related with EA of limited liability companies in Asia and India as well. *Secondly*, the study was carried out for a limited period only i.e., 10 years during 2010-2019. *Thirdly*, the study was based on a sample five economies representing the entire Asian region. Hence, there are some theoretical implications that nature and level of significance of the effect of resolving insolvency factors and economic factors on EA may vary accordingly from one type of business to another type of business, period to period, and place to place. The social implications are that the outcome of Asian region as whole may influence the performance of India in regard to the impact of RIFs and EFs on EA. Likewise, the outcome of India economy may influence the performance of other economies in the Asian region in regard to the impact of RIFs and EFs on EA. The study further highlights the need for the improvement on part of RIFs and EFs to enhance the EA in Asian region as a whole. Hence, the study helps all concerned stakeholders in the Asian region to make improvements on RIFs and EFs in such a way that they could influence the EA in the region significantly. The study concludes that the RIFs and EFs have an insignificant positive impact on EA in Asian region as a whole and India as well. The study further concludes that the impact is more when RIFs and EFs applied together as compared to the impact when applied individually.

The IBC has brought drastic changes so far as resolving the insolvency issues in terms of reduced time to resolve insolvency, reduced cost of resolving insolvency, and increased recovery of claims of creditors. Nishank (2019), stated that the Code has proven to be a game-changer as it enabled other companies to take over companies referred to National Company Law Tribunal for expanding their businesses, in the winding up of defaulting companies. He further stated that it provides a speedier resolution for the lenders who had to spend years in negotiating earlier mechanisms. This in turn, helped the Indian economy to grow by way of

reduced NPAs, increased CIRPs (reduced liquidations), and enhanced entrepreneurship development to some extent. M. S. Sahoo and Anuradha Guru (2020), found that the insolvency and bankruptcy legal framework influences various economic indicators like growth in credit facility, preservation of jobs, generation of employment and entrepreneurship development and, in turn, overall economic growth. They further stated that it also brings behavioural changes on part of creditors, debtors and entrepreneurs in terms of readiness to assume risks. Apart from the challenges, the Code has helped in improving the global rank of India in the ease of doing business putting, for the first time, Indian business in the top 100 world business ranks. With this development, the authors also expect a growth in FDI and GDP in the country. And it has also given an immense boom for M&A drive in India (Srijan Anant, 2019). Despite insignificant positive or negative correlations of strong or moderate or low nature between the IBC factors and entrepreneurship development, it can be concluded that the IBC has a significant economic impact in terms of entrepreneurship development India.

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APPENDIX

Data Sets – Part One

Table 1A: Resolving Insolvency Factors (RIF), Economic Factors (EF), and Entrepreneurial Activity (EA) in India (Southern Asia) During 2010 - 2019

Years	RIF1	RIF2	RIF3	RIF4	EF1	EF2	EF3	EF4	EF5	EA1	EA2	EA3
2010	4.3	25.91	9	37.5	52.6176	83.3333	52.7971	74.5408	50.1	1.15	0.11	0.04
2011	4.3	29.5304	9	37.5	54.0247	83.3333	62.594	78.8424	51.7	1.19	0.12	0.06
2012	4.3	27.8309	9	37.5	54.1851	83.3333	64.9642	78.2925	52.1	1.28	0.13	0.02
2013	4.3	27.357	9	37.5	56.3723	83.3333	68.8884	78.1348	52.3	1.35	0.11	0.01
2014	4.3	27.6941	9	37.5	56.6268	87.5	72.1992	90.243	52.5	1.39	0.08	0.02
2015	4.3	27.6854	9	37.5	56.6268	87.5	100	91.3254	54.1	1.44	0.09	0.02
2016	4.3	28.0049	9	37.5	55.6098	87.5	100	91.6179	54.9	1.50	0.11	0.02
2017	4.3	28.3663	9	53.125	55.594	87.5	100	91.0776	60.4	1.34	0.12	0.26
2018	4.3	28.5632	9	53.125	61.9813	87.5	100	91.5791	66.8	1.31	0.13	0.15
2019	1.6	77.0292	9	46.875	65.751	**87.5**	100	95.3279	70.1	1.33	0.14	0.1

Table 1B: Resolving Insolvency Factors (RIF), Economic Factors (EF), and Entrepreneurial Activity (EA) in Singapore (South Eastern Asia) During 2010 – 2019

Years	RIF1	RIF2	RIF3	RIF4	EF1	EF2	EF3	EF4	EF5	EA1	EA2	EA3
2010	0.8	96.5083	3	53.125	100	66.6667	100	99.6316	88.7	53.65	6.87	3.71
2011	0.8	96.5083	3	53.125	100	66.6667	100	99.6616	88.7	55.26	7.31	4.69
2012	0.8	96.5083	3	53.125	100	66.6667	100	99.688	88.7	57.08	7.57	4.52
2013	0.8	96.5083	3	53.125	100	83.3333	100	99.7007	89.5	60.18	8.22	4.25
2014	0.8	95.4733	4	53.125	100	87.5	100	99.7143	87.7	63.88	8.94	4.46
2015	0.8	95.4937	4	53.125	100	87.5	100	99.7217	84.9	66.10	7.86	4.92
2016	0.8	95.4937	4	53.125	100	87.5	100	99.7222	85.4	68.30	8.01	5.28
2017	0.8	95.4937	4	53.125	100	87.5	100	99.7282	85.6	72.34	8.58	5.13
2018	0.8	95.5413	4	53.125	100	87.5	100	99.7951	85.8	77.36	10.01	5.55
2019	0.8	95.5073	4	53.125	100	**87.5**	100	99.8061	86.2	82.25	10.19	5.42

Table 1C: Resolving Insolvency Factors (RIF), Economic Factors (EF), and Entrepreneurial Activity (EA) in Japan (Eastern Asia) During 2010 - 2019

Years	RIF1	RIF2	RIF3	RIF4	EF1	EF2	EF3	EF4	EF5	EA1	EA2	EA3
2010	0.6	99.767	3.5	81.25	70.2096	83.3333	100	96.2326	79.1	0.32	0.09	0.003
2011	0.6	99.83	3.5	81.25	68.9727	83.3333	100	96.2368	79.4	0.42	0.11	0.02
2012	0.6	99.8639	3.5	81.25	67.7539	83.3333	100	96.2313	79.3	0.54	0.14	0.03
2013	0.6	99.9176	3.5	81.25	67.2793	83.3333	100	96.2342	79.6	0.72	0.19	0.01
2014	0.6	99.9771	3.5	81.25	64.8833	75	100	96.2373	76.9	0.96	0.25	0.03
2015	0.6	98.9567	4.5	81.25	64.7674	75	100	96.2439	77.4	1.23	0.29	0.03
2016	0.6	98.8115	4.5	81.25	67.1275	75	100	96.2503	77.6	1.50	0.31	0.05
2017	0.6	99.0568	4.5	81.25	69.374	75	100	96.2663	77.7	1.82	0.36	0.04
2018	0.6	99.0858	4.5	81.25	70.3854	75	100	96.2711	77.8	2.18	0.39	0.04
2019	0.6	98.8115	4.5	81.25	70.3787	**75**	100	96.2729	77.8	2.56	0.41	**0.06**

Table 1D: Resolving Insolvency Factors (RIF), Economic Factors (EF), and Entrepreneurial Activity (EA) in Uzbekistan (Central Asia) During 2010 - 2019

Years	RIF1	RIF2	RIF3	RIF4	EF1	EF2	EF3	EF4	EF5	EA1	EA2	EA3
2010	4	23.8622	10	50	0	0	91.8679	94.5986	41.1	4.03	0.80	0.34
2011	4	25.4932	10	50	0	50	93.21	97.3697	41.1	4.49	0.85	0.37
2012	2	41.4138	10	50	0	66.6667	93.1585	98.112	46.2	4.75	0.66	0.38
2013	2	42.906	10	50	0	83.3333	100	98.2306	47.9	5.15	0.85	0.42
2014	2	42.906	10	50	77.245	87.5	100	98.3275	52.3	5.55	0.84	0.37
2015	2	44.4804	10	50	78.6645	87.5	100	98.2922	61.7	5.86	0.90	0.49
2016	2	42.5709	10	50	83.0764	87.5	100	98.3828	62.1	6.17	1.02	0.51
2017	2	39.998	10	50	82.8108	87.5	100	98.4318	66.6	6.84	1.20	0.49
2018	2	40.422	10	50	91.592	87.5	100	98.4503	67.8	8.04	1.62	0.40
2019	2	37.0664	10	50	92.3167	**87.5**	100	98.9108	69.9	10.29	2.72	0.42

Table 1E: Resolving Insolvency Factors (RIF), Economic Factors (EF), and Entrepreneurial Activity (EA) in Turkey (Western Asia) During 2014 - 2019

Years	RIF1	RIF2	RIF3	RIF4	EF1	EF2	EF3	EF4	EF5	EA1	EA2	EA3
2014	3.3	30.0091	0	50	80.6388	87.5	96.9658	88.7418	68.8	15.48	1.04	0.00
2015	4.5	20.1716	0	50	79.5771	87.5	97.2603	88.9051	69.1	16.43	1.25	0.02
2016	4.5	19.9616	0	50	79.5646	87.5	97.4485	89.1187	69.4	17.11	1.18	0.20
2017	5	16.51	0	50	79.7235	87.5	98.0616	92.0527	70.9	15.74	1.32	2.39
2018	5	15.7899	0	65.625	79.6647	100	100	94.6811	75.3	16.81	1.51	0.18
2019	5	11.3006	0	65.625	76.9281	100	100	96.9823	76.8	17.84	1.48	**0.24**

Table 1F: Resolving Insolvency Factors (RIF), Economic Factors (EF), and Entrepreneurial Activity (EA) in Asia (Average of All Five Countries) During 2010 - 2019

Years	RIF1	RIF2	RIF3	RIF4	EF1	EF2	EF3	EF4	EF5	EA1	EA2	EA3
2010	2.43	61.51	6.38	55.47	55.71	58.33	86.17	91.25	64.75	14.79	1.97	1.02
2011	2.43	62.84	6.38	55.47	55.75	70.83	88.95	93.03	65.23	15.34	2.1	1.29
2012	1.93	66.4	6.38	55.47	55.48	75	89.53	93.08	66.58	15.91	2.12	1.24
2013	1.93	66.67	6.38	55.47	55.91	83.33	92.22	93.08	67.33	16.85	2.34	1.17
2014	2.2	59.21	6.63	54.38	75.88	85	93.83	94.65	67.64	17.45	2.23	0.98
2015	2.44	57.36	6.88	54.38	75.93	85	99.45	94.9	69.44	18.21	2.08	1.1
2016	2.44	56.97	6.88	54.38	77.08	85	99.49	95.02	69.88	18.92	2.13	1.21
2017	2.54	55.88	6.88	57.5	77.5	85	99.61	95.51	72.24	19.62	2.32	1.66
2018	2.54	55.88	6.88	60.63	80.72	87.5	100	96.16	74.7	21.14	2.73	1.26
2019	2	63.94	6.88	59.38	81.07	87.5	100	97.46	76.16	22.86	2.99	1.25

Data Set – Part Two

Table 2A: Pattern of IBC Factors and TEA during 2017–2018 and 2021-2022

Year	Time to Resolve Insolvency by IBC*	Recovery of NPAs of SCBsby IBC	No. of CIRPs Ongoing under IBC	Total Entrepreneurial Activity in India
	(1)	(2)	(3)	(5)
2017-2018	230	49.6	539	9.3
2018-2019	326	45.7	1065	11.4
2019-2020	**396****	45.5	1819	15
2020-2021	468	20.2	1631	5.9
2021-2022	560	23.8	1745	14.4

Source: RBI, IBBI, and GEM.
*Note: *Average number of days for number of cases handled;*
***Average value of 2017, 2018, 2021, and 2022 due to unavailability.*

Workings –Part Two

Regression of TEA on IBC Factors (Time, Recovery and CIRPs)

Table 2B: Regression of TEA (Y) on Time (X_1)

Year	r_{yx1}	$\sigma_{y/}\ \sigma_{x1}$	$X_1 - \bar{X}_1$	$\bar{Y}$	$_{byx1}$	Regression of Yon X_1
2022-23	0.233	0.030	240	11.2	0.007	12.88
2023-24	0.233	0.030	321	11.2	0.007	13.45
2024-25	0.233	0.030	401	11.2	0.007	14.01
2025-26	0.233	0.030	481	11.2	0.007	14.57
2026-27	0.233	0.030	561	11.2	0.007	15.13

Table 2C: Regression of TEA (Y) on Recovery (X_2)

Year	r_{yx2}	$\sigma_{y/}\ \sigma_{x2}$	$X_2 - \bar{X}_2$	$\bar{Y}$	$_{byx2}$	Regression of Yon X_2
2022-23	0.274	0.272	-23.12	11.2	0.075	9.58
2023-24	0.274	0.272	-30.84	11.2	0.075	9.04
2024-25	0.274	0.272	-38.55	11.2	0.075	8.50
2025-26	0.274	0.272	-46.26	11.2	0.075	7.96
2026-27	0.274	0.272	-53.97	11.2	0.075	7.15

Table 2D: Regression of TEA (Y) on CIRPs' (X_3)

Year	r_{yx2}	$\sigma_{y/}\ \sigma_{x3}$	$X_3 - \bar{X}_3$	$\bar{Y}$	b_{yx3}	Regression of Yon X_3
2022-23	0.371	0.007	893	11.2	0.003	13.88
2023-24	0.371	0.007	1191	11.2	0.003	14.77
2024-25	0.371	0.007	1489	11.2	0.003	15.67
2025-26	0.371	0.007	1787	11.2	0.003	16.56
2026-27	0.371	0.007	2084	11.2	0.003	17.45

05

IMPACT OF INSOLVENCY AND BANKRUPTCY CODE, 2016 ON BANK'S CREDIT: A PANEL ANALYSIS

Shivam Agarwal

ABSTRACT

This paper investigates the transformative impact of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) on credit channels within the Indian banking sector, while isolating the influence of other factors affecting these channels. Spanning from 2011-12 to 2019-2020, encompassing five years preceding and four years succeeding the implementation of the IBC, the study delves into the dynamics of credit markets. Key variables such as base rate, Provision Coverage Ratio (PCR), capital adequacy rate, net interest margin (NIM), and the presence of IBC are scrutinized across eight Scheduled Commercial Banks (SCBs), comprising both private sector and public sector entities. The findings underscore a discernible correlation between the implementation of IBC and shifts in credit market behaviour. Notably, banks fortified with robust PCRs during the IBC era exhibit marked enhancements in their financial health, indicative of a more pronounced confidence in extending credit. Furthermore, the analysis reveals a consequential reduction in interest rates within banks fortified by strengthened credit rights, underscoring the significance of IBC in reshaping lending practices. This study contributes to a refined understanding of the evolving credit landscape in the aftermath of IBC implementation, shedding light on how regulatory interventions can generate positive outcomes within the banking sector. The observed reduction in the cost of debt signifies a potential avenue for policymakers and practitioners to leverage regulatory frameworks in fostering a more resilient and dynamic credit ecosystem.

Keywords: Insolvency and Bankruptcy Code, Insolvency laws, Credit channels, Credit availability, Cost of credit, Banking sector.

INTRODUCTION

The significance of the banking system in driving economic growth cannot be overstated, as it serves as a fundamental pillar supporting financial transactions and facilitating the flow of credit throughout the economy. As the banking sector expands, so do the avenues through which credit is channelled, enabling individuals and businesses to access funds for various purposes. Essentially, a bank functions as a financial intermediary that accepts deposits from the public and extends credit to borrowers at specified interest rates. It operates under a regulatory framework that authorizes it to receive deposits and provide lending services, thereby playing a crucial role in mobilizing savings and allocating capital efficiently within the economy.

Beyond their core functions of deposit-taking and lending, banks offer a wide array of financial services to meet the diverse needs of their clientele. These services encompass currency exchange, wealth management, safe deposit facilities, and in some cases, investment opportunities. Moreover, banks often serve as key intermediaries in facilitating transactions and mitigating risks within the financial system. Within the banking landscape, various types of banks cater to different segments of the market, including retail banks that primarily serve individual consumers, commercial and corporate banks that focus on providing financial services to businesses, and investment banks that specialize in underwriting securities and facilitating capital market activities.

In India, the banking sector operates under a regulatory framework established by the Banking Regulation Act of 1949. Oversight and supervision of banks are entrusted to the Reserve Bank of India (RBI), which was established under the RBI Act of 1934. The RBI plays a pivotal role in maintaining stability within the banking system, ensuring compliance with regulatory standards, and safeguarding the interests of depositors and other stakeholders.

Through its regulatory functions, the RBI seeks to promote the soundness and integrity of the banking sector, thereby contributing to the overall stability and resilience of the Indian economy. The definition of banks under both the Acts was given as follows[i]:

> The Bank shall be a body corporate by the name of the Reserve Bank of India, having perpetual succession and a common seal, and shall by the said name sue and be sued. – (Reserve Bank of India Act, 1934).[1]

> A 'Banking Company' means any company which transacts the business of banking in India. Where 'Banking' means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise – (Banking Regulation Act, 1949).[2]

The implementation of the IBC by the Government of India marked a pivotal moment in the country's economic landscape. Recognizing the need for a more efficient and effective insolvency framework, the Code aimed to streamline the process of liquidation and resolution for struggling firms. Prior to its enactment, the Indian insolvency regime was plagued by fragmentation, lengthy delays, and dismal recovery rates for creditors.[ii] This overhaul was prompted by years of recommendations for reform, signalling a concerted effort to address the shortcomings of the previous system and foster a more conducive environment for business restructuring and recovery.

At its core, the Code introduced a paradigm shift in the treatment of corporate insolvency, ushering in a creditor-centric approach and prioritizing the interests of financial creditors (FCs). This shift towards a creditor-in-control regime not only empowers creditors with greater decision-making authority but also instils a sense of accountability among debtors.

[1] The Reserve Bank of India Act, 1934, https://indiankanoon.org/doc/462219/ (last visited Apr 14, 2024).
[2] Paper Tyari, *Acceptance of Deposit by Banks in India*, https://papertyari.com/jaiib/legal-regulatory-aspects-banking/acceptance-deposit-banks-india/ (last visited Apr 14, 2024).

Furthermore, the Code's emphasis on a time-bound resolution process underscores the imperative of swift action in resolving insolvency cases, thereby minimizing disruptions to business operations and preserving economic value. Alongside these structural reforms, the establishment of institutions such as the Insolvency and Bankruptcy Board of India, tasked with oversight and regulation, along with the provision of professional services through Insolvency Professionals and Information Utilities, has bolstered the robustness and credibility of the insolvency framework, fostering confidence among stakeholders and investors alike. This paper examines the impact of the IBC on credit channels of banks while holding all other factors affecting credit channels constant.

In one of its policy statements, the Monetary Policy Committee (MPC)[iii] of the RBI highlighted that *"the environment for timely transmission of policy rates to banks' lending rates will be considerably improved if the banking sector's non-performing assets (NPAs) are resolved more quickly and efficiently"*. When we discuss the impact of the IBC on banks, we refer to how it has influenced banks' behaviour in providing credit to firms, individuals, etc. In line with the above statement from the RBI's MPC, it is noted that the efficient recovery of NPAs can lead to improvements in banks' lending rates.

John[3] analysed that the health of banks plays a crucial role in determining the strength of the interest rate channel in India.[4] Their study found that the quality of banks' assets, measured by gross NPAs (GNPAs) and stressed asset ratios,[iv] significantly impacted the NIMs of SCBs. This implies that a decline in asset quality can delay the transmission of monetary policy through the interest rate channel. This suggests that NPAs influence interest rates, and the cost of debt affects credit channels through credit demand. Therefore, it is assumed that an increase in credit availability and a reduction in the cost of credit will positively impact credit channels and demonstrate changes in banks' behaviour regarding credit supply. Additionally, it is hypothesized that the IBC affects credit demand in the economy, while holding other factors constant.

The paper is structured in the following manner: it begins by discussing the objectives of the paper. Following that, a review of literature is provided which helps in understanding the previous work on the topic and in clearing the path for achieving the objectives of the paper. Next, the paper covers hypothesis formation followed by the model formation and methodology used in this study. The result of analysis is followed by the conclusion of the findings and the future work and limitations of the study.

OBJECTIVES

This paper has the following objectives to achieve:

- To know the impact of IBC on banks' PCR.
- To study the impact of IBC on banks' credit channels.

[3] Joice John et al., *Asset Quality and Monetary Transmission in India*, Volume 37 (2018).
[4] Janak Raj et al., *Asset Quality & Credit Channel of Monetary Policy Transmission in India,* (2020), https://taxguru.in/rbi/asset-quality-credit-channel-monetary-policy-transmission-india.html?amp/.

REVIEW OF LITERATURE

Insolvency laws are introduced to fasten the insolvency process of a company. There are many reviews of how insolvency law works for a company. After introduction of the insolvency law in many countries, some researchers have worked on the question, "how this law impact the bank". After the introduction of IBC in India, there are few papers which have worked on this with an indirect road, i.e., credit channels. As banks are the major distributors of credit in an economy, the credit channel is the one of the major ways of analysing the impact of the insolvency law.

Berkowitz and Hynes[5] found that increasing homestead exemption levels correlate with a slight decrease in mortgage application denials and lower mortgage rates. Their study, focused on overall household credit, argued against aggregating secured and unsecured credit, highlighting the potential benefits of certain property exemptions for home mortgage lenders. Through their analysis of household and state-level data in the 1990s, they demonstrated that high exemption levels did not typically result in higher mortgage rates or application denials.[6] These findings indicate that homestead exemption provisions in insolvency law can enhance creditor confidence when issuing loans to borrowers.

In his paper, Hüpkes[7] delved into the need for a specialized regime for bank insolvency. He argued that the unique nature of bank insolvencies warrants special treatment to preserve financial stability. Hüpkes highlighted the crucial role banks play in the economy and outlined reasons why they require special treatment in insolvency procedures. He proposed two models for addressing bank insolvency: one involving specialized rules administered by bank supervisors or deposit protection agencies, and the other integrating banks into the general insolvency framework overseen by bankruptcy courts. Hüpkes favoured the former model, emphasizing the specialized knowledge of bank supervisors and their ability to consider broader economic implications. This underscores the importance of tailored insolvency procedures to safeguard financial stability.

Feibelman[8] presented a case study in February, 2007, *ICICI Bank v. Kaur*, highlighting the need for a new insolvency framework in India for consumer finance. He suggested reforms to streamline the insolvency regime, making processes more automatic to benefit creditors and provide social insurance for consumers. Feibelman emphasized that without an effective bankruptcy mechanism, creditors face difficulties in recovering debts from struggling debtors, leading to unpredictable returns. He argued that a robust bankruptcy law can provide timely resolution of claims, reduce asset wastage, and lower the cost of credit. Overall, his paper underscored India's longstanding need for an effective insolvency mechanism to enhance creditor confidence and improve debt recovery.

In their 2015 study, Rodano[9] revealed several key findings. *Firstly*, they observed that bankruptcy[v] reforms enhancing borrowers' rights led to increased interest payments on bank

[5] Jeremy Berkowitz and Richard Hynes, *Bankruptcy Exemptions, and the Market for Mortgage Loans*.
[6] Souphala Chomsisengphet and Ronel Elul, *Bankruptcy Exemptions, Credit History, and the Mortgage Market*.
[7] Eva Hüpkes, *Insolvency – Why a Special Regime for Banks*.
[8] Adam Feibelman, *Consumer Finance, and Insolvency Law in India: A Case Study*, 36.
[9] Giacomo Rodano, Nicolas Serrano-Velarde & Emanuele Tarantino, *Bankruptcy Law, and Bank Financing*, 120 Journal of Financial Economics 363 (2016), https://linkinghub.elsevier.com/retrieve/pii/S0304405X16000210.

financing and reduced firm investment. *Secondly*, they noted that strengthening creditors' rights in liquidation procedures resulted in decreased bank financing costs and stimulated firm investment. Conducted following the Italian Bankruptcy Law Reform of 2005-2006, their research highlighted the importance of differentiating between liquidation and reorganization effects. Their findings suggest that bolstering creditor rights in liquidation processes instils confidence, prompting lower-interest credit provision due to reduced risk. Further research can validate and deepen these insights, offering a more nuanced understanding of bankruptcy law reform dynamics.

In their 2015 article on credit card demand and bankruptcy laws, Dawsey[10] highlighted several findings:

a) Borrower characteristics vary based on state insolvency laws, with stricter states showing lower default risk indicators.

b) Borrowers in lenient exemption states are less responsive to interest rate changes.

c) Insolvency laws have a greater impact on borrower responsiveness with higher introductory interest rates, especially for credit-constrained borrowers.

The study aimed to examine state bankruptcy laws' impact on credit card demand responsiveness. It hypothesized that borrower-friendly laws would decrease credit demand, particularly among credit-constrained borrowers. Analysis suggests lenient insolvency laws reduce credit demand, potentially increasing debt costs, consistent with prior research. Conversely, creditor-friendly laws may lower interest rates, improving debtor access to credit. Further investigation will clarify these laws' effects on credit supply and demand.

Allen and Basiri[11] in their paper found that, "an expected benefit from law making proposals more attractive than bankruptcy for borrower have greater access to cheaper credit *ex-ante."* Their paper as based on the 2009 BIA amendment in Canada. Their paper from above statement suggests that moving toward creditor-friendly laws change borrowers' behaviour to expectation of getting cheaper credit. So, sometime this law changes the credit demand just by creating an expectation of getting future credit in cheaper rate.

Chandani[12] focused on NPA recovery of Banks in the iron and steel sector through IBC, 2016. Their findings highlight the IBC's superior efficiency in NPA recovery compared to other channels in India. They emphasize its revolutionary impact, globally recognized by institutions like the IMF and World Bank. Furthermore, they underscore IBC's shift of recovery power from debtor to creditor, enhancing debt recovery for both parties. Their study illuminates how IBC effectively tackles the NPA issue, streamlining the recovery process. Subsequent sections explore recent NPA recovery trends in India.

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[10] Amanda E. Dawsey, *State Bankruptcy Laws and the Responsiveness of Credit Card Demand*, 81 Journal of Economics and Business 54 (2015), https://www.sciencedirect.com/science/article/pii/S0148619515000363.

[11] Jason J. Allen & Kiana Basiri, *The Impact of Bankruptcy Reform on Insolvency Choice, and Consumer Credit*, SSRN Journal (2016), https://www.ssrn.com/abstract=2785860.

[12] Arti Chandani et al., *A Study to Analyze Impact of Insolvency and Bankruptcy Code 2016 On NPA's Of Commercial Banks with Reference to Iron and Steel Sector*, *in* Proceedings of the Proceedings of the 9th Annual International Conference on 4C's-Communication, Commerce, Connectivity, Culture, SIMSARC 2018, 17-19 December 2018, Pune, MH, India (2019), http://eudl.eu/doi/10.4108/eai.18-12-2018.2286382.

Sukumaran[13] delved into the operational mechanisms of the IBC and evaluated its efficacy in facilitating the recovery endeavours of commercial banks in India. His research findings suggest that the IBC offers a market-linked and time-bound resolution for stressed assets, thereby reinstating the integrity of debt contracts. It acts as a safeguard against wilful defaulters, compelling promoters to recognize the inability to exploit banks. Through the resolution of bad loans within the banking system, the IBC not only promotes financial stability but also entrusts companies into capable and credible hands, fostering a path toward good governance.

Bose[14] examined the impact of the IBC on credit access and distressed firms' performance, finding a positive effect. The IBC boosted credit supply for distressed firms, reducing both long-term and short-term debt costs. This improvement coincided with enhanced distressed firm performance. The unified IBC model strengthened creditors' rights, fostering confidence to lend to distressed firms and increasing overall credit availability. This perspective complements prior discussions on credit demand and supply.

Having examined the impact of insolvency laws on credit channels and, with reference to Bose, the authors understand that the *IBC similarly affects credit channels as the insolvency laws of various countries do*. Consequently, they proceed to the next part where they discuss the common assumptions underlying this project and the methodology employed in preparing this paper. It is succeeded by the conclusion, where the authors delve into the findings gleaned from this paper and provide a concluding remark.

FORMULATION OF MODEL

This section aims to formulate testable hypothesis regarding the relationship between the IBC and banks. Giannetti[15] presents evidence indicating that stronger creditor rights are associated not only with higher levels of long-term debt but also with its greater availability. Hart and Moore[16] argue that cash-constrained firms rely on bank financing to undertake investment projects. Gopalakrishnan and Mohapatra,[17] leveraging an extensive cross-national dataset at the firm level, illustrate how a resilient insolvency framework diminishes the probability of firms defaulting on their debt and aids in attenuating the negative impacts of economic fluctuations on default risk. Based on these insights, hypothesis is developed to further investigate the relationship between the IBC and banks.

So, the IBC, like other strong insolvency law, can maintain creditor rights. Therefore, the hypothesis of this study is:

H0: IBC increases credit availability as well as reduces the cost of credit.

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[13] K. Sukumaran, *Insolvency and Bankruptcy Code a Boon to Banking System*, (2021).

[14] Udichibarna Bose, Stefano Filomeni and Sushanta Mallick, *Does Bankruptcy Law Improve the Fate of Distressed Firms? The Role of Credit Channels*, 68 Journal of Corporate Finance 101836 (2021), https://www.sciencedirect.com/science/article/pii/S0929119920302807.

[15] Mariassunta Giannetti, *Do Better Institutions Mitigate Agency Problems? Evidence from Corporate Finance Choices*, 38 The Journal of Financial and Quantitative Analysis 185 (2003), https://www.jstor.org/stable/4126769.

[16] O. Hart & J. Moore, *Default and Renegotiation: A Dynamic Model of Debt*, 113 The Quarterly Journal of Economics 1 (1998), https://academic.oup.com/qje/article-lookup/doi/10.1162/003355398555496.

[17] Balagopal Gopalakrishnan and Sanket Mohapatra, *Insolvency Regimes and Firms' Default Risk under Economic Uncertainty and Shocks*, 91 Economic Modelling 180 (2020), https://linkinghub.elsevier.com/retrieve/pii/S0264999319319613.

IBC impact on banks' credit

In reference to several studies exploring the relationship between insolvency laws and credit, a model has been developed to illustrate how the credit channel may be influenced by the IBC. Bose conducted an in-depth investigation into this topic using a difference-in-difference (DID) model. Their study elucidated the impact of the IBC on credit channels, particularly for distressed firms in comparison to their counterparts. Building upon these findings, the study aims to examine the effect of the IBC on bank interest rates to test the hypothesis (H0).

Assumptions:

a) The study assumes that with reduction of cost of credit, it means that credit availability has been increased by banks.

b) It is also assumed that banks with good PCR get more affected by IBC than banks with bad PCR because IBC increases creditor confidence.

Description of model

The study examines the cost of credit under the assumption that increased credit availability leads to a reduction in the cost of credit. Gopalakrishnan and Mohapatra utilized cross-country data to demonstrate that robust insolvency laws decrease the likelihood of firm defaults. Similarly, Rodano investigated the relationship between bankruptcy law and bank financing, employing a DID method to illustrate the impact of amendments to the Italy Bankruptcy Insolvency Act, on the cost of bank financing in Italy. Dawsey also employed the DID method to establish that the influence of state laws on borrowers' responsiveness increases with interest rates.

Building on these previous studies, the current research focuses on loan interest rates as the dependent variable (Y_{it}), where Y represents the interest on loans (i.e., base rate) of bank *i* at time *t*. The study utilizes the IBC as a time dummy variable, assigned a value of 1 for years after 2016 and 0 otherwise (prior to 2016), following the approach of Bose. The formulated DID model in the study is presented as follows:

$$Y_{it} = \alpha_0 + \alpha_1 (IBC_t * Z_i) + \alpha_2 Z_i + \alpha_3 \beta_{it} + (Bank_i * Year_t) + E_{it}$$

Z_i is a dummy variable which takes 1 as a value when banks' PCR is above 70% or 0 otherwise (for PCR below 70%). $(IBC_t * Z_i)$ captures the impact of IBC on banks' PCR. β is the capital adequacy ratio of bank i at time t. In this regard, following Vig[18] and Bose, the control for such shocks by augmenting the main regression specification to include the interaction between bank and time $(Bank_i * Year_t)$ fixed effects. E_{it} is the standard error taken by us into account. PCR is the ratio of Net Non-Performing Advances by Total Advances. Capital Adequacy Ratio (CAR) is the ratio of banks' capital in relation to its risk weighted assets and current liabilities.[19] A higher CAR means the bank can absorb losses without diluting capital.[20]

[18] Vikrant Vig, *Access to Collateral and Corporate Debt Structure: Evidence from a Natural Experiment*, 68 The Journal of Finance 881 (2013), https://onlinelibrary.wiley.com/doi/abs/10.1111/jofi.12020.

[19] Capital Adequacy Ratio: Latest Capital Adequacy Ratio News, Designation, Education, Net worth, Assets, The Economic Times, https://economictimes.indiatimes.com/panache.

[20] The Economic Times, *Capital adequacy ratio - Check the financial health of your bank with these 8 ratios,* https://economictimes.indiatimes.com/wealth/save/check-the-financial-health-of-your-bank-with-these-8-ratios/capital-adequacy-ratio/slideshow/74927105.cms (last visited Apr 14, 2024).

Methodology and data sources

This section outlines the data sources and methodology employed in the paper. The study incorporates variables such as base rate, PCR (as a dummy variable), CAR, NIM, and IBC (a time dummy) for eight SCBs, comprising four private sector banks and four public sector banks. The analysis spans from 2011-12 to 2019-2020, encompassing five years before and four years after the implementation of the IBC. A panel analysis is conducted with T = 9 and N = 8. Data was sourced from the Handbook of Statistics on the Indian Economy, the Reserve Bank of India, and Reuters[21] for the base rate.

RESULTS

In this section, the paper presents the results of the analysis. A pertinent question that arises regarding the dataset selection is why only these banks were considered. The rationale behind this selection lies in the significant transformations and revolutions witnessed by the banking sector in the previous decade. Many banks underwent mergers to revitalize smaller banks and reduce liabilities, while the RBI also introduced new banking segments such as Small Finance Banks and Payments Banks. Since these banks are relatively new and did not exist for the entire period under study, they were excluded from the analysis. Similarly, nationalized banks that are merged into larger nationalized banks were excluded, along with banks like IDBI that were disinvested by the Government of India during the study period, as they could potentially introduce outlier situations in the analysis.

Descriptive statistics

It was evident that from the literatures of other countries on this topic, that insolvency laws provides the creditor, confidence while providing the loans. In India, the banking sector faces the major problem of NPAs. In this paper, the reduction of NPA (showing the high PCR) after IBC is related with the reduction of interest rate showing the increasing confidence of creditors (SCBs). Table 1 provides descriptive statistics, showcasing the trends of base rate before and after the IBC implementation.

Table 1: Trend of Base Rate before and after IBC

Variables	2011-14	2015-2019	2010-2019
Axis Bank	9.9510	9.9443	9.9473
HDFC	9.7156	9.1867	9.4218
ICICI	9.7375	9.1033	9.3852
IndusInd	10.6688	10.6129	10.6377
Bank of Baroda	10.2500	9.4890	9.8272
Punjab National Bank	10.1271	9.3441	9.6921
State Bank of India	9.6875	9.0783	9.3491
Union Bank of India	10.2450	9.2820	9.7100

Source: Reuters

[21] Reuters, *India Base Rates of Banks*, https://www.reuters.com/article/idUSL4N2CI4F0/ (last visited Apr 14, 2024).

The table clearly indicates a reduction in banks' base rates following the introduction of the IBC in India. While there could be multiple reasons for this, the influence of the IBC is examined through panel estimations. Additionally, the statistics suggest that the average base rate of public sector banks experienced a more substantial reduction compared to that of private sector banks.

Panel estimation

In this study, panel estimation is conducted for the model, and the results are presented. Table 2 displays the outcomes of the pooled regression, fixed effect, and random effect models. Subsequently, the Lagrange FF Multiplier and Hausman test are employed to determine the most suitable outcome for the study.

Table 2: Model Estimation

Dependent Variable: Y_{it}			
Panel Models	**Pooling Estimation**	**Fixed Effect**	**Random Effect**
Constant	9.931 (0.475)***	—	8.788 (0.842)***
$IBC_t * Z_i$	-0.768 (0.245)***	-0.656 (0.203)***	-0.635 (0.199)***
Z_i	0.132 (0.182)	0.187 (0.154)	0.141 (0.149)
$CRAR_{it}$	-0.078 (0.040)*	-0.011 (0.061)	-0.053 (0.051)
NIM_{it}	0.265 (0.116)**	0.611 (0.164)***	0.486 (0.141)***
Significance level: *10%; **5%; ***1%			
R^2	0.239	0.331	0.299
Adjusted R^2	0.194	0.209	0.257

Source: Authors' Compilation

The results indicate that all panel estimators yielded similar outcomes. Upon analysis, it suggests a significant decrease in the base rate with an increase in the interaction term of IBC and PCR. Additionally, a higher CAR is associated with a lower base rate, signifying reduced fear of default by banks. Conversely, a lower CAR may raise concerns about financial stability, potentially leading to increased base rates to offset perceived risks, negatively impacting borrowers and economic activity. Furthermore, a positive relationship exists between NIM and the base rate, implying that banks adjust their base rates to maintain or enhance profitability in response to higher NIMs. Thus, when NIM increases, banks may opt to raise their base rates to capitalize on improved margins.

In the next step, the study proceeds to test which method of panel estimation is most appropriate for the model. Table 3 provides result of Lagrange FF Multiplier and Hausman Test.

Table 3: Method Selection Tests

Test	**Lagrange FF Multiplier**	**Lagrange FF Multiplier**	**Hausman Test**
	BP – (Random Effect)	BP – (Time Fixed Effect)	
Chi sq. (P. Value)	30.178 (0.000)	0.273 (0.601)	2.545 (0.637)

Source: Authors' Compilation

The test results indicate that the random effect method is the most suitable for estimating the model. Following this, diagnostic tests are employed to assess the robustness of the panel (random effect) model.

Table 4: Diagnostic Tests

Test	Test Stats. (P. Value)
Serial Correlation (Breusch-Godfrey/Wooldridge test)	5.329 (0.805)
Homoskedasticity (Breusch-Pagan test)	5.851 (0.211)

Source: Authors' Compilation

The robustness tests demonstrate that the model is robust, with no spurious errors in the coefficients, and the estimation results are satisfactory. In the next section, the results are summarised and concluded.

CONCLUSION

The findings of this study elucidate that following the introduction of the IBC, banks with high PCRs experienced a reduction in the base rate. Conversely, in the absence of the IBC, these banks were witnessing an increase in the base rate. The findings of this study align with Dawsey, who concluded that creditors under strict insolvency laws exhibit lower default risk. Our model reveals that when banks are in a strong position and benefit from increased credit rights due to the IBC, it leads to a reduction in interest rates. Specifically, the model indicates that higher PCRs signify better bank health, and the effect of the IBC on PCR results in a more significant improvement in bank health. Enhanced bank health enables banks to offer loans at lower interest rates, as they become more stable. A higher PCR reflects improved asset quality and reduced vulnerability, allowing banks to extend credit more readily and affordably to individuals.

Gopalakrishnan and Mohapatra conducted a study where they examined how stronger creditor rights reduce firms' risk of default during periods of heightened economic policy uncertainty. In conclusion, it can be stated that the IBC has instilled more confidence in banks to extend credit, leading to an increase in credit supply and a subsequent reduction in the cost of debt. The IBC has empowered creditors by shifting from a debtor-in-possession model to a creditor-in-possession model, as highlighted by Bose.

** This research builds upon the foundation laid during an internship at IBBI, New Delhi. Additionally, the authors extend sincere thanks to Ms. Kokila Jayaram for her guidance and supervision throughout the internship tenure.*

[i] Reserve Bank of India: About Us.

[ii] Bankruptcy Law Reforms Committee, *The Interim Report of the Bankruptcy Law Reforms Committee* (2015)

[iii] Sixth bi-monthly Monetary Policy Statement, 2016-17. Resolution of the Monetary Policy Committee (MPC), Reserve Bank of India. Dt: 08/02/2017, Mumbai, Press Release: 2016-2017/2126.

[iv] GNPA and stressed asset ratio are defined as GNPA as a percentage of gross advances and stressed asset (GNPA + restructured assets) as a percentage of gross advances respectively.

[v] Bankruptcy and insolvency are being used here interchangeably.

06

GUARANTOR'S QUANDARY UNDER IBC

Ansh Gupta, Ajanta Gupta and Shiv Anant Shanker

ABSTRACT

In India, guarantees are a prevalent security mechanism used by financiers to secure loans extended to corporate borrowers. Under Section 128 of the Indian Contract Act, 1872, a guarantor's liability is co-extensive with that of the principal debtor, enabling creditors to directly proceed against guarantors. Recognizing the intertwined nature of corporate debt and related guarantees, provisions for personal guarantors (PGs) under the Insolvency and Bankruptcy Code, 2016 (IBC/Code), were notified in 2019.

A series of landmark judgments by the Hon'ble Supreme Court upheld the constitutionality of PG proceedings, clarifying that the moratorium under section 14 applies exclusively to the corporate debtor's (CD) assets, not the guarantors. Additionally, the Court denied guarantors the right of subrogation under the IBC and allowed creditors to simultaneously pursue claims against both the CD and its guarantors.

Given the critical role of guarantees in debt recovery, the IBC framework presents several legal and practical challenges in their treatment. This paper seeks to address these complexities, providing clarity and proposing solutions to improve the resolution process and enhance outcomes under the IBC.

INTRODUCTION

It is common for financiers/bankers in India to get guarantees as part of the security arrangement when making loans accessible to company borrowers, whether through facilities or by subscribing to non-convertible debentures issued by such debtors. These guarantees provide credit backing for financing transactions and are often issued by individual promoters or borrowers' group companies, either directly or through trustees designated by creditors. As per Section 128 of the Indian Contract Act, 1872, a surety's liability is co-extensive with that of the principal debtor, unless the contract states otherwise. Surety's liability is the same as the principal debtor's and a creditor can go straight against the surety.

On November 15, 2019, the Code brought PGs under IBC through a notification. Since then, their rights and responsibilities under the IBC have been challenged in numerous legal forums. The verdicts and orders of tribunals and courts in India have frequently provided guidance on the status of guarantees issued by companies/PGs under IBC. The moratorium under section 14 of the IBC will only apply to the CD's assets and not to the guarantor's assets. Section 14 of the Code was changed in 2018, and a clarification was introduced to say that guarantor/surety to the corporate debtor in a guarantee arrangement is not subject to

the clauses of section 14. Regarding *Ghanashyam Mishra and Sons Pvt Ltd v. Edelweiss Asset Reconstruction Company Ltd*, the Hon'ble Supreme Court ruled in paragraph 95(i) that the claims outlined in the resolution plan shall stand frozen and be binding on the Corporate Debtor and its employees, members, creditors, the Central Government, any State Government, any local authority, guarantors, and other stakeholders once the plan is duly approved by the Adjudicating Authority under subsection (1) of section 31 of the Code. The right of subrogation permits the guarantor to act as the creditor and reclaim the money paid by the principal debtor. However, PGs do not have this right under the IBC. Further, corporate insolvency resolution process (CIRP) and Corporate/PG's proceedings can run simultaneously, and the creditor can file claims in both the proceedings. Since bankers rely largely on guarantees to recover debts, there are various complications and practical challenges surrounding guarantees with claims and rights thereto under IBC, which need timely considerations and guidance.

OBJECTIVE OF THIS RESEARCH PAPER IS TO ADDRESS THE FOLLOWING ISSUES

A. In the context of invocation of Bank Guarantees (BGs) or Letter of Credit (LCs) during moratorium of the CD

Issue A1: How interim resolution professional/Resolution Professional (IRP/RP) treat claim for BGs/LCs invoked prior to commencement of CIRP of CD?

Issue A2: Can banker/creditor file a claim for uninvoked BGs/LCs (Live BGs/LCs) which remains uninvoked during CIRP?

Issue A3: How IRP/RP treat such claim filed for uninvoked BGs/LCs during CIRP?

Issue A4: Can BGs/LCs be invoked during CIRP?

Issue A5: Can BG be encashed by third party during moratorium?

Issue A6: Can invocation of BG issued by CD be treated as Preferential Transaction under section 43 of IBC?

Issue A7: How IRP/RP treat such claim of invoked BGs/LCs?

Issue A8: How to deal with margin money kept for BGs/LCs during CIRP?

Issue A9: Can margin money be appropriated by the Bank during the period of moratorium during CIRP?

Issue A10: How should IRP/RP deal with expired BGs/LCs during CIRP?

Issue A11: Can guarantee given on behalf of CD by third party be restricted during moratorium on invocation of BG by the beneficiary?

B. In the context of Personal Guarantors (PG) to Corporate Debtor

Issue B1: What are the key distinctions between the insolvency and liquidation for CDs and Personal Guarantors to Corporate Debtors, as defined under the IBC and its rules and regulations?

Issue B2: Can Committee of Creditor (CoC) in its commercial decision extinguished the Personal Guarantees of dissenting Financial Creditors (FCs) in CIRP?

Issue B3: Whether National Company Law Tribunal (NCLT) or Debt Recovery Tribunal (DRT) has jurisdiction over PGs when CIRP is not pending against CD?

Issue B4: Whether Double dip rule permitted in insolvency inflates the claim amount and reduces the realisation percentage with respect to guarantee given by multiple entities in group insolvency/ claims in CIRP as well as PG proceedings? If yes, how to deal with the same?

Issue B5: How to maximise the pie: Intermingling of assets of the CD and guarantors.

Issue B6: Can PG initiate CIRP proceeding under section-7 of the Code against the CD (principal debtor) on payment of debt under PG proceedings under the Code?

Issue B7: Can principal borrower be discharged when resolution plan is approved in CIRP of Surety/ Guarantor?

RESEARCH METHODOLOGY

The research methodology will be doctrinal research, also known as the 'black letter' methodology/ qualitative empirical research wherein the main focus of the research will be on interpreting existing provisions of IBC and CIRP Regulations, PG Regulations, and various judgments passed by Hon'ble Supreme Court, High Court, National Company Law Appellate Tribunal (NCLAT) and NCLT. Through literature review, 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 will be used to understand and analyse the issue.

A. Dealing with invocation of BGs or LC during moratorium of the CD

A bank guarantee is an assurance provided by the issuing bank to a beneficiary (the person in whose favor the guarantee is issued/ third party) against losses or damages in the event that the client (the party on whose behalf the guarantee is offered/ CD) defaults or fails to execute the conditions of the agreement. Under an LC, the buyer and seller will sign a sales contract, and the buyer (importer) will apply to their bank (issuing bank) for a letter of credit, which will then be forwarded to the bank of the supplier (advising bank). BG/LC constitute an independent contract between the bank and the beneficiary. Notwithstanding any ongoing legal disputes between the parties involved, the beneficiary is entitled to claim the entire amount under guarantee/LC. The conflict occurs when third-party guarantees are enforced during a CD's moratorium period, for whom CIRP has been initiated.

Issue A1: How IRP/RP treat claim for BGs/LCs invoked prior to commencement of CIRP of CD?

The banker/creditor is entitled to indemnification from the CD as the beneficiary (third party) has invoked its BG/LC, and the bank has paid for that invocation. Since the LC/BG has been invoked, it is no longer operative, and the right to payment has been established prior to the start of the insolvency proceedings against the CD, hence it becomes a "claim" against the CD as on the insolvency commencement date, pursuant to section 6(3) of the

Code. The bank/creditor would file a claim of amount paid to third parties after adjusting the used margin money kept by CD.

Issue A2: Can banker/creditor file a claim for uninvoked BGs/LCs (Live BGs/LCs) and remains uninvoked during CIRP?

The LC/BG is still in effect and uninvoked for the duration of its natural life because the beneficiary hasn't invoked it against the bank. There is no need for the CD to compensate the bank as the banker has no legal claim because the bank has not paid the supplier/beneficiary. However, as any live BG or LC has the potential to be invoked at any time, it is shown as a liability on the CD's balance sheet and can be treated as a continent liability. Therefore, by virtue of co-joint reading of section 3(6) of the Code which provides "claim" as a "*right to payment*"; 3(11) of the Code which defines "debt" as "*liability or obligation in respect of a claim which is due from any person*" and section 5(8) of the Code which provides inclusive definition of "Financial debt" and includes "*(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution; (i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clause (a) to (h) of this clause*;", the Bank should file a claim before IRP/RP.

Issue A3: How IRP/RP treat such claim filed for uninvoked BGs/LCs during CIRP?

Pursuant to the public announcement made, IRP as well as RP has the responsibility of receiving and compiling claims that creditors submit to them. Thus, the claim submitted for uninvoked BG/LC should be considered by IRP/RP and post verification, the same should be part of Information Memorandum. Since, claim filed for such BG/LC has yet invoked, so there is no present liability to pay by the CD and can fall under the category of contingent liability. Further, such liability may be crystallized during the CIRP, hence the banker should be permitted to update such claim as and when it is necessary. For treatment of uninvoked BGs/LCs during CIRP, the Hon'ble NCLAT in the matter of *Export Import Bank of India v. Resolution professional JEKPL Pvt. Ltd.* (CA (AT) (Insolvency) No. 304 of 2017 judgement dated 14th August 2018), clarified that

> maturity of claim or default of claim or invocation of guarantee for claiming the amount has no nexus with filing of claim pursuant to public announcement made under section 13(1)(b) r/w Section 15(1)(c) or for collating the claim under section 18(1)(b) or for updating claim under section 25(2)(e). For the purpose of collating information relating to assets, finances and operations of Corporate Debtor or financial position of the Corporate Debtor, including the liabilities as on the date of initiation of the Resolution Process as per Section 18(1), it is the duty of the Resolution Professional to collate all the claims and to verify the same from the records of assets and liabilities maintained by the Corporate Debtor.

Issue A4: Can BGs/LCs be invoked during CIRP?

The banker has the right to be compensated by the CD since the creditor has invoked its LC/BG and the bank has paid in response to that invocation. The right to payment has been established and is therefore qualifying as a claim. However, there had been conflicting judgment with respect to invocation of BG/LC during the CIRP and admissibility of claim thereto, in

view of moratorium under section14 of the Code. It is now settled position that BG/LC can be invoked during CIRP. In the matter of *IDBI Bank v. Indian Oil Corporation Ltd. & Anr.*, (CA (AT) (Insol.) No.543 of 2021 judgement dated 10th January 2023) and *Mitsubishi Heavy Industries Ltd. v. Punj Lloyd Ltd. and Ors.* (CA(AT)(I)-1479/2023 judgement dated 9th August 2024), the NCLAT has held that section 14 of IBC in no manner impact invocation of BG during pendency of the moratorium. Referring to clause in section 3(31) which specifies that a Performance Bank Guarantee is not considered a "Security Interest." It is widely established that the Appellant's ability to invoke the BG while the moratorium is in effect is unaffected by section 14. In *Bharat Aluminium Co. Ltd. v. J.P. Engineers Pvt. Ltd.* [CA (AT)(Insolvency) No. 759 of 2020, dated 26-2-2021], the NCLAT defined the meaning of Non-Performance Bank Guarantees holding that even Non-Performance Bank Guarantees may be invoked under a moratorium. The modified section 14(3)(b) that exempts "surety in a contract of guarantee" from the moratorium's application and the ruling of the *Supreme Court in SBI v. V Ramakrishnan*, which upheld the notion that a moratorium does not prevent legal action against guarantors for the debt of the corporate debtor, served as the foundation for this ratio. As a result, the current state of the law permits the invocation of both Performance Bank Guarantees and Non-Performance Bank Guarantees throughout the moratorium.

Issue A5: Can BG be encashed by third party during moratorium?

The Hon'ble SC in the matter of (*Standard Chartered Bank v. HECL and Anr* (Civil Appeal No(s).9288 Of 2019 on 18th December 2019) stated that "*bank guarantee is an independent contract between bank and the beneficiary, and the bank is always obliged to honour its guarantee as long as it is an unconditional and irrevocable one*". The NCLAT in the matter of *Bhuvan Madan IRP of Indrajit Power Pvt. Ltd. v. Nominated Authority, Ministry of Coal and Anr.*(CA (AT) (Insolvency) No. 989 of 2024 decided on 1st July 24) held that section 14 of the Code does not create a bar on encashment of BG during moratorium NCLAT in the matter the *National Small Industries Corporation Ltd. v. Sh. Prabhakar Kumar Liquidator of Sh. Ganesh Equipment Pvt. Ltd.* (CA (AT) (Insolvency) No. 841 of 2021 decided on 16th October 2023) held that encashment of BG would not affect the CD's assets; the only thing that would change is that the claim against the specified amount from the CD would now be made by Bank rather than Creditor.

Issue A6: Can invocation of BG issued by CD be treated as Preferential Transaction under section 43 of IBC?

The NCLT Kolkata Bench in the matter of *West Bengal State Electricity Distribution Company Ltd. (WBSEDCL) v. Punjab National Bank and Ors.*(I.A. (I.B.C) No. 699/KB/2023 in C.P.(I.B.) No. 2179/KB/2019 decided on 24th July 2024) held that one of the prerequisites for a transaction to be classified as preferential is that it must involve the CD's assets. This means that any transaction made during the relevant period by the CD could only be considered preferential if it was made by the CD, i.e., out of its assets. Nonetheless, the encashment cannot be referred to as a preferential transaction because the Bank guarantee is a distinct contract whose fulfilment is unrelated to the CD's assets. The third party has right to invoke the BG and that the bank shall not obstruct such an attempt. It won't qualify as a dual claim because amount recovered by invoking such Bank Guarantee can be adjusted and the admitted claim shall be revised accordingly.

Issue A7: How IRP/RP treat such claim of invoked BGs/LCs?

On invocation of BG/LC, the bank should file an updated claim before RP and RP on verification should admit the claim as FC in consideration of any security of the margin money kept by the CD for such BG/LC.

Issue A8: How to deal with margin money kept for BGs/LCs during CIRP?

Banks often prefer to provide secured guarantees, which are backed by borrower-provided collateral, in order to reduce the risk exposure associated with guarantee being issued. If a bank guarantee is called/invoked, the bank expects to use these secured assets to reasonably offset its liability. One type of collateral that the borrower may give to establish a bank guarantee is margin money. A guarantee is given by a bank in exchange for a specific quantity of margin money or sometimes against 100% margin funds held as Fixed Deposit Receipts (FDRs). This money is kept with the bank as a fixed deposit receipt for the duration of the guarantee and is used to honour payments upon invocation. If a bank guarantee matures without being used, the borrower receives a credit for the margin money. There has been conflicting treatment in court rulings regarding dealing with *margin money against BG/LC during a CIRP.*

The NCLAT, in the matter of *Bank of Baroda, Corporate Financial Services Branch v. Sundaresh Bhatt* (CA (AT) (Insolvency) No. 635 of 2019) dated February 20, 2020 held that the funds that were lying with the bank as margin funds in the form of three FDs in the name of the CD were appropriated after the initiation of CIRP, and the same could not have been done under Section 14 of IBC. However, NCLAT in *Indian overseas Bank v. Arvind Kumar* (CA (AT) (Insolvency) No. 558 of 2020 decided on 28th September 2020) held that upon the invocation of the bank guarantee, margin money goes toward payment to the beneficiary and, as a result, there is nothing that can be reversed to the CD. NCLAT took a different position and prohibited the resolution professional from claiming the margin money that the CD had deposited with the bank. Also, in the matter of *C&C Construction Ltd. v. Power Grid Corporation of India Ltd.* (Company Appeal (AT) (Insolvency) No. 781 of 2019 & I.A No. 746, 951 & 952 of 2021 decided on 19th July 2021, NCLAT ordered the bank to release the full value of the guarantee after deducting the sum given by the CD as margin money for the issuance of that guarantee. It also clarified that the bankers are also accountable for the bank guarantees they issue, and the money will come from the banks' funds rather than the corporate debtor's fund directly.

In the matter of *Punjab National Bank v. Supriyo Kumar Chaudhuri & Ors.* (CA (AT) (Insolvency) No. 657 of 2020 decided on 16th September 2022), the NCLAT dealt with the issue of "whether margin money deposited by way of FDR (fixed deposit receipts) against a letter of credit (LC) construes, a 'security' and whether this margin money can be appropriated by the bank during the period of moratorium on the ground that it does not form a part of the CD's assets". NCLAT held that "*margin money is construed as substratum of a Trust created to pay to the beneficiary to whom Bank Guarantee is given*". Until the asset is released from the trust, the original owner will not have any rights over it once it has been placed into trust by legal documents for the beneficiary's benefit. Margin money cannot be considered an asset of the CD. LC is a contingent liability of the CD that crystalises upon the occurrence of a future event, it is essentially comparable to a contract of guarantee. Any action to foreclose, reclaim,

or ensure any "Security Interest" generated by the CD with respect to its property is prohibited under section 14(1)(c). NCLAT allows the bank to appropriate use of the margin money during the moratorium period as it is not an asset of the CD and that no "Security Interest" was created by the CD.

In the matter of *Mr. Ravi Sankar Devarakonda v. IDBI Bank Limited* (I.A. No.401/2021 in CP(IB) No.184/7/HDB/2019 decided on 19th March 2023) NCLT Mumbai on the ruling of the NCLAT, viewed that, *"Margin money is construed as substratum of a trust created to pay to the beneficiary to whom the bank guarantee is given and cannot be treated as an asset of the Corporate Debtor."'*

The NCLT Mumbai Bench in the matter of *Mr. Ajay Joshi, RP for Indian Steel Corporation Ltd. v. Union Bank of India* judgment (IA No.929/2022 in C.P. (IB) No. 979/MB/2020 decided on 3rd April 2024) held that it is evident from a plain reading of section 14 of the Code that the moratorium is intended to give from immediate effect i.e. from the date of the order declaring moratorium under section 14 of the Code. For the duration the LC is in effect, the borrower's contribution to satisfy the obligation under the document is considered as margin money and held by the bank. The amount lying in current account of CD, even if it was subject to a charge, continues to be an asset of the CD and adjustment or deduction of amounts from the current account of the CD during the moratorium period is not justifiable.

These contradictory NCLAT rulings cast question on how margin money is to be treated when a bank guarantee is invoked during a moratorium. Dealing with the issue of treatment of margin money during CIRP, it is to be noted that when the order of moratorium is passed, no authority or bank can make adjustment with the assets of the CD. The RP shall retain ownership of any properties, whether movable or immovable, the bank deposit FDRs, or any margin money currently lying with the Bank. Hence, margin money as well as FDRs would be treated as par with other immovable assets/movable assets of the CD (for which mortgage/ lien created) and would fall under the ambit of section 14 of moratorium being an asset of the CD. What has been excluded under the section 14 is for recovery of any amount under contract of guarantee by the third party. Further, the definition of security interest specifically clarifies the mere creation of performance guarantee would be tantamount to security interest. It does not amply the margin money would mechanically be covered under such exclusion when the margin money or FDRs have been specifically created to secure such payment in the contract of guarantee. Therefore, on invocation of Bank guarantee by the third party, bank is obliged to pay the third party/beneficiary for the full amount. Upon payment to the third party, the bank needs to file/update a claim to the RP of the CD. Thus, to the extent the margin money is kept by CD to the bank, the claim of bank is to be classified as secured debt and remaining as unsecured. All the covers in the form of margin money or FDRs, on very commencement of the CIRP of the CD are assets of the CD which falls under the purview of moratorium under section 14 of the Code and no authority or bank can alter it.

Issue A9: Can margin money be appropriated by the Bank during the period of Moratorium during CIRP? Or,

Can IRP/ RP claim margin money after the invocation of BG during the Moratorium under section 14 of IBC

As discussed above, margin money cannot be appropriated by the Bank during the period of Moratorium during CIRP. It is reiterated that margin money or FDRs, on very commencement

of the CIRP of the CD are assets of the CD which falls under the purview of moratorium under section 14 of the Code and no authority or bank can alter it.

Issue A10: How should IRP/RP deal with expired BGs/LCs during CIRP?

NCLAT in the matter of *Indian Overseas Bank v. Arvind Kumar* (2020) and NCLT Mumbai in the matter of *Dhiren Shantilal Shah v. Indian Bank* (IA-148/2021 in CP (IB) No.4164/MB-IV/2019 decided on 6th June 2023) held that the CD only receives the money retained as margin towards the live bank guarantee in the event that the relevant bank guarantee expires. In all other circumstances, the money remains unclaimed. Furthermore, there is a well-established legal principle that, in the event of a commencement of CIRP of the CD, BG/LC do not expire with the start of the moratorium. Though it is apt to state that BG/LC do not expire with the commencement of CIRP of the CD, but the margin money of FDRs are assets of the CD on very commencement of the CIRP of the CD which falls under the purview of moratorium under section 14 of the Code and RP need not wait for expiry of such BGs/LCs during CIRP, to take control of such assets.

Issue A11: Can guarantee given on behalf of CD by third party be restricted during moratorium on invocation of BG by the beneficiary?

As discussed earlier, invocation of BG/LC distinct and independent contract between bank and beneficiary, thus such invocation is not restricted under section 14 of the Code on moratorium for the CD under CIRP irrespective of the fact that who's has given guarantee/ assurance to the bank for repayment on default either the CD itself or any third party on behalf of the CD. Thus, assurance given by the third party on behalf of the CD also cannot take the benefit or in other words, misuse the provision of section 14 of the Code (moratorium) to restrict the payment to beneficiary during the CIRP of the CD as fulfilment is unrelated to the CD's assets. The beneficiary has right to invoke the Bank Guarantee and that the Bank/ third party on behalf of the CD cannot obstruct such an attempt.

B. In the Context of Personal Guarantors (PG) to Corporate Debtor

Issue B1: What are the key distinctions between the Insolvency and liquidation for CDs and PG to Corporate Debtors, as defined under the IBC and its rules and regulations?

The IBC is a comprehensive regime that takes within its sweep both corporate as well as individual insolvency, PG to CD presently, with the prime objective of resolution in a time bound manner maximising value and liquidation/bankruptcy as last resort. The Bankruptcy Law Reforms Committee (BLRC) in its report of 2015, observed that the goal of corporate and individual insolvency have a lot in common and that would be to provide a impartial and orderly procedure for dealing with the financial affairs of insolvent enabling both debtor as well as creditor to participate with the least possible delay and expense and ensuring the correct ex-ante incentives so that insolvents are not able to unfairly strategise during the process of insolvency. However, it observed the two distinctions that exist for individuals: First, unlike a formal organization, an individual cannot be liquidated during the bankruptcy procedure. Second, where the odds of recovery are so slim that the expenses of resolving the insolvency would simply place further strain on the debtor, the creditor, or the State, the Code offers debt relief for a specific class of debtors. Thus, while resolving the PGs to CDs

being natural persons set to have certain differences as compared to artificial created entities. Though, basic concept of resolution of CDs and PGs to CDs is similar, the major point of differences are tabulated below:

Distinct feature of Corporate Debtor and Personal Guarantor (PG)

S. No	Point of difference	Corporate Debtor	Personal Guarantor/ Individual
	Insolvency Resolution process		
1	**Threshold limit**	Default of ₹ One Crore	Default of ₹ One Thousand
2	**Fresh Start process**	Not Available	Chapter II of Part III of the IBC/Code provides a fresh start process for debtors with low income and assets. A debtor himself or through RP can file fresh start application in respect of his qualifying debts before AA, if (a) Gross annual income of the debtor < ₹ 60,000/- (b) Aggregate value of the assets of the debtor < ₹20,000 (c) Aggregate value of the qualifying debts < ₹30,000 (d) the debtor is not an undischarged bankrupt; (e) the debtor does not own a dwelling unit, regardless it is encumbered or not; (f) a fresh start process, insolvency resolution process or bankruptcy process is not existing against him; It may be noted the provisions of Fresh start process has not been notified yet.
3	**Application by Creditors**	Can be FC u/s 7 or OC u/s 9	Any creditor u/s 95. No classification in respect to financial or operational creditor
4	**Application by Debtor**	Yes, permitted u/s 10	Yes, permitted u/s 94
5	**Role of RP for initiation of insolvency resolution process of individual (PG to CD)**	No role of RP in assisting the AA for admission of application	The RP after being duly appointed mandate to verify the application as submitted by the debtor or creditor for initiating the insolvency resolution process. Once the RP is through with the examination of the application

			submitted, thereafter he shall compile a report suggesting the admission or rejection of the application and submitted to the AA. The AA on the basis of the received report from RP, shall decide whether to admit or reject the application submitted to it by the debtor or creditor.
6	**Concept of Interim moratorium**	No	Yes. As per section 96, an interim moratorium commences on the date of the application for insolvency in relation to all the debts of the guarantor and shall cease to have effect on the date of admission of insolvency. During the moratorium period: i. Any pending legal action/ proceeding in respect of any debt to be deemed to have been stayed. ii. The creditors of the debtor would not initiate any legal action or proceeding in respect of any debt
7	**Withdrawal of application**	Yes Requires 90% consent of Committee of Creditors (CoC), if constituted	Yes Requires 90% consent of creditors
8	**Publication of Public Announcement**	Apart from newspaper, explicit provision to publish on the website designated by the Board	No provision to publish on the website designated by the Board
9	**Committee of creditors**	Mandatory to constitute CoC by RP, which shall comprise of financial creditors only. However, if there is no FC, then OCs will constitute the CoC	No concept ofCoC. All creditors can attend the meeting of creditors
10	**Classification of Creditors**	Classification of creditors in terms of FCs, OCs and other creditors	There is no classification of creditors in terms of FCs and OCs. However, the creditors are classified as secured and unsecured debt

11	**Moratorium**	Applicable Section 14 exclusively covers the corporate debtor's own assets; its "debt" is not covered by this provision. Additionally, a contract of guarantee to a corporate debtor expressly excludes proceedings against a surety.	Applicable
12	**Investigation of Avoidance Transactions**	During CIRP, RP is mandated to determine the preferential, undervalued, the transaction's defrauding creditors, exorbitant credit transactions and fraudulent transactions, if any and file an application before AA thereto.	No avoidance transactions provisions during insolvency resolution
13	**Right of Secured Creditor**	Secured creditor is bound to be part of resolution process. No right to secured creditor for non-relinquishment of security interest.	As per section 110, a secured creditor may not forfeit his right to enforce security, and then submit an affidavit to the RP at the meeting of the creditors stating - (a) that the right to vote exercised by secured creditor is only in respect of unsecured part of the debt; and (b) estimated value of unsecured part of the debt.
14	**Approval of Resolution Plan**	Approval of plan requires 66% assent of CoC	Approval of plan requires 75% assent of creditors present in case of PG to CD
15	**Right of Dissenting Creditor**	Minimum entitlement to dissenting creditor linked with water mechanism under section 53 of the Code	No provision of minimum entitlement to dissenting creditor. No linkage to priroty of payment under section 178
16	**Rejection of Plan/ Non-submission of plan**	Rejection of plan in CIRP leads to compulsory liquidation	Application for bankruptcy is to be filed, there is no automatic bankruptcy proceedings

	Liquidation/ Bankruptcy Process		
17	**Process and IP designated**	Liquidation Process and appointed IP to conduct the process is designated as Liquidator	Since, an individual cannot be liquidator. Hence, Bankruptcy Process and appointed IP to conduct the process is designated as Bankruptcy Trustee
18	**Initiation of process**	Compulsory initiated u/s 33,	Creditor/debtor become entitled to file for bankruptcy:
		- Does not receive resolution plan before the expiry of the CIRP or the maximum period permitted for completion CIRP - AA rejects the resolution plan u/s 31 for the non-compliance of the requirements specified therein - The resolution plan approved by the AA is contravened	- AA rejects the insolvency resolution application u/s 100 - AA rejects the resolution plan u/s 115 - Premature closing of resolution plan u/s 118
19	**Recall of process**	No such provision. However, AA order can be appeal before NCLAT u/s 61	Under section142, AA can reverse the process either on application or suomoto on grounds like wrong initiation or full repayment
20	**Concept of Interim moratorium**	Not provided	Imposed u/s 124 on filing of application and ends on bankruptcy order
21	**Involvement of Creditors in the process**	Stakeholder's Consultation Committee (SCC) is constituted. Recommendation of SCC is advisory/ not mandatory. Prior to constitution of SCC, CoC under CIRP continues to work	Bankruptcy Trustee works under section 153 after procuring the approval of Committee of Creditors.
22	**Concept of Excluded debt and assets**	No such concept here	As per Section 79 (15), "excluded debt" means – (a) liability to pay fine imposed by a court/tribunal;

			(b)liability to pay damages for any negligence, nuisance or breach of a statutory, contractual or other any legal obligation; (c) liability to give maintenance to any person under any law for the time being in force; (d) liability for student loan; and (e) any such other debt as may be prescribed; As per section 79(14), (14) "excluded assets" includes – (a) unencumbered tools, books, vehicles etc as are necessary to the debtor/ bankrupt for his personal use or for the purpose of his employment, business or vocation, (b) unencumbered furniture, household equipment and provisions required for satisfying the basic domestic needs of the bankrupt and his immediate family; (c) any unencumbered personal ornaments of such value, as prescribed, of the debtor or his immediate family which cannot be separated in accordance with religious usage; (d) any unencumbered life insurance policy or pension plan purchased in the name of debtor or his immediate family; and (e) an unencumbered single dwelling unit owned by the debtor of such value as prescribed;
23	**Investigation of Avoidance Transaction**	Provided	Covered preferential, undervalued and exorbitant credit transactions
24	**Final Order**	Dissolution of the CD	Discharges/releases the bankruptcy from all debts.

From the forgoing discussion and based on market review, the following recommendations are suggested:

(i) **Threshold Limit for PG**: In the case of *State Bank of India v. V. Ramakrishnan* and others (civil appeal no. 3595 OF 2018 decided on 14th August 2018), the Hon'ble Supreme Court observed that if a PG proceeding is started before the Corporate Debtor's CIRP, it will be transferred to the NCLT; if it is started after the CIRP has started, the application for initiation of the PG proceeding can only be filed in the NCLT that has jurisdiction over the CD. While this ruling reinforced that a PG Proceeding can be initiated on its own even prior to the start of CIRP. Section 78 stipulates that in cases where the default amount is at least one thousand rupees or any amount that the Central Government may designate, but not more than one lakh rupees, Part III of the Act applies to individuals or partnership firms. It has been observed that it is being considered that application of PG to CD can be initiated only when there is default of debt to CD and there is personal guarantee. Threshold of CD default of ₹One crore is required. While minimum amount of default requirement for individual is ₹1000 and same is being talked for initiation for PG case without filing CIRP of the CD. Due to lack explicit provision, such view is being considered, it would be appropriate for the authority to clarify this ambiguity by reading all provisions harmoniously and enable PG to CD application only when there is default of ₹One crore to CD.

(ii) **Clarity on proof of invocation of guarantee:** A document reflecting the invocation of a guarantee under IBC is required to be filed before filing a section 95 of the IBC. The document should show how the guarantee was invoked to make the respondent liable in the proceedings. To invoke the guarantee in terms of the Deed of guarantee, the notice under section 13(2) of the SARFAESI or loan recall notice could be provided as proof of invocation of guarantee. Furthermore, a notice served by a creditor under section 95(4)(b) of the Code should be regarded as sufficient to invoke a bank guarantee, given that the Code is a comprehensive and self-contained legal framework. These documents can be included in the list of documents attached with Form for filing application initiation of insolvency resolution of PG to CD.

(iii) **Report of RP during admission:** Section 99 of the Code requires the RP to review the application filed by debtor or creditor and provide a report to the AA suggesting that the application be approved or denied, with in ten days of his appointment. In the matter of *Dilip B Jiwrajka v. Union of India & Ors.* (WP (Civil) No 1281 of 2021), Hon'ble SC has clarified that role of RP under Section 99 is that of a facilitator and is to gather relevant information on the basis of the application submitted under section 94 or section 95 and after carrying out the process which is referred to in sub-section (2), sub-section (4) and sub-section (6) of section 99, to submit a report recommending the acceptance or rejection of such application. The use of expression in the statute such as "examine the application", "ascertain" and "satisfies the requirements" and "recommend" the acceptance or rejection of the application, confirms that the RP is not entitled to perform an adjudicatory function or to arrive at any binding conclusions on facts. Rather, the role of the RP is purely recommendatory in nature and cannot bind the creditor, the debtor or the AA. Although role of RP is crystal clear now but there is need to provide the standard format of the report to facilitate the admission and additionally sufficient time of 21 days instead of 10 days, may be provided to RP to prepare the report more diligently.

(iv) **Misuse of Interim Moratorium**: In the matter of *Dilip B Jiwrajka v. Union of India & Ors.* (WP (Civil) No 1281 of 2021), Hon'ble SC has clarified that section 96's interim-moratorium has the effect of halting any ongoing legal action or process related to any debt, and neither the debtors nor the creditors may start any new legal actions or proceedings related to any debt. The key phrase "in respect of any debt" is used in both clauses (b)(i) and (b)(ii) of sub-section (1) of section 96, indicating that the interim moratorium's goal is to prevent the start or continuation of legal action or proceedings against the debt. Section 96 of the law establishes a moratorium for protective reasons. The moratorium's goal is to shield the CD from the filing of lawsuits or the continuing of of legal actions or proceedings in respect of the debt. However, it is noted that the debtors and wilful defaulters are abusing the section 96 interim-moratorium to delay the recovery process and prevent the creditors from taking legal action against them. Due to their significant net worth, close relationship to CD, and financial and legal acumen, PG are more likely to abuse the same.

In the matter of Amrit Kumar Patel, CP (IB) No.773/ND/2020, Hon'ble NCLT observed that the PG has filed application under section 94 with an ulterior motive to stall the recovery proceedings and taking the undue benefit of interim-moratorium as provided under section 96 of the Code. In the matter of *Jagdish Prasad Saboo v. IDBI Bank Limited*, Special Civil Application No. 19261/2022, the Gujarat High Court held that the intention of the moratorium granted under section 96 of the Code, 2016 cannot be extended to the proceedings with respect to a borrower who had been declared as a Wilful Defaulter. IBC can be referred only to the debt, as mentioned therein. In the matter of *Adarsh Jhunjhunwala v. State Bank of India & Anr,* WPO1548/2021, the Calcutta High Court observed that if wilful defaulter proceedings, criminal proceedings, or quasi-criminal proceedings are stayed during an interim-moratorium under section 96, the same would defeat the object and purpose of the Code. The Court further stated that allowing interim-moratorium under IBC to stall wilful defaulter proceedings would have the effect of promoting impropriety and illegality, by permitting a wrong doer to commit further wrongs.

In the case of *Lalit Kumar Jain v. Union of India & Ors.*, the Hon'ble SC noted among other things that the Parliamentary objective was to treat PGs differently from other categories of individuals. PGs were separated into a distinct species, for which the AA was common with the CD to whom they had stood guarantee, due to the close relationship between these individuals and the corporate entities to which they stood guarantee, as well as the potential for two separate processes to be conducted in different forums, with its attendant uncertain outcomes. Sections 2(e), 5(22), 60, and 179 of the Code provide adequate indication that, despite being a part of the broader group of individuals, PGs were to be, in light of their intrinsic connection with CDs, dealt with differently from other individuals. Ministry of Corporate Affairs in its discussion paper dated 18.01.2023 regarding proposed changes to the Code, suggested to remove the applicability of interim moratorium for PG to CD cases. Though new amendments are in pipeline and may take its own time, nevertheless, the Central Government u/ 96(3) is empowered to dispense with applicability of such provision for any class of creditors.

(v) **Publication of Public Announcement:** On December 1, 2019, the provisions pertaining to bankruptcy and insolvency resolution pertaining to PGs to CDs came into effect. So far 3184 applications of PGs to CDs had been filed as of June, 2024, according to information obtained from the applicants, IPs, and data gathered from various benches of NCLT and DRT. Of them, under sections 94 and 95 of the Code, respectively, 451 applications have been made by the debtors and 2733 by the creditors. Of them, 3134 have been filed before various NCLT benches, and 50 have been submitted before various DRT benches. Out of 3184, RP has been appointed in 1542 cases and 468 cases have been admitted. 117 cases were dismissed/withdrawn before appointment of RP and 103 have rejected/dismissed/withdrawn after appointment of RP. 146 of the 468 PIRPs that were admitted have been closed. Out of these, 12 have been withdrawn, 108 have been closed due to non-submission or repayment plan rejection, and 26 have resulted in repayment plan. The debtor or creditor may file for bankruptcy if the resolution process is unsuccessful or if the repayment plan is not carried out. As of June 2024, 56 bankruptcy applications had been filed based on information from applicants, IPs, and data gathered from several NCLT and DRT benches. Under Section 123 of the Code, the creditors have filed 55 applications and one by debtor under section 124 of the Code. Of them, one has been submitted to DRT, Chennai, while 55 applications have been submitted to various NCLT benches. In view of numerous proceedings going on and information symmetry, it is highly recommended that details of PG to CD may be made available on the IBBI portal alike of CD matters. Public announcement, claims, status of PG to CD case etc. can be displayed on the website of the IBBI to facilitate the stakeholders for such admissions and status of their claims thereof.

(vi) **Entitlement to dissenting creditors**: Under PG to CD, a majority of more than three-fourths of the creditors present in person or by proxy who vote on the resolution at a meeting of the creditors must approve the repayment plan or any modifications to it. A report of the creditors' meeting regarding the repayment plan must be prepared by the RP which shall inter alia include a) the repayment plan's approval or rejection, along with a list of any modifications; b) the resolutions proposed at the meeting and the decision made on them; c) a list of all the creditors who attended or were represented at the meeting, along with voting records for each creditor at all meetings of the creditors; and d) any other information that may be relevant.. During CIRP of the CD, a dissenting FC is entitled to the amount specified in Section 30(2) of the IBC; this amount cannot be less than the amount to which the dissident FC would otherwise be entitled in the event of the CD's liquidation. The amount is to be distributed in accordance with order of priority provided in Section 53(1). However, no protection has been accorded to dissenting creditors under PG to CD proceedings.

(vii) **Status of avoidance transactions filed during CIRP under excluded debt:** When the AA has approved the repayment plan, it shall be binding on the creditors mentioned in the repayment plan and the debtor too. The final discharge order of AA releases the debtor of all his debts except the "Excluded debt". It is to be noted that though the excluded debt definition covers the liability to pay damages for negligence, nuisance or

breach of a statutory, contractual or other legal obligation, but treatment of pending avoidance transactions and also order thereto is uncertain. It is suggested that amount under avoidance transactions may expressly be covered under the excluded debt so as no escape route be bestowed on PG under IBC proceedings for misappropriation of funds of the CD.

(viii) If a personal guarantor dies during the insolvency resolution process then what will be the status of that IRP process: The report of the BLRC, Nov. 2015, recommended that during negotiations for repayment plan: In the event of the death of the debtor during the period of negotiations, the legal representative of the debtor may assume responsibility for the same. If the debtor dies during the implementation of the plan, then the legal representative of the debtor can choose to continue with the repayment plan, or request for an adjudicator led bankruptcy process which will lead to the sale of the deceased debtors' assets up to the value of debt owed to creditors at that point in time. This ensures that the next-of-kin continues to bear the cost either through period cash flow payments to creditors, or some loss of inheritance through the sale of the debtor's assets. However, such provisions had not been incorporated under the Code. It may be noted that section 169 of the Code allows continuance of proceedings on death of bankrupt. "*If a bankrupt dies, the bankruptcy proceedings shall, continue as if he were alive*". Since legal representative steps into the shoe of deceased bankrupt, decisions of AA can be guiding better.

Issue B2: Can CoC in its commercial decision extinguished the Personal Guarantees of dissenting FCs in CIRP?

In *Lalit Kumar Jain v. Union of India*, the Supreme Court emphasized that settling a CD under the IBC does not absolve its guarantors from liabilities. Resolution plans, which frequently extinguish claims against the corporate debtor, expressly protect those against promoters and guarantors. In *Puro Naturals JV v. Warana Sahakari Bank* (Company Appeal (AT) (Insolvency) Nos.661-663 of 2023 dated November 24, 2023), the main issue before NCLAT was whether a resolution plan's having a clause of extinguishment of security interests and guarantees of creditors, including those who dissented, is in conformity with section 30(2) of the Code. The CoC gave Puro Naturals JV, the approved resolution applicant, a resounding 78.03% majority vote. The NCLAT rendered a final decision, holding that a resolution plan that permits the extinction of security interests and personal guarantees of financial creditors, including those who disagree, does not contradict section 30(2) of the IBC or the CIRP Regulations. Furthermore, the resolution plan for Ujaas Energy by SVA Family Welfare Trust proposed ₹74.8 crores to creditors, including ₹23.8 crores to release personal guarantees of the corporate debtors. Despite being approved by a 78% majority of creditors, Bank of Baroda objected, claiming it is not permissible to release the personal guarantees. The scheme was rejected by the NCLT, which backed the Bank's opposition. The NCLAT reversed the NCLT's ruling and held that a resolution plan may include a provision that extinguishes security interests, such as personal guarantees, after compensating the FC in whose favor the security interest was created. According to the NCLAT, the CoC approved a plan that involved the release in accordance with its commercial judgment. Due to the lack of a substantial question of law, the SC dismissed an appeal on this matter.

Above cited cases have raised a serious question that whether the CoC's rulings have the authority to revoke a creditor's entitlement to a debt owed—by the guarantor, not the corporate debtor. Need to mention that the liability under the guarantee is not a debt payable by the CD. Rather, the guarantee is a third-party obligation that was established by a guarantee contract between a creditor and a third party (often the corporate debtor's promoters/directors). Of certainly, the creditor that receives the guarantee may forego its claims under it, but can the CoC make a decision that eliminates this privilege without the approval of each individual creditor? It is made clear by the IBC that the CIRP pertains solely to the CD and its assets, and hence, it does not address the rights of creditors with respect to the CD. Despite acknowledging that a resolution plan cannot address the guarantor's assets, the NCLAT's opinion rejects the possibility that resolving a personal guarantor's obligation without considering their assets under resolution plan of the CD might violate the creditor's rights. An explicit provision for curtailing the extinguishment of creditors right for recovering through PG proceeding is considered utmost necessary.

Issue B3: Who has jurisdiction over personal guarantors when CIRP is not pending against corporate debtor, NCLT or DRT?

Sections 179 and 60 of the Code describe how the jurisdiction of DRT and NCLT interact with one another. According to section 179, DRTs will have the authority to consider the bankruptcy cases of individuals and partnership firms, subject to section 60 of the Code. According to Section 60 of the Code, the NCLT will preside over the adjudication process for corporate entities, including CDs and personal guarantors, when it comes to insolvency resolution and liquidation. Section 60(2) of the Code specifies that if CIRP or the CD's liquidation procedure is going on, an application pertaining to the insolvency resolution, liquidation, or bankruptcy of a corporate guarantor, or PG of the corporate debtor, shall be filed before the NCLT. The Code's section 60(3) provides for the transfer of ongoing legal actions against the PG to the Corporate Debtor's jurisdictional NCLT from any court or tribunal.

The distinguishing factor to determine the jurisdiction of DRT and NCLT for the purposes of insolvency resolution process of a personal guarantor would be the status of CIRP proceedings-pending or commenced post initiation of PG proceedings. If the CIRP of the CD for whom the guarantee is given, is pending with NCLT, the AA is NCLT for PG cases. If the CIRP is not pending, AA will be DRT. In the case of NCLT, the jurisdiction shall be same bench where CIRP proceedings of the CD is conducted. In case of DRT, the bench having jurisdiction in residential address of guarantor shall be the jurisdiction. If the proceedings are initiated in DRT and subsequently CIRP proceedings commences, the insolvency proceedings against personal guarantor shall be transferred to the concerned NCLT. Further, an appeal against order of NCLT can be made to NCLAT. An appeal against order of NCLAT on the question of law can be made to the Supreme Court. An appeal against order of DRT can be made to Debt Recovery Appellate Tribunal (DRAT). An appeal against order of DRAT can be made to the Supreme Court

In the cases of *Altico Capital India Ltd. v. Rajesh Patel* and *Insta Capital Pvt. Ltd. v. Ketan Vinod Kumar Shah*, the Mumbai bench of the NCLT was asked to determine which forum would be the proper AA for the insolvency proceedings of a personal guarantor in the event that the

NCLT received an application for insolvency or liquidation of the CD, but the application was not yet concluded. The NCLT held that an application for the personal guarantor's insolvency is not maintainable unless the CD was the subject of insolvency or liquidation; furthermore, NCLT opined that filing applications seeking the insolvency of personal guarantors without the CD undergoing insolvency or liquidation would tantamount to vesting NCLT with the jurisdiction of DRT. In *Rohit Nath v. KEB Hana Bank Ltd.*, the Madras High Court likewise adopted a similar stance. An appeal for civil revision brought by a PG against an ongoing PG proceeding before the DRT was heard by the Honorable Madras High Court. In this case, the Madras High Court construed section 60(2) of the Code to suggest that PGs would only be covered by section 60 while the CD is going through CIRP, and it dismissed the petition accordingly. It further stated that personal guarantor proceedings must inevitably be brought only before the jurisdictional DRT and not before any other tribunal in cases where no CIRP has been filed against the Corporate Debtor.

However, the NCLT, Delhi Bench in *PNB Housing Finance Ltd. v. Mr. Mohit Arora and Ors*. noted that the Hon'ble Supreme Court held in the Lalit Kumar Jain v. Union of India case that section 60(1) is not impacted by section 60(2) of the Code, and section 179(1) of the Code is subject to section 60 of the Code, which includes sub-section (1). Accordingly, NCLT will have jurisdiction over the insolvency resolution (and liquidation) for corporate persons, including corporate debtors and personal guarantors thereof, in accordance with Section 60(1) of the Code. NCLT, Delhi Bench concluded that "*in a situation where Application(s) in relation to the Corporate Debtor for initiation of CIRP is pending at National Company Law Tribunal (NCLT) then, initiation of CIRP of the Corporate Debtor is not a prerequisite for maintainability of an application under Section 95 of the IBC, 2016 filed for initiating IR Process against the Personal Guarantor of that Corporate Debtor before the NCLT*".

In *Mahendra Kumar Jajodia v. State Bank of India* (SBI), SBI filed an application to begin the personal guarantor proceedings against the guarantor. The NCLT Kolkata dismissed the application on the grounds that it was premature as there was no ongoing CIRP or liquidation procedure against the corporate debtor. The NCLAT reinstated the SBI plea before the NCLT on the rationale that section 60 of the Code does not in any way preclude filing proceedings under section 95 of the Code; rather, its purpose is to guarantee the consolidation of the relevant proceedings before the same NCLT and section 60(1) of the Code allows an application to initiate personal guarantor proceedings to be submitted in the jurisdictional NCLT even in cases where section 60(2) does not apply to it. Hence, NCLAT overturned the ruling of NCLT, Kolkata. The NCLAT's ruling was upheld by the Supreme Court stating that "*We do not see any cogent reason to entertain the Appeals. The judgment impugned does not warrant any interference*". It was noted that the lack of any CIRP or liquidation proceedings pertaining to the CD before the NCLT does not allow for the rejection of an application under Code against the personal guarantor of the corporate debtor.

Having said above, there is currently uncertainty over the NCLT and DRT's authority over personal guarantors in light of the most recent contradictory rulings from the NCLTs and the High Court. The Working Group on Individual Insolvency Report, published in August 2017, stated that the DRT is the appropriate forum for all other cases involving individuals and firms, and that NCLT is the forum for personal guarantors falling under the purview of sub-

section 2 and 3 of section 60 of the Code. Section 179 of the Code provides that the Adjudicating Authority for individuals and partnership firms is the DRT. However, for personal guarantors, both the NCLT and DRT have jurisdiction in different scenarios.

Further, according to the Personal Guarantor Rules, the DRT is designated as an appropriate forum in cases involving the insolvency of individuals and partnership firms covered by Part III of the Code. It can be further argued that section 60(2) of the Code's words "without prejudice," when read in conjunction with sections sub-section 1, 3 and 4 of section 60 of the IBC/Code, clearly leads to the conclusion that an application relating to a PG cases can only be filed before the NCLT while the corporate debtor's insolvency/liquidation process is ongoing. Moreover, the jurisdiction of PG cases would depend on the PG itself, thus it would be appropriate to clarify that the DRT would be appropriate authority for PG cases when no CIRP proceedings are ongoing before NCLT.

Issue B4: Whether Double dip rule permitted in insolvency inflates the claim amount and reduces the realisation percentage with respect to guarantee given by multiple entities in group insolvency/ claims in CIRP as well as PG proceedings? If yes, how to deal with the same?

The Insolvency Law Principle of "Double-Dip' is a globally accepted norm which allows an FC to move against multiple estates for the same claim. However, if a creditor recovers its claim against one of the obligors, it cannot also recover from another obligor for the same claim.

It is important to mention that admission of a CIRP does not in itself mean that the creditor who initiated the application will recover the entire amount of its claim. Section 128 of the Indian Contract Act, 1872 enables a creditor to pursue remedy against both the principal borrower and the guarantor, as liability of a guarantor(s) is co-extensive with that of the principal borrower, unless the contract provides otherwise. Thus, if the principal borrower defaults in repayment of debt to a creditor, the creditor may choose to pursue remedy against the guarantor for repayment of debt. In effect, insolvency proceedings of a CD and its guarantors are closely linked to each other.

The *Insolvency Law Commission Report March, 2018 noted that* Section 60 of the Code requires that the AA for the CD and personal guarantors of the CD should be the NCLT that has territorial jurisdiction over the place where the registered office of the CD is located. This creates a link between insolvency resolution process or liquidation process of the CD and the personal guarantor of the CD such that the matters linking to the same debt are to be dealt in the same tribunal. It recommended that section 60(a) may be suitably amended to provide the same NCLT the authority to deal with the insolvency proceedings of the corporate guarantor as that of the corporate debtor. Making it clear that simultaneous proceedings were very much a part of the intent behind the Code. Sub-section 2 of section 60 of the IBC/Code, was amended by the Insolvency and Bankruptcy (Second Amendment) Act, 2018, to provide that where a CIRP or liquidation process of a CD is pending before NCLT, an application for insolvency resolution process or liquidation process or bankruptcy process of a corporate guarantor or personal guarantor of the CD, as the case may be, shall be filed before that NCLT. Sub-section (3), as amended by the said Amendment Act provides that the insolvency resolution process or liquidation process or bankruptcy process of a corporate guarantor or personal

guarantor of the CD, as the case may be, pending in any court or tribunal shall stand transferred to the AA dealing with insolvency resolution process or liquidation process of such CD. This is to ensure that the CIRP of a CD and the insolvency resolution of the individual guarantors of the same CD do not proceed on different tracks, before different forums, leading to a conflict of interests, situations or decisions.

It is to be noted that in the matter of *Dr. Vishnu Kumar Agarwal v. M/s. Piramal Enterprises Ltd.*, NCLAT has held that multiple CIRP applications submitted by the same creditor for the same set of claims against various CDs cannot be admitted. However, in *Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Pvt. Ltd. & Ors.*, the Appellate Authority allowed the simultaneous initiation of CIRP against the principal borrower and its corporate guarantors and review its aforesaid judgement in the Piramal Enterprises Ltd. case.

In Kaupthing Singer and Friedlander Ltd.. the UK Supreme Court re- viewed a large number of previous authorities on the concept of double proof, i.e. re- covery from guarantors in the context of insolvency proceedings. The court held that:

> 11. The function of the rule is not to prevent a double proof of the same debt against two separate estates (that is what insolvency practitioners call "double dip"). The rule prevents a double proof of what is in substance the same debt being made against the same estate, leading to the payment of a double dividend out of one estate. It is for that reason sometimes called the rule against double dividend. In the simplest case of suretyship (where the surety has neither given nor been provided with security, and has an unlimited liability) there is a triangle of rights and liabilities between the principal debtor (PD), the surety (S) and the creditor (C). PD has the primary obligation to C and a secondary obligation to indemnify S if and so far as S discharges PD's liability, but if PD is insolvent S may not enforce that right in competition with C. S has an obligation to C to answer for PD's liability, and the secondary right of obtaining an indemnity from PD. C can (after due notice) proceed against either or both of PD and S. If both PD and S are in insolvent liquidation, C can prove against each for 100p in the pound but may not recover more than 100p in the pound in all.

Insolvency Law Commission Report, February 2020 – *"As the right to simultaneous remedy is central to a contract of guarantee, the Committee suggested that in cases where both the principal borrower and the surety are undergoing CIRP, the creditor should be permitted to file claims in the CIRP of both of them. Since, as the Code does not prevent this, the Committee recommended that no amendments were necessary in this regard***.".** However, the Committee agreed that upon the recovery of any portion of a creditor's claims in one of the proceedings, there should be a corresponding review of the claim amount recoverable by that creditor from another proceeding. However, the right to simultaneous remedy under a contract of guarantee does not sanction a creditor to recover more than what is due to him.

Fletcher, in his book *'The Law of Insolvency"* has stated that "*Where the creditor to whom the liability is owed has already roved in insolvency of principal debtor, the surety's own liability is thereafter reduced to amount for which creditor's proof has been admitted, less value of any dividends that has been paid to him."*

From the forgoing discussion with regard to double filing of claims for same debts in various

entities and analysing the present provisions in the Code, CIRP, Liquidation and PG Regulations, it is recommended that:

(i) **Full disclosure of simultaneous filing of claims in claim forms and updation thereto**: There is need to provide the adequate check and balances with regard to multiple filing of claims for same debts. It is observed that such measures have been taken in PG Regulations in claim form filed by creditor by mentioning details such as (i) Amount claimed by me in the CIRP or liquidation process of the CD (ii) The amount admitted by the RP / liquidator of said process (iii) Amount realised by me in the said process, if any. However, no such details have been stated in the claim form filed by creditors under CIRP Regulations but mandates to update the claim form when the claim is satisfied, either partly or fully, from any source in any sort or manner, after the commencement of insolvency. On the contrary, such updation of claim is absence under PG Regulations. It is utmost necessary the RPs of both CIRP as well as PG proceedings should be well informed about initiation of proceedings, if any, amount of claim submitted and admitted thereof, covered by security interest, if any etc.

(ii) **Clarity in default amount in PG application and voting rights of creditors:** Moreover, at the time of admission of PG application, it has been observed that it is a general practice that creditors mainly bankers are initiating the PG proceedings with the same amount which was lodged in the CIRP proceedings irrespective of resolution plan approved or not. Although the resolution plan may takes 3-5 years to settle the claims, it would be appropriate that PG proceedings may be permitted to initiate with the remaining debt of the CD i.e. amount provided in the resolution plan to be deducted and the same remaining amount of debt for which guarantee have been given, should be used for allocation of voting rights.

(iii) **Accounting realisation from various proceedings to main debt:** Further, since there is one debt which relates to CD, it is necessary that realisation of any amount in relation of this debt should be reflected in realisation percentage of such debt. Any recovery from PG proceedings must be added to the debt to CIRP proceedings of the CD. Similarly, corporate guarantees given by different entities to one debt should be depicted in the main CD to whom the debt was granted. This could easily be found in the insolvency of group insolvency. Realisation in silos of different proceedings would undermine the efficacy of the IBC. It is paramount for creditor as well as IBC to present the complete picture of one debt with respect to multiple entries of claim in different proceedings and realisation thereto.

Issue B5: How to maximise the pie: Intermingling of assets of the CD and guarantors?

A CD's resolution procedure is limited under the Code to the CD's assets. But in a number of instances, the CD's assets and those of its guarantor—whether corporate or personal—are so intricately intertwined that a meaningful settlement of the CD would not be possible in a different action. For example, even though a structure, piece of equipment, or machinery may be owned by the CD, the land it is located on might be owned by a guarantor. In these situations, limiting the CD's resolution process to its assets yields ineffective results. Consequently, the question of whether a procedure should be developed under the Code to

include these guarantor assets in the total asset pool that the CIRP can utilize to effectively resolve the CD is currently under discussion.

In the matter of *Bank of India v. Sri Balaji Forest Products Private Limited* . Ld. Senior Counsel relied on the decision made by the Hon'ble National Company Law Appellate Tribunal in the case of *Vanguard Credit & Holdings Pvt. Ltd. v. Kshitiz Chhawchharia* (RP) of Ramsarup Industries Ltd. & Anr. (Company Appeal (AT) (Ins.) No. 1125 of 2019) to argue that it is legal to include the property of the suspended board of directors and guarantors that has been mortgaged to the corporate debtor's financial creditors and has been invoked under the SARFAESI. It was argued that the properties of the CD's guarantors and suspended board of directors were also mortgaged with the company's FCs in this current instance. Unquestionably, the CD's guarantors and suspended board of directors have mortgaged the entire land to the financial creditors. Furthermore, it is an undeniable fact that the CD's whole plant and factory are located on land that is owned by the company's suspended board of directors and guarantors but has been mortgaged to FCs. Furthermore, it acknowledged the fact that the CD's plant and factory were built on the property of the suspended board of directors and guarantors, and that the corporate debtor was free to use them.

In above scenarios, resolution applicants are reluctant to come forward since the land belongs to a third party, typically a related party of the CD or promoter, and the right to use it may be questioned or refused at any time, or the third party may fight the matter on trivial grounds. This has discouraged a number of resolution applicants from submitting proposals, even for feasible CDs. Since the land is not a part of the resolution estate, many cases have proven to be extremely challenging to settle. Even when the underlying asset and the CD's loans are guaranteed by connected parties through different instruments, resolution of such circumstances is challenging and the CD cannot be successfully resolved without addressing this circumstance holistically. Resolution may occur if the promoters' and guarantors' assets, which are mortgaged or charged to creditors in order to secure the loan for the CD, are included in the resolution estate.

It is to be noted that MCA in its discussion paper on 18.01.2023 proposed to intermingle the assets of the CD with guarantors without which a meaningful resolution of the CD is not possible provided a secured creditor has acquired possession of the secured asset of the guarantors of the CD under the SARFAESI Act, 2002, that is linked to the CD's assets and he may have the option to sell such properties through a special window formed under the CIRP process. It is necessary to comprehend the right of secured creditor for security interest is premised on the consent of the guarantors. Further, IBC being one stop shop solution for all default and debts, condition to take possession under SARFAESI Act, 2002 is overthought and unnecessary. Thus, intermingling of assets of the CD with the guarantors is a welcome proposal but overstretching the enabling provision would be futile and ineffectual.

Issue B6: Can personal guarantor initiate CIRP proceeding under section-7 of the Code against the CD (principal debtor) on payment of debt under personal guarantor proceedings under the Code? Or, Right of subrogation permits PG to recover debts from principal debtor on payment of dues?

Section 140 and 141 of the Contract Act, provides that the surety is subrogated to the creditor's rights against the principal debtor once it has paid the guaranteed amount. This implies that

the surety may use all of the creditor's rights against the principal debtor, including the right to recoup any money through lawsuit and the right to use any security the creditor may have for the debt. The right of subrogation allows the guarantor to step into creditor's shoe and recover the paid amount from the principal debtor.

Right of subrogation denied on approval of resolution plan: The Hon'ble SC affirmed the decision of NCLAT in the matter of *Lalit Mishra & Ors. v. Sharon Bio Medicine Ltd. & Ors.* [2018] wherein NCLAT denied the right of subrogation when objected by promoters as personal guarantors on the approval of resolution plan. NCLAT clarified that the IBC did not intend for the Personal Guarantors to profit from the exercise of legal remedies open to creditors, who would otherwise be able to recover their dues by enforcing the separate contracts known as personal guarantees. It is settled law that guarantors' obligations are coextensive with those of the borrower. Resolution under the Code is not a recovery suit. The object of the Code is, *inter alia*, maximization of the value of the assets of the CD, then to balance all the creditors and make availability of credit and for promotion of entrepreneurship of the CD. While considering the resolution plan, the creditors focus on resolution of the borrower CD, in line with the spirit of the Code. Hon'ble Supreme Court in *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta & Ors*. [2019], held that any fresh proceedings by virtue of subrogation on the CD managed by SRA are contrary to the scheme of IBC. The Supreme Court in *Lalit Kumar Jain v. Union of India & Ors* (2021) addressed that guarantors' liability does not change even after the resolution plan is approved as the contract between the creditor and guarantor is independent of the resolution process of the principal debtor/CD. In *Ghanashyam Mishra and Sons Pvt. Ltd. v. Edelweiss Asset Reconstruction Company Ltd.* (2021), the SC restored the clean state principle post approval of the resolution plan and thus, any right of subrogation would be contrary to this principle. NCLT Special Bench for approval of resolution plan for Jaypee Infratech Ltd held that personal guarantor has no right to subrogation, or to recover its dues from the CD, after approval of the resolution plan. Hon'ble SC upheld the decision of NCLAT in the matter of *Mr. Vikas Aggarwal v. Asian Colour Coated Ispat Ltd. and Ors*., wherein it again clarified that in light of the explicit requirements of Section 238 of the Code, the Personal Guarantors are not entitled to any relief in spite of the provisions of sections 140 and 141 of the Indian Contract Act, 1872. Every stakeholder must respect the unavoidable and inaccessible fact that the personal guarantor's right of subrogation is extinguished under IBC and any deviation from this principle will negatively affect the corporate debtors' ability to revive, the financial creditors' interests, and the country's economy as a whole.

The issue before us is whether right of subrogation permitted if PG paid payment on the behalf of the CD/principal debtor before initiation of CIRP of the CD or during the CIRP. It may be noted that the personal guarantor's right to subrogation is not an absolute right under CIRP against the debtor, and as such, he cannot start the CIRP against the debtor. This undermines the fundamental purpose of the Code by further reducing the value of the debtor's assets. It is acknowledged that the CIRP under the IBC aims to reorganize the assets and give creditors security rather than pursuing a recovery process. If the guarantor initiates CIRP against the debtor, it would create a never-ending cycle of litigation between the parties. However, PG can submit a claim in the CIRP of debtor company and the same to be considered at lower pedestal in the waterfall mechanism i.e. after the payment of creditors of the CD.

Issue B7: Can Principal Borrower be discharged when resolution plan is approved in CIRP of Surety/ Guarantor?

The Hon'ble SC in the matter of *BRS Ventures Investments Ltd. v. SREI Infrastructure Finance Ltd. and Anr.* Civil Appeal No. 4565 of 2021 decided on 23rd July 24, took note of findings in *Lalit Kumar Jain v. Union of India & Ors* (2021), that the contract between the surety and the creditor is independent, the surety's discharge will not occur simply because the principal borrower's resolution plan is approved. When the resolution plan is accepted in the surety's CIRP, the same guidelines will be followed. In such a scenario, the approval of the resolution plan of the surety will not amount to the discharge of the principal borrower to repay the loan amount to the creditor after deducting the amount recovered from the corporate guarantor. The SC further analysed that whether the assets of the principal borrower were part of CIRP in respect of corporate guarantor. Since principal borrower is the subsidiary of the surety i.e. holding company and the assets of the subsidiary company of the CD cannot be part of the resolution plan of the CD. Therefore, the assets of the principal borrower/subsidiary were not part of the resolution plan of the surety/holding company. Thus, Principal Borrower is not discharged when resolution plan is approved in CIRP of Surety/ Guarantor and FC has right to initiate proceeding against the principal borrower under section 7 of the Code for the remaining amount not paid by the surety.

CONCLUSION

In order to give the CIRP under the IBC more teeth, it was necessary to ensure that the promoters of CDs, who stood as personal guarantors (PGs) to the staggering loans for companies, were brought into the insolvency net. The ground reality is that many of the enterprises that have failed over the years have received large sums of credit from banks and financial institution based on the goodwill of their promoters. Consider the following scenarios. It has been reported that top 10 personal guarantors have guaranteed a total Debt of over ₹1.6 lakh crore. For instance, erstwhile promoter of Bhushan Power and Streel Ltd., and his wife are among the debtors, having provided personal guarantees to the tune of around ₹24,000 crores to allow loans from a consortium bank. Personal guarantees of about ₹90,000 crore was given for loan to Dewan Housing Finance Limited (DHFL) and for around ₹22,000 crore loan to the Videocon company etc.

As per the IBBI quarterly newsletter ending on June, 2024, so far 3184 applications have been filed under PG to CD for resolution process and 56 applications have been filed before PG to CD bankruptcy process. Out of 3184 applications, about 84% of cases i.e. 2,964 are pending for admission under IBC. As of June 2024, just 468 cases out of this total have been admitted. Of these, 26 PG to CDs cases yielded in resolution under IBC wherein the creditors have recovered Rs. 102.78 crore which is 2.16 of their admitted claims from personal guarantors under the IBC. Though is recovery of 2.16% is not optimal, but it does contain the claims of the CD so such data could not be viewed in isolation. Nevertheless, the pendency of admission emphasized the need for expanding the NCLT and DRT. Delays are directly linked with valuation and realisation. Larger the delays, lower the valuation and realisation. When handling guarantees under the Code, having a clear structure and set of procedures would reduce litigation and expedite the process. There is a need to relook the treatment of

guarantees under the Code for faster resolution and better realisation. Looking at the minuscule recovering of percentage in PG proceedings, there is need for RBI and DFS to contemplate the personal guarantees backed by real security.

The Code has been widely acknowledged as having brought about a significant behavioral change amongst the creditors and debtors. The inevitable consequence of a resolution process is that the control and management of the firm moves away from existing promoters and managers, most likely, forever. One sees the fear in errant promoters of losing their company. IBC has helped to strengthen the position of creditors, weakened the hands of unscrupulous borrowers and poor managements and has brought about behavioral changes which will go a long way in transforming the corporate credit culture in India. As IBC evolves further, it could become the most potent instrument in driving good credit behavior and ethical business practices among borrowers, and proactive, responsible behavior among lenders, proving to be a boon for the economy and the nation.

07

ENHANCING THE ROLE OF INSOLVENCY PROFESSIONALS IN MANAGING COLLECTIVE INVESTMENT SCHEMES CRISIS IN INDIA: A PROPOSAL FOR REGULATORY INTEGRATION

Asit Behera and Pooja Singla

ABSTRACT

The landscape of Collective Investment Schemes (CIS) in India has undergone significant transformation since their inception, evolving into a critical component of the country's financial market. However, this sector has not been immune to challenges – both regulatory and operational. This paper delves into the complexities faced by CIS, particularly in the context of insolvency and financial distress. It highlights the pivotal role of the Securities and Exchange Board of India (SEBI) and the need for an enhanced regulatory framework to manage the crises effectively. The authors propose the integration of Insolvency Professionals (IPs) into the CIS regulatory framework as a strategic solution. This integration aims to leverage the expertise of IPs in managing financial distress to ensure efficient resolution of defaulting CIS cases. The paper underscores the importance of a cooperative framework between SEBI and the Insolvency and Bankruptcy Board of India (IBBI) to facilitate this integration. Furthermore, the involvement of trustees or SEBI-authorized officers is deemed crucial in safeguarding the interests of depositors and investors, ensuring that SEBI's perspective is integrated into the insolvency proceedings. The recommendations for regulatory reforms and procedural enhancements are intended to boost investor confidence and promote the orderly development of the CIS sector.

INTRODUCTION AND BACKGROUND: THE GROWTH AND CHALLENGES OF CIS IN INDIA

Evolution and growth of Collective Investment Schemes in India

The landscape of CIS in India has undergone significant transformation since their inception, evolving into a critical component of the country's financial market. These schemes, which pool resources from individual investors to invest in a diversified portfolio of assets, have witnessed exponential growth over the past few decades. This growth can be attributed to several key milestones, including regulatory reforms and the introduction of innovative investment products that cater to the varied risk appetites and financial goals of investors.

In the early 2000s, the Indian financial market saw a paradigm shift with the SEBI taking stringent measures to regulate CIS, aiming to protect investors and enhance market transparency. These regulatory efforts, coupled with India's economic growth and the

increasing financial literacy among its populace, have significantly contributed to the proliferation of CIS.

The appeal of CIS lies in their ability to offer diversified investment portfolios, which mitigate individual asset risk and cater to a broad spectrum of investors. Retail investors find CIS attractive for their relatively low entry barriers and the expertise provided by fund managers, while institutional investors value the opportunity to allocate large sums of capital across various asset classes efficiently.

What is a Collective Investment Scheme?

Broadly, a 'fund' or 'scheme' is a pool of money contributed by a range of investors who may be individuals or companies or other organisations, which is managed and invested as a whole, on behalf of those investors. Generically such funds are sometimes known as 'collective investments' since they collect people's money together. Traditionally, most collective investments fell into one of three main categories: pension funds–that is, funds into which people save during their working life, which can only normally be accessed upon their retirement, in order to receive a pension (in some countries provident funds fulfil a similar role); insurance funds–that is, funds into which people save whereby the fund agrees to pay them a specific sum upon the occurrence of certain events (such as the inappropriately named life insurance which actually pays out on death, to the deceased's nominated beneficiaries); and investment funds into which people save, but where money can be put into and taken out of the fund at any time and where payouts are not specifically related to any one event occurring.[1]

The question first arose before the United States Supreme Court in *SEC v. W.J. Howey Co.*[2] in which it laid out the test for determining whether an arrangement constitutes an "investment contract" under the Securities Act of 1933. Specifically, the Court stated:

> The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.

The key elements of the Howey test are:

1. Investment of money - This covers cash investment by the investor, even if the investment also involves some incidental property interest.
2. Common enterprise - This is satisfied by horizontal commonality among multiple investors pooling funds/assets, or vertical commonality where the investor's fortunes are interwoven with the promoter's efforts.
3. Expectation of profits - The investor's motivation must be the expectation of profits to be derived from the entrepreneurial or managerial efforts of others.

[1] Mark St Giles, Ekaterina Alexeeva and Sally Buxton, Managing Collective Investment Funds, John Wiley & Sons, 2nd ed.)
[2] SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

4. Solely from efforts of others - The profits must come predominantly from the efforts of the promoter or third party, as opposed to the investor's own efforts.

So, in essence, it is a situational test focusing on whether the scheme involves the investing of money in a common enterprise with the expectation of profits arising solely through the efforts of others.

Section 2(b) of the Securities & Exchange Board of India Act, 1992 (SEBI Act, 1992)[3] defines CIS means any scheme or arrangement which satisfies the conditions specified in section 11AA.

Here is the reproduction of Section 11AA of the SEBI Act, 1992:

Collective investment scheme.

11AA. (1) Any scheme or arrangement which satisfies the conditions referred to in sub-section (2) or sub-section (2A) shall be a collective investment scheme:

Provided that any pooling of funds under any scheme or arrangement, which is not registered with the Board or is not covered under sub-section (3), involving a corpus amount of one hundred crore rupees or more shall be deemed to be a collective investment scheme.

(2) Any scheme or arrangement made or offered by any person under which,—

(i) the contributions, or payments made by the investors, by whatever name called, are pooled and utilized for the purposes of the scheme or arrangement;

(ii) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable, from such scheme or arrangement;

(iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors;

(iv) the investors do not have day-to-day control over the management and operation of the scheme or arrangement.

(2A) Any scheme or arrangement made or offered by any person satisfying the conditions as may be specified in accordance with the regulations made under this Act.

(3) Notwithstanding anything contained in sub-section (2) or sub-section (2A), any scheme or arrangement—

(i) made or offered by a co-operative society registered under the Co-operative Societies Act, 1912 (2 of 1912) or a society being a society registered or deemed to be registered under any law relating to co-operative societies for the time being in force in any State;

(ii) under which deposits are accepted by non-banking financial companies as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934);

(iii) being a contract of insurance to which the Insurance Act, 1938 (4 of 1938), applies;

[3] Securities and Exchange Board of India Act, 1992.

(iv) providing for any Scheme, Pension Scheme or the Insurance Scheme framed under the Employees Provident Fund and Miscellaneous Provisions Act, 1952 (19 of 1952);

(v) under which deposits are accepted under section 58A of the Companies Act, 1956 (1 of 1956);

(vi) under which deposits are accepted by a company declared as a Nidhi or a mutual benefit society under section 620A of the Companies Act, 1956 (1 of 1956);

(vii) falling within the meaning of Chit business as defined in clause (d) of section 2 of the Chit Fund Act, 1982 (40 of 1982);

(viii) under which contributions made are in the nature of subscription to a mutual fund;

(ix) such other scheme or arrangement which the Central Government may, in consultation with the Board, notify, shall not be a collective investment scheme.

To put it simply, it is defined as any scheme or arrangement made or offered by any company under which the contributions, or payments made by the investors, are pooled and utilised with a view to receive profits, income, produce or property, and is managed on behalf of the investors is a CIS. Investors do not have day to day control over the management and operation of such scheme or arrangement.[4]

The Dave Committee (Committee), constituted by the SEBI, conducted a comprehensive review of the regulatory framework governing CIS in India.[5] The Committee's report highlighted several critical aspects of CIS regulation and proposed recommendations to strengthen investor protection and maintain the integrity of the securities market.

One of the primary concerns addressed by the Committee was the need for a clear definition of CIS. The report emphasized that the existing definition under section 11AA of the SEBI Act, 1992, was broad and could potentially encompass various investment arrangements, leading to regulatory ambiguity.[6] To address this issue, the Committee proposed a more specific definition that would bring clarity and enable effective regulation of CIS.[7]

The Committee also stressed the importance of mandatory registration of CIS with SEBI. It noted that the existing regulatory framework, particularly Regulation 3 of the SEBI (Collective Investment Schemes) Regulations, 1999 (CIS Regulations), prohibited any person other than a registered Collective Investment Management Company (CIMC) from launching or operating a CIS.[8] However, the Committee observed that there were instances of unregistered CIS operating in the market, exposing investors to significant risks.[9]

To tackle the problem of unregistered CIS, the Committee recommended that SEBI take proactive measures to identify and take action against such entities. It suggested that SEBI

[4] FAQ- Collective Investment Schemes issued by SEBI https://www.sebi.gov.in/sebi_data/docfiles/20623_t.html#:~:text=Any%20scheme%20or%20arrangement%20made,the%20investors%20is%20a%20CIS.
[5] Securities and Exchange Board of India, Report of the Committee on Collective Investment Schemes (Dave Committee Report) (1999).
[6] *Id.*
[7] *Id.*.
[8] The Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999, Regulation 3.
[9] Dr. S.A. Dave Committee (Interim) Report on Collective Investment Schemes.

utilise its powers under section 11(2)(c) and section 11B of the SEBI Act, 1992 to issue directions and take enforcement actions against unregistered CIS. The Committee also proposed increasing public awareness about the risks associated with investing in unregistered schemes.

Another key recommendation of the Committee was to enhance the eligibility criteria for registration of CIMCs. It proposed that the net worth requirement for CIMCs be increased to ensure that only financially sound entities are allowed to operate CIS.[10] Additionally, the Committee suggested that the fit and proper criteria for key personnel managing CIS be strengthened to maintain high standards of integrity and competence in the industry.[11]

The Committee also emphasised the need for regular monitoring and supervision of CIS by SEBI. It recommended that SEBI conduct periodic inspections and audits of CIMCs to ensure compliance with regulatory requirements and to protect the interests of investors.[12] The report also suggested that SEBI establish a dedicated department or unit to focus on the regulation and supervision of CIS. Pursuant to the same, changes have been carried out.

Law for CIS in India

Pursuant to the Dave Committee Report, to operate a CIS, it is mandatory to do so exclusively through a CIMC, and the scheme must receive prior approval from SEBI. This requirement is clearly outlined in Regulation 3 of the CIS Regulations, which states that no person other than a CIMC which has obtained a certificate of registration from SEBI shall carry on or sponsor or launch a CIS.[13]

The compulsory prior approval requirement, along with SEBI's discretionary power to reject the scheme, has been identified as a significant factor contributing to the absence of any registered CIMCs with SEBI, according to publicly available records.[14] This is despite the rapid expansion of crowdfunding schemes in recent years.

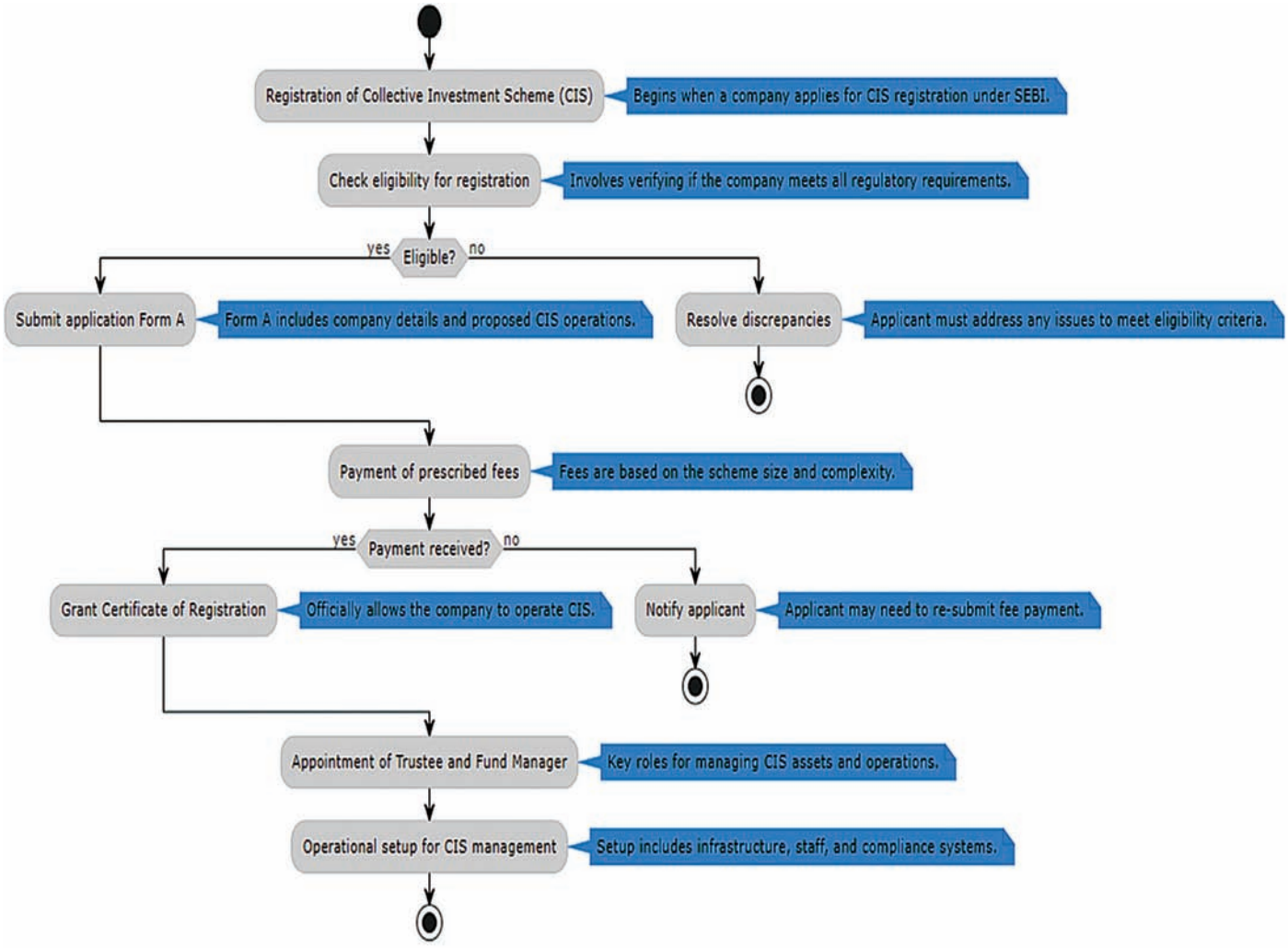
In an attempt to evade the prior approval requirement, some entities have structured their investment schemes as fractional ownership or joint partnerships rather than presenting them as investment contracts. However, SEBI has taken a proactive approach in clamping down on such attempts. The regulator has clarified that if these schemes possess the essential characteristics of a CIS, they will be treated as unregistered CIS. SEBI's power to take such action is rooted in section 11(2)(c) and section 11AA of the SEBI Act, 1992 as well as Regulation 3 of the CIS Regulations, which empower the regulator to oversee and register CIS while defining the criteria for a scheme to be classified as a CIS.[15] Furthermore, Regulation 65 of the CIS Regulations grants SEBI the power to issue directions to CIMCs and trustees to

[10] The Securities and Exchange Board of India Act, 1992, §§11(2)(c), 11AA.
[11] Public Records, Securities and Exchange Board of India, https://www.sebi.gov.in/.
[12] SEBI Annual Report 2022-23.
[13] *supra note 8*.
[14] *supra note 12*.
[15] *supra note 11*; *supra* note 10.

protect the interests of investors, including prohibiting them from operating unregistered CIS.[16]

A registered CIMC is eligible to raise funds from the public by launching schemes. Such schemes have to be compulsorily credit rated as well as appraised by an appraising agency.[17] The schemes also have to be approved by the Trustee and contain disclosures, as provided in the Regulations, which would enable the investors to make informed decision.

A brief flowchart on the same has been presented below:



[16] The Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999, Regulation 65.
[17] *Id.*, Regulation 24(2) and 24(3).

The regulations lay out comprehensive guidelines covering the operation, management, and winding up of CIS, aiming to ensure transparency and fair play in these investment vehicles. They specify the rights of investors, including access to information and grievance redressal mechanisms, and outline the obligations of the managing entities. SEBI is empowered to inspect the records of CIS, enforce compliance, and initiate actions against defaulters, which include winding up schemes and imposing penalties. This robust regulatory framework is designed to safeguard investor interests, maintain market integrity, and foster a healthy investment environment within the collective investment space in India.

The Investor Education and Protection Fund Authority, as part of its investor awareness measures, has listed some Dos and Don'ts for investors of CIS.[18] Further, to strengthen the regulatory framework for CIS, the SEBI has time and again intervened and made necessary amendments in the CIS Regulations. In 2022, the SEBI enhanced the net worth criteria and track record requirements for entities managing such schemes. Also, the regulator mandated a minimum of 20 investors and a subscription amount of at least ₹20 crore for each CIS. In addition, the regulator had put a cap on cross-shareholding in CIMC to 10 % to avoid conflict of interest. With regard to eligibility criteria, the applicant, or its promoters should have a soundtrack record and general reputation of fairness and integrity in all their business transactions.[19]

MAJOR INTERNATIONAL JURISDICTIONS ON CIS

United States (U.S.)

In the United States, CIS are primarily regulated under the Investment Company Act of 1940.[20] This Act defines the obligations and the governance of investment companies, including mutual funds, which are the most common form of CIS in the U.S. The Act requires these funds to register with the Securities and Exchange Commission (SEC) and adhere to specific financial standards and disclosure requirements.

United Kingdom (UK)

In the UK, CIS are regulated under the Financial Services and Markets Act 2000[21] (FSMA), with detailed rules provided by the Financial Conduct Authority (FCA) in the Collective Investment Schemes Sourcebook.[22] The FSMA provides an overarching framework for the management of financial services, including CIS, in the UK while The FCA's regulations cover the operation, promotion, and management of these schemes, ensuring that they operate in a manner that is fair to investors and transparent. The Collective Investment Schemes Sourcebook is part of the FCA Handbook, detailing rules specific to the creation and operation of CIS.

[18] https://www.iepf.gov.in/content/iepf/global/master/Home/InvestorAwareness/resources/dos-and-don-ts/collective-investment-schemes.html, (last visited April 23, 2024).
[19] Securities and Exchange Board of India (Collective Investment Schemes) (Amendment) Regulations, 2022.
[20] Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-64.
[21] Financial Services and Markets Act 2000, c. 8 (Eng.).
[22] FCA Handbook, Collective Investment Schemes Sourcebook.

European Union (EU)

While the UK has left the EU, EU regulations previously applied to the UK and continue to influence CIS regulations due to their reach and impact across Europe. In the EU, CIS are primarily regulated under the Undertakings for Collective Investment in Transferable Securities Directive (UCITS),[23] which allows for the distribution of funds across EU member states without additional authorization from each country. The UCITS establishes requirements for CIS in the EU to operate freely across member states under a harmonized regulatory framework.

CHALLENGES FACING COLLECTIVE INVESTMENT SCHEMES

As per SEBI Annual Report 2022-23, as on 31.03.2023, there was only one registered CIMC, M/s GIFT Collective Investment Management Company Ltd., which was registered during 2008-09.[24] However, no CIS has been launched by this CIMC till date. In contrast, the data shows that 1034 and 766 no. of complaints were received in the category of CIS schemes during the years 2021-22 and 2022-23 respectively.[25]

During 2021-22, SEBI passed four final orders against entities found to be carrying out unauthorized CIS. The final orders, *inter-alia*, directed the company (and its directors) to wind up its existing CIS and make repayments to investors within a specified time period. Additionally, during 2021-22, SEBI, after examination, referred 70 cases of unauthorized money mobilization to jurisdictional agency/ regulator concerned, viz., State Governments, RBI, Ministry of Corporate Affairs, Ministry of Agriculture etc., as these cases did not fall under SEBI's purview.[26]

I went looking for trouble, and I found it.- Charles Ponzi

Despite their significant contributions to the financial market's depth and breadth, CIS in India have not been immune to challenges. Instances of financial distress, mismanagement, and fraud have surfaced, casting shadows over the schemes' reliability and the regulatory framework's effectiveness. Notably, high-profile cases involving misappropriation of funds and misleading investment strategies have led to substantial financial losses for investors and eroded public trust in these investment vehicles.

For example, certain schemes have been found guilty of diverting investor funds to high-risk ventures without clear disclosure, while others have faced liquidity crises, unable to meet redemption requests during volatile market conditions. These incidents highlight systemic vulnerabilities within the CIS framework, raising questions about the adequacy of oversight and the enforcement of investment guidelines.

The impact of these challenges on investor confidence cannot be overstated. Many investors, particularly retail participants, have grown wary of investing in CIS, fearing the loss of their

[23] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast), OJ L 302, 17.11.2009.

[24] SEBI Annual Report 2022-23.

[25] *Id.*

[26] SEBI Annual Report 2021-22.

hard-earned money. This sentiment, if unchecked, threatens not only the viability of CIS but also the broader financial market's stability, as it could lead to reduced capital inflow and diminished liquidity.

Moreover, the repercussions extend beyond individual investors. The financial distress of CIS can have systemic implications, affecting the overall health of the financial market and potentially leading to wider economic consequences. This scenario underscores the need for a robust mechanism to address the vulnerabilities of CIS, protect investor interests, and ensure the financial system's resilience.

In the past 2-3 years, there has been a mushrooming of web-based platforms offering fractional ownership of real estate assets. These platforms provide investors an option to invest in buildings and office spaces including warehouses, shopping centres, conference centres, etc. The minimum investment on these Fractional Ownership Platforms (FOPs) ranges from ₹10 lakhs to ₹25 lakhs. The underlying real estate assets offered on FOPs are similar to the real estate or property defined under the SEBI (Real Estate Investment Trust) Regulations, 2014 (REIT Regulations).[27]

The Consultation Paper on Regulatory Framework for Micro, Small & Medium REITs (MSM REITs)[28] stated it has become necessary to consider whether it is an appropriate juncture to require registration and regulate these FOPs in order to bring about, *inter alia*, regulatory oversight, common uniform standard disclosure practices, ensuring liquidity by way of listing or similar such measure, investor redressal mechanism, etc., to safeguard the interest of investors. Towards this end, this consultation paper attempts to bring forth the salient features of such FOPs and proposes extending the framework of REIT Regulations, with due modifications as required, in order to bring these FOPs under the regulatory ambit/ regulatory perimeter of SEBI. This would not only help develop the real estate market but also provide investor protection measures and lead to an orderly development of this sector and the market.

The Saradha scam

The Saradha scam, also referred to as the Saradha Group financial scandal, came to light in 2013. Spearheaded by businessman Sudipto Sen, the Saradha Group launched its scheme in the early 2000s, garnering attention from small investors with promises of high returns. With a network of around 200 private players, the group collected approximately ₹2,500 crore within a few years. Marketing strategies, including celebrity endorsements and cultural event sponsorships, aided in attracting investors.[29]

Initially, Sudipto Sen raised funds through redeemable bonds and secured debentures. However, Indian securities regulations and the Companies Act stipulate that a company cannot collect capital from more than 50 individuals without issuing proper documentation like a prospectus and balance sheet, following approval from the SEBI. When SEBI began scrutinizing the company's operations in 2009, Sudipto Sen resorted to opening approximately 239 companies to create confusion and continue operating the chit fund without interference.[30]

[27] *Consultation Paper on Regulatory Framework for Micro, Small & Medium REITs (MSM REITs),* May 2023.
[28] *Id.*
[29] *Saradha Group Scam- How Ponzi Schemes Trapped Many*, Fin School by 5Paisa, (Oct. 13, 2023).
[30] *Id.*

The Saradha Group employed various tactics to gather funds, including CIS such as tourism packages, forward travel, hotel bookings, timeshare credit transfers, real estate, infrastructure finance, and motorcycle manufacturing. These schemes were disguised as investment opportunities regulated by state governments rather than SEBI. However, SEBI was monitoring all these activities closely.[31] The scheme expanded to Odisha, Assam, and Tripura, drawing nearly 1.7 million investors.

In 2011, the Saradha Group acquired Global Automobiles, a motorcycle company burdened with significant debt. Additionally, it purchased other companies such as West Bengal Awadhoot Agro Private Ltd and Landmark Cement. These acquisitions were intended to present a façade of diversified interests to the group's agents and depositors, portraying the Saradha Group as operating successfully across various sectors.[32]

In 2012, SEBI instructed the group to cease collecting funds from investors without regulatory approval. By January 2013, the company faced a financial crisis, marked by cash outflows exceeding inflows. The scheme collapsed by April, leading to complaints from agents and investors to the police. Initially, the West Bengal government established a Special Investigation Team, led by Kolkata Police Commissioner Rajeev Kumar. However, in 2014, the case was transferred to the CBI following a Supreme Court directive.[33]

After detecting the scam, the State Government set up ₹500 crore relief fund for small investors who had put money in the scheme, to prevent from going bankrupt.

MVL Ltd.

In the case of MVL Ltd., a real estate developer sold IT/cyberspaces in its project to numerous buyers under an assured return plan and construction link instalment plan. Consequently, an application for provisional registration was required. However, SEBI determined that the project constituted an unregistered CIS based on the application's contents. SEBI's order directed the developer to wind up the CIS, refund collected funds, and barred market access until compliance. Notably, the project lacked a clearly defined area, with discrepancies between allotted areas and floor plans. Buyer agreements didn't include layout plans, and the application stated buyers wouldn't receive specific units. Moreover, some investors had buy-back options with varying returns, contradicting the developer's claim of a fixed 5% interest. The developer appealed to the Securities Appellate Tribunal (SAT). The SAT affirmed SEBI's findings, ruling the project was indeed a CIS, as investors' payments were pooled for profit generation. Therefore, the appeal against SEBI's order was dismissed.[34]

INSOLVENCY OF CIS

While recognizing the potential advantages of a robust CIS sector, it is evident from past experiences that collective investments should exclusively occur within a formal legal and regulatory framework, accompanied by a strong governance structure. Allowing promoters of

[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] *Appellant's Real Estate Project was a CIS without Specific Unit Number Commitments to Investors,* Taxmann, (June 1, 2023).

investment schemes to solicit funds from the general investing public for collective investment without such a framework significantly heightens the risk of breaching operator obligations towards investors and destabilizing the financial system. This risk is particularly pronounced as CIS typically manage assets on behalf of widely dispersed groups of investors who rely on the governance system for crucial aspects of CIS monitoring. Among these investors, there may be high net worth individuals or institutions, but CIS also appeal to smaller savers who often lack the time, financial expertise, and resources to conduct thorough data analysis or take action against promoters.

Governance failures within CIS can manifest in a wide array of issues. Documented abuses have encompassed straightforward theft or misappropriation of assets, transactions conducted at inappropriate valuations, use of deceptive promotional tactics, ambiguity regarding asset ownership, negligent or self-serving investment decisions or management, omission of crucial details about the venture, imposition of unreasonable fees, inability to enforce promoter obligations, and absence of an accountable entity for seeking recourse. Certain schemes, though unregistered, have resulted in insolvency, causing significant losses for investors. While some schemes may avoid the aforementioned abuses, they may still primarily serve the interests of promoters and other insiders rather than prioritizing investor welfare.

India has witnessed numerous instances of governance failures within CIS, with several cases being brought under the Insolvency and Bankruptcy Code, 2016 (IBC/ Code). The IBC represents a landmark reform in Indian insolvency and bankruptcy law, aimed at consolidating and amending the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms, and individuals in a time-bound manner. The cases of CIS admitted under IBC framework underscore the critical need for stringent regulatory measures and robust oversight to safeguard investor interests and maintain financial stability.

Active cases of CIS under IBC

Pancard Clubs Limited

Pancard Clubs Limited (PCL/Corporate Debtor i.e. CD) is a private limited company, incorporated on 24.01.1997, under the Companies Act, 1956. Its registered office is located in Prabhadevi, Mumbai. PCL was engaged in the business of owning, developing, and operating hotels, clubs, and resorts across India, offering various holiday schemes to investors/customers.

The SEBI classified the investments made by various investors in the CD as a CIS, operated under the guise of a timeshare scheme for the purchase of room nights in various properties and resorts owned by PCL. SEBI, by way of an Order dated 29.02.2016,[35] directed PCL to refund monies amounting to ₹7,035 crore to the investors of its CIS within three months and ordered that the CIS be wound up. Subsequently, PCL filed an appeal against this order with the Hon'ble SAT, which upheld SEBI's Order.

Further to this, SEBI issued Orders on 02.12.2016, 09.12.2016, and 21.12.2016, attaching movable and immovable properties of the CD and commenced recovery proceedings. During the recovery process, SEBI issued notices, conducted E-auctions, and sold movable and

[35] Certiûcate No. 1020 of 2016 dated December 02, 2016 drawn up by the Recovery Officer, Mumbai, SEBI.

immovable properties connected to PCL. Approximately 15 out of 68 properties were sold, and the proceeds were deposited with SEBI.

Some investors challenged the auction and sale of the assets by SEBI at the Hon'ble Bombay High Court (BHC), alleging that the assets were sold at undervalued prices. On 09.01.2019, the BHC stayed the auction of the residual 53 properties and ordered a status quo concerning the 15 properties already sold through auction, directing purchasers not to create any further third-party rights pending final disposal of the matter.

Additionally, criminal proceedings were initiated by the Government of Maharashtra through the Economic Offences Wing (EoW) Mumbai against PCL, its directors, subsidiaries, related persons, etc. Various properties of the CD were also attached by the Government of Maharashtra under section 4 of the MPID Act, and these proceedings are ongoing before the Special Court, MPID in Mumbai.

Amidst these legal complexities, an application was filed under Section 7 of the IBC by a few investors before the Hon'ble National Company Law Tribunal (NCLT), Mumbai, which was admitted via an Order dated 09.09.2022. Pursuant to the corporate insolvency resolution process (CIRP) conducted by the IP, it was found out that there are 1657924 (Sixteen lakh fifty-seven thousand nine hundred twenty-four) creditors in the matter.[36]

The CD has been successfully resolved vide order dated 25.04.2024[37] in which resolution plan of Chemhub Tradelink Private Limited which is wholly owned by certain promoters and promoter group of Kiri Industries Limited has been approved to the tune of about ₹697 crores as against admitted claims of ₹8,933 crore.

HBN Dairies

HBN Dairies and Allied Limited was incorporated in 1998, with a basic objective of manufacturing dairy products and production of raw milk under the CIS. The Company though on the face of it was dealing with Dairy and Allied business, however it was essentially a CIS (Ponzi Scheme), wherein the company collected money from lakhs of people promising decent returns. SEBI has concluded detailed investigation[38] and found that the CD was engaging in fund mobilizing activity by floating unauthorized CIS and also attached various properties of the CD. Pursuant to same, CIRP was admitted vide order dated 14.08.2018.[39]

On an application made by the RP, the Hon'ble NCLT vide order dated 30.04.2019 directed the SEBI to de-attach the assets of the CD and handover the possession to the RP. This order was challenged before the NCLAT but was dismissed. On further challenge before Hon'ble Supreme Court, the interim stay on the de-attachment order was availed by the SEBI. Currently, the SEBI has been directed not to alienate the properties of the CD while the RP is directed to continue the CIRP. Since no resolution plan was received by the RP, NCLT ordered liquidation in this matter on 31.01.2020. The SEBI appeal before the Supreme Court is still pending for final adjudication.

[36] As per list of creditors filed by IP on IBBI website on https://ibbi.gov.in/en/claims/front-claim-details/15241.
[37] Mr. Rajesh Sureshchandra Sheth v. Chemhub Tradelink Pvt. Ltd., IA No. 8 of 2024 IN CP(IB) No. 4578 of 2018.
[38] Adjudication Order No. AO/JS/VRP/49-58/2017 dated December 29, 2017.
[39] Mr. Bhanu Rain & Ors. v. M/s. HBN Dairies Allied Ltd. C.P. N0.IB-547(PB)/2018.

G.C.A. Marketing Private Limited

The CD in this case was operating in Multi-Level Marketing, selling FMCs, Ayurvedic, Desi Medicines, Herbal & Cosmetic Products with plants like Rattanjot, Jatropha Carcus, Kranj & Jojoba. The CD solicited applications for an investment scheme through application forms and contract framing. Investors participated in the "Lumpsum Payment Plans under Single Instalment Plan for a term of 6 or 10 years," with the plan reaching maturity entitling them to the assured return, which the CD failed to fulfil.

The financial creditors (FCs)/investors were required to complete the purported 'Application Form' and 'Contract Forming agreement with the CD for the investment scheme promoted by the CD. Upon receiving contributions from the FCs/investors and processing the customer application form, the CD issued a certificate/consent letter and receipts to the customers/ investors under the alleged investment scheme. These FCs primarily consist of small investors, including impoverished farmers, uneducated or retired individuals, and those from lower-middle-income brackets, who invested their hard-earned retirement funds or savings in these schemes to potentially grow their wealth over time.

Hon'ble NCLT while admitting this case made the reference to the case of *Mr. Bhanu Ram & Ors. v. M/s HBN Diaries & Allied Ltd.*, wherein it was noted that the investment schemes introduced by the CD qualify as 'Assured Returns' schemes. This determination was based on the fact that investors in these schemes are promised a higher sum upon the scheme's completion. Consequently, the purpose of such schemes is deemed to generate profits for the investors, as the invested amount inherently accrues interest, which is disbursed to investors upon the schemes' maturity. Therefore, the sums accumulated and owed to the applicants from the investment schemes initiated by the CD are classified as 'Assured Returns' and consequently constitute 'Financial Debt' under section 5(8) of the Code.[40]

The CIRP is currently undergoing for the CD.

Ablaze Info Solutions Private Limited

CIRP was admitted vide order dated 14.08.2018.[41] About 35000 claimants had made small investments in the CD. Presently liquidation process in going on for the CD.

Osian's Connoisseurs of Art Pvt. Ltd.

On a company petition filed by IDBI Bank against the Osian's Connoisseurs of Art Pvt. Ltd., proceedings under section 7 was initiated by order dated 19.12.2021 passed by the Adjudicating Authority (AA).[42] Osian's Connoisseurs of Art Private Limited', the CD was founded in 2000. CD was in business of artworks and has its own auction house and the centre for research and documentation. The CD sponsored a private trust called 'Osian Art Fund' under the Indian Trusts Act, 1882. 'Oseta Investments Trustee Company Pvt. Ltd.' (Oseta or Trustee) for short) was appointed as a Trustee of the Trust. The CD launched a fund, "The Osian's Art Fund Scheme Contemporary 1" inviting subscription from private investors in order to make

[40] Mr. Dayashankar Verma and 103 others v. G.C.A. Marketing Private Limited, CP (IB) No. 30-Chd-Pb-2020.
[41] Esspee Hitech Private Limited v. Ablaze Info Solutions Private Limited, (IB)1028(ND)/2018.
[42] IDBI Bank Limited v. Osian's Connoisseurs of Art Pvt. Ltd., C.P. No. 1067/IBC/MB/2019.

investments in artworks and an amount of ₹102.40 crore was collected from 656 investors for the said purpose. SEBI, the Appellant herein issued a show cause notice and initiated proceeding under the SEBI Act, 1992 against the CD holding a duty of sponsoring and managing 'CIS' without obtaining the Registration Certificate under section 12(1B) of the SEBI Act, 1992 and Regulation 3 of the CIS Regulations. After certain litigations between the SEBI and the CD, final order was passed by SEBI on 28.05.2021 under section 11 and section 11B of the SEBI Act, 1992. In the instant matter, the resolution plan notices the amount to be refunded as per the SEBI's order dated 28.05.2021. The resolution plan also contains a clause for discharge of the liability of the SEBI.[43]

A PROPOSAL FOR INTEGRATION OF INSOLVENCY PROFESSIONALS INTO CIS REGULATION IN INDIA

A survey conducted of the 31 jurisdictions (including India) by the Emerging Markets Committee of the International Organization of Securities Commissions revealed that there is a large CIS sector active in emerging markets. At the end of 2007 there were a total of 21,012 CIS active in the respondent markets. These schemes held assets with a total value of over US$1.9 trillion. During the survey period, the total number of CIS funds rose by 28.7%. The total value of AUM more than doubled, rising by 105.6%.[44]

In conclusion, while CIS in India can prove to play a pivotal role in democratizing access to the financial markets and facilitating economic growth, the challenges they face highlight the imperative for enhanced regulatory oversight and innovative solutions to enforce actions against the defaulting CIS. It is within this context that the proposal for utilising the expertise of IPs in CIS regulation, comes into picture. IPs are professionals enrolled with an Insolvency Professional Agency and registered with the IBBI, appointed by NCLT to execute the insolvency resolution, liquidation and bankruptcy process of companies, LLPs or partnerships, individuals, as the case may be. The issues dealt with in this paper and recommendations thereafter offer a nuanced approach to managing crises in CIS and safeguarding the interests of the investors.

Issue-1: Whether insolvency of CIS can be dealt under the IBC?

To delve into this issue, the authors examine the relevant provisions of IBC. Section 227 of IBC provides as follows:

> Notwithstanding anything to the contrary contained in this Code or any other law for the time being in force, the Central Government may, if it considers necessary, in consultation with the appropriate financial sector regulators, notify financial service providers or categories of financial service providers for the purpose of their insolvency and liquidation proceedings, which may be conducted under this Code, in such manner as may be prescribed.

The term 'financial service provider' as defined in section 3(17) of IBC *means a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator*. Further, the term 'financial sector regulator' as defined in section

[43] Securities and Exchange Board of India v. Mr. Girish Siriram Juneja and Anr. (2023) ibclaw.in 797 NCLAT.
[44] Report of the Emerging Markets Committee of the International Organization of Securities Commissions, *The Development of the Collective Investment Schemes Industry in Emerging Markets 2005 to 2007*, December, 2009.

3(18) of IBC *means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government.*

The Central Government vide its notification dated 18.11.2019 notified the first category of financial service providers under section 227 of IBC, in consultation with the Reserve Bank of India. The insolvency resolution process of non-banking finance companies (which include housing finance companies) with asset size of ₹500 crore or more, were notified to be undertaken in accordance with the provisions of the IBC, read with the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019[45] (Financial Service Provider Rules). The said Rules came into force on 15.11.2019.

On the other hand, the process of winding up CIS *akin* to liquidation process under IBC, is stipulated in Regulation 37 to 39 of CIS Regulations. Where a registered CIS is required to be wound up as per the said regulations, the trustee gives a public notice of the circumstances leading to winding up of the CIS and dispose of the assets of CIS in best interest of the unit holders of the CIS. 'Trustee' as defined in regulation 2(1)(cc) of CIS Regulations *means a person who holds the property of the collective investment scheme in trust for the benefit of the unit holders.*

The winding up directions can also be issued by SEBI to unregistered CIS in terms of regulation 65 of CIS Regulations. The said provision also empowers the SEBI to require the defaulter CIS to refund any money or the assets to the concerned investors along with the requisite interest.

Recommendation: By soliciting deposits and offering assured returns, CIS fall within the realm of financial services. However, it's noteworthy that CIS has not yet been officially categorized under the Financial Service Provider Rules. For a CIS to be eligible for inclusion under the IBC, registration by the relevant regulatory body is mandatory. However, the current scenario indicates that even if CIS were to be notified under the IBC, it wouldn't address the issue at hand, as all active cases discussed in this paper involve unregistered CIS schemes. In these instances, SEBI has taken action in accordance with the provisions outlined in the SEBI Act, 1992, and CIS Regulations.

Given that the winding-up provisions are inherent in the CIS Regulations, the closure of any registered or unregistered CIS and subsequent distribution of proceeds should ideally fall under the purview of SEBI's framework. However, leveraging the expertise and skill set of IPs registered with the IBBI could prove beneficial in winding-up proceedings. This synergy between SEBI's regulatory framework and the capabilities of IPs are elaborated upon in next section of this paper.

[45] MCA notification S.O. 4139(E) dated November 18, 2019, https://ibbi.gov.in//uploads/legalframwork/7bcd2585a9f75b9074febe216de5a3c1.pdf.

Issue-2: How can IPs be effectively integrated into the SEBI regulatory framework of CIS?

Role of IPs under IBC: IPs have emerged as pivotal figures in the landscape of financial distress management in India, following the enactment of the IBC. IPs are at the heart of this reform, equipped with the authority and responsibility to manage the process of insolvency resolution, liquidation, and bankruptcy.

An IP acts as a neutral third party between the debtor and creditors, managing the assets of the debtor and operating the business as a going concern to maximize value for all stakeholders. Their role is multifaceted, encompassing the assessment of the financial state of the entity, overseeing the collection of all claims against the entity, and formulating plans for the reorganization or liquidation of assets. IPs are selected based on stringent criteria, ensuring they possess the necessary expertise in law, finance, or business management to navigate the complexities of insolvency proceedings.[46]

SEBI regulatory framework for unregistered CIS: Section 11AA of the SEBI Act, 1992 stipulates that any pooling of funds under a scheme or arrangement, which exceeds an aggregate amount of ₹100 crore and lacks registration with SEBI, is deemed to fall within the purview of a CIS. Moreover, section 12(1B) of the aforementioned Act prohibits individuals from engaging in any CIS activities without obtaining prior certification from SEBI. Additionally, section 15D empowers SEBI to levy penalties on entities operating CIS without the requisite registration.

To enforce such penalties, section 28A grants SEBI authority to seize movable and immovable assets as well as bank accounts belonging to the defaulter, and even appoint a receiver to manage said assets. A number of 117 recovery certificates amounting to ₹75,643 crore with respect to CIS are pending as on March, 2023. Further, out of the pending 3,203 recovery certificates, 692 recovery certificates have been certified as 'Difficult to Recover Dues' (DTR) and the total amount under these DTR certificates is ₹73,287 crore.[47]

Winding up of CIS: The winding-up of CIS is governed by regulations 37 to 39 of CIS Regulations. For registered CIS, the trustee is responsible for publicizing the winding-up circumstances and disposing of assets for the unit holders' benefit. Regulation 65 empowers SEBI to direct the winding up of unregistered CIS and for refund of money or assets to investors.

Recommendations:

(a) **Suitability of IPs for SEBI regulatory actions:** IPs possess a nuanced understanding of financial markets, legal frameworks, and crisis management strategies, enabling them to undertake the comprehensive assessment and control necessary for managing distressed schemes. Their training and experience in balancing the interests of various stakeholders during insolvency proceedings equip them with the skills needed to navigate the complexities of defaulted CIS schemes.

The integration of IPs into the regulatory framework governing CIS necessitates the

[46] Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016, Regulation 5.
[47] *supra* note 27.

establishment of a cooperative framework between IBBI and SEBI. A foundational pillar of this cooperative framework is SEBI's role in appointing IPs. By vetting and appointing IPs, SEBI ensures that only qualified professionals with a proven track record in financial distress management and insolvency resolution are entrusted with the responsibility of managing or disposing off the assets of the CIS in the best interest of investors. The IPs registered with the IBBI can assume the role of (a) a receiver for recovery of penalty amounts imposed by the SEBI in case of unregistered CIS; and (b) a trustee for effecting the winding up proceedings of the CIS.

(b) **Appointment Process of IPs by SEBI:** To facilitate the appointment of IPs, SEBI can prepare a panel of IPs, categorized based on their expertise, experience, and areas of specialization. This panel may serve as a ready repository from which SEBI can make swift appointments in case of winding up of any CIS or when a receiver is being appointed for managing the properties of the CIS. Another critical component of the framework is the determination of fees for the IPs' services by SEBI. Establishing a standardized fee structure will ensure transparency and fairness, preventing any potential conflicts of interest or undue influence. The fees can be indicative of complexity of the tasks involved and be competitive enough to attract highly skilled professionals to these roles.

Issue-3: How can the intersection of SEBI Regulations and IBC be effectively managed in active CIS insolvency cases?

In the case of *HBN Dairies & Allied Limited*, the battle between SEBI and IBC ensued as the Hon'ble NCLT admitted the petition for insolvency proceedings against the company due to its failure to repay debts to depositors. While SEBI had directed the auctioning of properties owned by HBN Dairies to recover funds from illicit CIS, NCLT's decision prompted a legal tussle. Similarly, in the cases of *Pancard Clubs Limited* and *G.C.A. Marketing Private Limited*, SEBI's actions intersected with insolvency proceedings under IBC, highlighting the complexities arising from financial defaults and regulatory interventions in India's corporate landscape.

There's been a debate regarding this issue, with arguments supporting both the IBC and SEBI, causing a divergence of opinions among legal experts. Some argue in favour of NCLT's intervention due to the low success rate in asset disposal under CIS fraud cases by SEBI, leading to delays in returning funds to investors. They emphasize that the IBC's provisions, especially the moratorium period under section 14, should take precedence over SEBI's actions to ensure effective management of CDs. Conversely, SEBI contends that both Acts can coexist, citing the regulation of CIS schemes under its CIS Regulations of 1999. SEBI highlights specific conditions defining CIS schemes and the mandatory registration requirement under its regulations. Moreover, SEBI argues that investors in CIS schemes aren't FCs under the IBC, as they hold tradable units rather than debt instruments. The debate extends to jurisdictional issues, with critics accusing NCLT of overstepping its bounds by applying section 238 of the IBC. Nonetheless, supporters argue that the Code's non-obstante clause empowers it to prevail over conflicting laws, as clarified by judicial precedents and the Bankruptcy Laws Reforms Committee's recommendations. They stress the importance of prioritizing time-bound debt resolution provided by the IBC and highlight the economic benefits of expedited recovery

through insolvency proceedings. Overall, the prevailing sentiment favours upholding NCLT's order, affirming the primacy of the IBC in resolving corporate insolvency disputes.[48]

In *Mohan Lal Dhakad v. Bng Global India Ltd,*[49] the National Company Law Appellate Tribunal (NCLAT) found that CD had committed to providing a return on investment to investors, taking into account the time value of money. Consequently, the AA concluded that the Appellant qualifies as an FC, and the CIS falls within the scope of the definition of financial debt. Similar issue is also pending adjudication before the Hon'ble Supreme Court in the matter of *HBN Dairies*[50] and it will bring about necessary clarity in this regard.

Further, there are other similar issues as in the case of fractional ownership of real-estate or where an assured sum is promised for investment in real-estate. In the case of *Nikhil Mehta & Sons (HUF) v. AMR Infrastructure Ltd.,*[51], the appellants had entered into MoUs with AMR Infrastructure Ltd. (the CD) to purchase flats/shops/offices in their projects under a 'Committed Return Plan' where the CD was supposed to pay monthly assured returns to the appellants till possession. The CD stopped paying the assured returns. The appellants filed an insolvency application under section 7 of the IBC as FCs, which was rejected by the NCLT. The NCLAT held that the appellants are 'financial creditors' under the IBC based on:

a) The assured returns were shown by the CD as 'commitment charges' under the 'Financial costs' head in their annual returns, at par with interest on loans.

b) TDS was deducted by the CD on the assured returns paid to appellants under Section 194A as interest income.

c) The sale agreement was in the nature of a financial transaction disbursing debt against the consideration for the time value of money.

The NCLAT set aside the NCLT order and directed the NCLT to admit the insolvency application if otherwise complete.

Recommendation: As per CIS Regulations, it is mandatory for the CIS to be structured as a Trust. The Trustee is entrusted with adhering to the established rules and regulations, operating in the best interests of the unit holders, safeguarding assets, and maintaining continuous compliance. It is the CIMC that appoints the Trustee, who holds the assets of the CIS.[52]

To effectively address the ongoing legal disputes and prioritize the welfare of depositors/ investors in current CIS insolvency cases, the involvement of a trustee as a representative of depositors is crucial. Given that cases of CIS insolvency under the IBC typically involve unregistered schemes without a designated trustee, it becomes necessary to nominate a SEBI authorized officer to oversee the insolvency resolution process and safeguard the interests of depositors. This measure ensures that SEBI's perspective is integrated into the proceedings, facilitating the recovery efforts of SEBI in such cases.

[48] Clash of the Authorities – Sebi v. IBC, Taxmann, December 23, 2019.
[49] 2021 SCC OnLine NCLAT 84.
[50] SLP (C) No. 13678 of 2019.
[51] Company Appeal (AT) (Insolvency) No. 07 of 2017 decided on 21-Jul-2017.
[52] The Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999, Regulation 21.

A reference can also be drawn from the matter of *Anant Kajare v. Eknath Aher & Ors.*[53] in which pursuant to the CIRP of M/s. Royal Twinkle Star Club Limited (RTSCL), Citrus Check-Inns Ltd. (CCIL) and its associate sister concerns, the Hon'ble Supreme Court directed the Resolution Professional (RP) and others, that all future expenses incurred, and payments made by the RP will be in consultation with an officer authorized by SEBI. It also directed that in addition to the usual advertisements, the sale of each of the properties (to be auctioned) shall be duly publicised through the SEBI website. Presently auction is being carried out by the IP in the matter with the last auction being announced on 07.02.2024 as per the data available on SEBI's website.[54]

CONCLUSION

The intersection of SEBI CIS Regulations and IBC in the context of active CIS insolvency cases presents multifaceted challenges and opportunities. The debate surrounding the inclusion of CIS under the purview of the IBC underscores the need for regulatory clarity. Since the winding-up provisions of CIS are delineated in the CIS Regulations, the authors propose that closure of any registered or unregistered CIS and subsequent distribution of proceeds should fall under the purview of SEBI's framework. However, integrating IPs into SEBI's CIS regulatory framework offers a promising solution, leveraging their expertise in financial distress management to navigate the complexities of defaulting CIS cases. Achieving a seamless integration will require collaborative efforts between SEBI and IBBI to establish a cooperative framework and streamline appointment processes.

Additionally, the involvement of trustees or SEBI authorized officers in ongoing CIS insolvency cases is crucial in safeguarding the interests of depositors and investors, and ensuring that SEBI's perspective is integrated into the proceedings. As the legal landscape evolves, recommendations for regulatory reforms and procedural enhancements serve to enhance investor confidence and facilitate the efficient resolution of CIS insolvency cases.

[53] Civil Appeal No. 20971/2017 dated 13-Dec-19.

[54] Notice of Auction in the matter of Royal Twinkle Star Club Ltd. and Citrus Check Inns Ltd. pursuant to directions of the Hon'ble Supreme Court, https://www.sebi.gov.in/enforcement/auction-notice-under-recovery-proceedings/feb-2024/notice-of-auction-in-the-matter-of-royal-twinkle-star-club-ltd-and-citrus-check-inns-ltd-pursuant-to-directions-of-the-hon-ble-supreme-court_81756.html (April 22, 2024).

08

INDIA SHOULD INTRODUCE AN INSOLVENCY LAW FOR THE MUNICIPALITIES AND LOCAL BODIES

Devendra Mehta

ABSTRACT

Municipalities have to undertake massive capital expenditure to build infrastructure and fulfil their obligations to the citizens as envisaged in the Constitution. However, they are faced with dwindling revenues, high administrative expenses, deteriorating credit profile, borrowing restrictions, and conditionalities on receipt of the grants. As a result, municipalities need to find novel methods to enhance their revenue generating and fund-raising capabilities. Introduction of legislation for insolvency of municipalities and similar local bodies will help spur infrastructure financing. Though, the bounds of such an insolvency law will be determined by Constitution, an insolvency law will bring transparency, mitigate risk, lower borrowing costs, garner wider pool of capital, delineate principles between public interest and creditor rights, and signal to lenders that debt restructurings will be predictable. Additionally, certain novel methods which are sparsely used at present, may see wider usage by the municipalities to bolster their financial position, on introduction of such a law. Concurrently, numerous best practices and precedents established in the corporate insolvency resolution process can be transitioned into a municipal insolvency law enabling a smoother implementation.

BACKGROUND

Village Panchayats, the rural local governing bodies, have been functioning in India since ancient times and continued to be in existence under the Mughals and the British, in some guise. The urban local bodies have been in existence since two hundred years. The Municipal Corporation of Chennai (Madras) was set up in 1688 and that of Kolkata (Calcutta) and Mumbai (Bombay) in 1726.

Post-independence, the assimilation of local governing bodies, the third tier, in the mainstream government was initiated with the enactment of the Seventy-Third and Seventy-Fourth Amendments to the Constitution; Part IX, consisting of articles 243 to 243O pertain to The Panchayats and Part IXA, consisting of articles 243P to 243ZG deal with The Municipalities.

This paper primarily deals with The Municipalities[1] (TMs). Article 243W in conjunction with

[1] The Municipalities include Nagar Panchayat, Municipal Council and Municipal Corporation as defined in article 243Q of the Indian Constitution. The definition excludes Cantonment Boards on grounds of national security. Also, the current structure of Insolvency and Bankruptcy Code has been dealing with corporate insolvency resolution process and the guarantors of the aforesaid corporates. The clauses pertaining to partnership firms and individuals have not been notified. In similar vein the rural urban bodies have been kept out of the purview of the paper and may be included at a later date.

the Twelfth Schedule of Constitution delineates eighteen functions/duties that a State Government may assign to TMs. These functions apart from public duty may also have the potential to generate revenue for TMs: land use and construction of buildings, management of roads and bridges, water supply, solid waste management, and urban amenities etc. In consonance with the aforesaid functions, vide article 243X, the State may authorise and/or assign TMs to levy, collect or appropriate taxes, duties, tolls, and fees etc. In addition, the Constitution also provides that the Finance Commissions should review the financial position of TMs, an aspect briefly discussed later in the paper. However, the duties and the funding required to perform those duties have not marched in tandem; the latter perpetually falling short. Out of the 18 functions to be performed by municipal bodies less than half have a corresponding financing source.[2]

THE MUNICIPALITIES AND URBANISATION

India has been urbanising rapidly on the back of a growing economy wherein the population is transitioning out of the farmlands. Numerous methodologies and classification systems are in existence to define urbanisation; the census criterion, metropolitan regions, urban agglomeration, megapolis, and metropolitan city etc. Irrespective of the classification one adopts, at the very minimum, one-third of India's population is urban and is expected to increase to 43% by 2035.[3]

From a governance perspective, a Nagar Panchayat is for the areas transitioning from rural to urban, a Municipal Council is for a small urban area and a Municipal Corporation for a large urban area.

The absolute numbers of urbanisation are often understated due to political resistance. "Often the rural local governments themselves are reluctant to go-urban because local politicians are apprehensive that they would not have access to large amounts of funds as for rural development schemes; they also fear regulations which urbanisation brings with it".[4]

It is a truism that the development of urban infrastructure in India has not kept pace with the urbanisation. The need will further aggravate as the existing infrastructure deteriorates or requires rebuilding, due to adverse climatic events like rising sea levels, floods, heat islands, and sandstorms etc. To cater to the infrastructure needs the TMs need to enhance their revenue generating and fund-raising capabilities in conjunction with capacity building and institutional support from the State and the Central Government.

State of Municipal Finance in India

Municipal revenues in India from own sources have been low, at 0.43% of GDP, and the total municipal revenues/expenditures have stagnated at around 1% of GDP for over a decade. In contrast, municipal revenues/expenditures account for 4.5% for Poland, 6% for South Africa, 7.4% for Brazil, 13.9% for United Kingdom and 14.2% for Norway.[5]

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[2] Reserve Bank of India, *Report on Municipal Finances*, (Nov. 2022), at 2.
[3] UN Habitat, *World Cities Report 22 – Envisaging the future of cities*, 2022, at 330.
[4] Isher Judge Ahluwalia et al, *State of Municipal Finances in India – A study prepared for the Fifteenth Finance Commission*, (Mar. 2019), at 1.
[5] Isher Judge Ahluwalia et al, *supra* note 4, at 7.

The composition of municipal revenues varies across countries in accordance with their respective constitutions and unique characteristics.

Goods and Services Tax was detrimental to municipal finance

Revenue generating capacity of TMs in India have suffered with the introduction of Goods and Services Tax (GST). Local and consumption taxes like octroi,[6] local body tax, entry tax and advertisement tax which were the prerogative of TMs have been subsumed within the GST. To make matters worse, the proceeds of GST are divided between Centre and the State with no constitutional provision providing for sharing with the third tier i.e., TMs. In contrast, many countries across the world have provided for sharing such taxes with their urban local bodies.[7]

Today, property tax, accounting for approximately half of tax revenues, is the primary source of revenue.[8] Limited revenue sources increase dependence of TMs on transfer of funds from the upper tiers, i.e., the State and the Central Government (30% - 35% of revenue receipts) resulting in lack of financial autonomy.[9] Further, these transfers are not with regular periodicity but are based on whims and fancy of the State Government. Moreover, Members of Legislative Assembly, possibly favour erratic transfers, if at all, to showcase their power.

Thus, TMs have not only to claw back the revenue lost but also improve efficiency of existing revenue streams to reduce dependency on transfers. In addition, TMs should find incremental sources of revenue and funds to provide requisite services.

Archaic laws and conventions govern municipal finance

TMs in India are required to balance their budget by law; indirectly creating a ceiling on the expenditure. Also, TMs treat all expenditure as similar irrespective of the nature of expense; revenue, or capital.[10] This antiquated accounting convention needs to change considering the capex requirements of infrastructure that needs to be built. Further, most TMs cannot borrow without the permission of the respective State governments, who in turn may prescribe conditions on the types of instruments, limits, and tenor of repayment;[11] a handful of states have rolled out a policy within which TMs are allowed to borrow.

Municipal borrowings in India are concentrated at few large corporations and is negligible at less than 0.05 per cent of GDP cumulatively for all TMs. More than half of the borrowings are from banks, financial institutions, and loans from Centre/State governments. Capital markets bond issuances are less than a tenth of the total borrowings of which majority have been used for capital expenditure.[12] Bonds of 14 municipalities are listed on Stock Exchanges; Pune, Greater Hyderabad, Ahmedabad, Surat, Indore, Lucknow, and a few others.

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[6] Maharashtra Goods and Services Tax (Compensation to the Local Authorities) Act 2017 provides for compensation on account of octroi to all 27 municipal corporation in Maharashtra. A few other states too have taken some measures but none as robust as that of Maharashtra.

[7] Isher Judge Ahluwalia et al, *supra* note, at 4.

[8] Reserve Bank of India, *supra* note 2, at 12.

[9] *Id.*, at 13.

[10] Isher Judge Ahluwalia et al, *supra* note 4, at 5.

[11] Reserve Bank of India, *supra* note 2, at 27.

[12] *Id.*, at 17.

A study of 37 large municipal corporations revealed that revenue expenditure was 63% of total expenditure. Within revenue expenditure, administrative expenses accounted for 57%.[13] Thus, the TMs do not have the requisite capacity for the much-needed capital expenditure. Further, deteriorating revenue in conjunction with high administrative expense leads to adverse credit profile making it difficult for TMs to borrow.

Abolition of Planning Commission also resulted in a gap on account of capital expenditure, as the same was earlier a plan outlay.[14]

Thus, a suitable mechanism needs to be devised that makes it attractive for lenders to lend, against requisite security, to TMs. This will enable TMs to fulfil their obligations to citizens in face of insurmountable odds.

Other impediments to municipal finance

Competitive electoral politics has been responsible for the deteriorating fiscal position of the states and the situation may worsen further. Adverse fiscal position will make it increasingly difficult for the states to allot additional funds to TMs. Moreover, hike in property tax rates or user charges for services provided by TMs is also frowned upon by the politicians, even though the property values as recorded by the TMs are always lagging the market value. A study of six largest municipalities revealed that TMs faced challenges in aligning value of properties to market and levy tax accordingly.[15] Also, increase in user charges require the permission of the State who are loathe to grant the same due to public opposition.[16]. The aforesaid low base gets further eroded in case of poor macro-economic environment; Brihanmumbai Municipal Corporation's (BMC) property tax collection for the fiscal year 2023-24 at ₹32 billion was substantially below its target of ₹45 billion.[17]

In addition, TMs give several exemptions to religious and charitable institutions, public properties, educational institutions, senior citizens etc. Central Government properties too are exempt from municipal taxes.[18] Furthermore, the freedom to realize better revenue through unlocking property value is restricted. For example, a higher FSI in Mumbai will yield higher property taxes but the power to increase FSI vests with the State Government.[19] All the above create challenges for TMs to enhance revenue.

Kyoto, a city in Japan, which was on the verge of bankruptcy is an example wherein similar problems were encountered and provides a partial template for the likely solutions.

Kyoto's temples and shrines, which are legally registered religious corporations, are exempt from property taxes. To preserve the city's traditional atmosphere, the height of buildings is limited resulting in lower property taxes. Also, due to demographics some residents pay low or no property tax; 10% of Kyoto's residents who are college students and about 28% of

[13] Ayush Khare et al, *Finances of Municipal Corporations in Metropolitan Cities of India – A study prepared for the Fifteenth Finance Commission*, ICRIER Team, (June 2019), at 21.
[14] Isher Judge Ahluwalia et al, *supra* note 4, at 5.
[15] Ayush Khare et al, *supra* note 13, at 25.
[16] *Id.*, at 31.
[17] Richa Pinto, *At ₹3k cr, BMC records lowest property tax mop up in 10 years*, The Times of India, (Apr. 2, 2024), at 3.
[18] Ayush Khare et al, *supra* note 13, at 27.
[19] *Id.*, at 33.

residents who are over 65.[20] In addition, the city took some projects which never achieved the forecasted revenues, primarily, the Tozai subway line;[21] an aspect discussed later in the paper vis-à-vis China.

Kyoto thus had to prepare a restructuring plan that calls for trimming the bureaucracy, raising the minimum age of those eligible for discounts, and cutting subsidies.

Rio de Janeiro in Brazil declared a state of public calamity[22] in 2016, the primary reason being the decrease in tax collection, especially regarding goods, services, royalties, and special interests in oil. One of the reasons for decrease was excessive tax incentives.[23] This again demonstrates that too many tax-incentives may be popular in short run but are disastrous for the fiscal health in the long run.

Role of Finance Commissions in municipal finance

Article 280(c) of the Constitution casts a duty on Finance Commission to recommend measures needed to augment the Consolidated Fund of a State to supplement the resources of TMs.

Six Finance Commissions, from FC-X to FC-XV, have given their recommendations for local bodies. The grants for urban local bodies have increased from ₹1,000 crore of FC-X to ₹87,144 crore of FC-XIV, though the actual disbursements were 10% to 18% lower due to failure of local bodies to meet the conditionalities.[24] FC-XV has recommended a total grant of ₹1,21,055 crore.

The conditionalities prescribed for grants have varied from year to year. FC-X and FC-XI required that no grant amount was to be used for expenditure on salaries and wages. In addition. the FC-XI suggested usage of grants for maintenance of accounts and audit, development of a financial database and balance for maintenance of core services like primary education, health care, safe drinking water, sanitation etc.

The FC-XII recommended that priority be given for the creation of financial databases and maintenance of accounts using modern technology and management systems. Further 50% of grant should be used for solid waste management.[25]

The FC-XIII stipulated nine conditions to access 33% of the grants. These conditions primarily pertained to accounts, audits, budget documents, electronic banking, state finance commissions, property tax and delivery standards for essential services.

The FC-XIV recommended grants in two parts; an unconditional basic grant and a 20% conditional performance grant. The conditional performance grant required local governments to show an increase in own source of revenue and submit audited annual accounts.

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[20] Eric Johnston, *Kyoto is facing bankruptcy. What happens now*, The Japan Times, (Sep. 21, 2021).
[21] Lucy Kraft, *Kyoto, Japan's beautiful imperial capital, is going broke fast*, CBS News, (May 20, 2022).
[22] Abnormal situation arising due to disasters, damages or losses resulting in postponement of payment of debt instalments, expenses etc.
[23] Catarina Ferraz, *Local public entities in distress – a critical analysis of the Brazilian approach, When liquidation is not an option: A global study on the treatment of local public entities in distress*, INSOL International, (Nov. 2022), at 121.
[24] XV Finance Commission, *Finance Commission in Covid Times – Report for 2021 – 26*, Volume-I Main Report, (Oct. 2020), at 172.
[25] Isher Judge Ahluwalia et al, *supra* note 4, at 22.

Municipalities, in addition, had to publish the service level benchmarks relating to basic urban services each year.

The FC-XV prescribed minimum entry level conditions for the grants; web-based availability of annual accounts for the previous year and audited accounts for the year before previous as well as notification of minimum floor rates of property taxes. In addition, for million plus cities about 32% was tied to ambient air quality standards and the remaining for meeting service level benchmarks on drinking water supply, rainwater harvesting, water recycling, solid waste management and sanitation. For non-million plus cities 40 per cent of the grants is untied and 60 per cent is tied to the national priorities of drinking water, rainwater harvesting, solid waste management and sanitation.

The common threads that run through the recommendations of finance commissions are that of more robust accounts, timely audits and meeting the service level benchmarks for essential services; all improving over the years, but not yet satisfactory. The importance can be gazed from the fact that the Constitution too under article 243Z states that the State must make provision with respect to maintenance of accounts of municipalities and the auditing of such accounts.

The way forward for municipal finance

As articulated above, TMs must undertake massive capital expenditure to provide the services as provided in the Constitution but are faced with dwindling revenues, high administrative expenses, deteriorating credit profile, borrowing restrictions, conditionalities on grants of finance commission and the arduous task of balancing the budgets.

FC-XV has suggested more efficient property tax administration and rationalisation of professional tax to improve revenue. In addition, all levels of governments should jointly explore, introduction of three tiered GST. Moreover, TMs should have an unfettered right to vehicle taxes, parking taxes, green surcharges, local entertainment tax, land-based taxes, and unlocking of land value including FSI to augment municipal revenues.

As the examples of Kyoto and Rio illustrate inefficiencies of revenue is a potential hazard for long term. Similar fate awaits several municipalities / cities / councils in the United Kingdom. One in ten councils in England have warned that they will go bankrupt in the next twelve months.[26] Councils are handling the financial distress as befits them; Thurrock, Slough, Croydon, and Birmingham have raised local taxes by 10%,[27] Nottingham intends to raise prices of events, public toilets, and transport;[28] Middlesborough voted for maximum tax rise along with a charge for green waste;[29] Birmingham is dimming streetlights, resorting to less frequent waste collection and stopping expenditure on arts.[30] Across England libraries, museums, leisure centres and parks are bracing for cuts.[31]

[26] Patrick Butler, *Nearly one in 10 English councils expect to go bust in next year, survey finds*, The Guardian, (Feb. 28, 2024).

[27] Eugenio Vaccari and Yseult Marique, *One in five councils at risk of bankruptcy – what happens after local authorities run out of money*, The Conversation, (Feb. 14, 2024).

[28] *Id.*

[29] Naomi Corrigan, *Council budget to avoid bankruptcy approved*, BBC News, (Mar. 10, 2024).

[30] Tom Rees, *UK Town's are going Bankrupt. Here's what's gone wrong*, Bloomberg, (Feb. 28, 2024).

[31] Local government's financial crisis: Are local institutions disappearing?, Open access Government, 17th Jan. 2024.

Thus, the municipalities must strike a fine balance of revenue enhancement without inconveniencing its populace; a stitch in time saves nine.

Whilst the revenue enhancement mechanisms will take care of revenue expenditure and contribute partly to infrastructure enhancement, the States should liberalise borrowing thresholds for TMs for the capital projects, with appropriate caps and within defined financial ratios. Caps, ratios, and vigil on off-balance sheet borrowing is a prerequisite to avoid situation like that of China described later in the paper. Borrowings within bounds of rationality will ensure that creation of new infrastructure is not hindered due to lack of funds. Certain provinces in Canada like Ontario, Quebec, Manitoba, Prince Edward Island, allow municipalities to borrow only for capital projects albeit with caps.[32]

Also, several large cities are being constructed across the globe vying for the same pool of limited finance; ninety-one cities have been announced in past decade of which fifteen in the last year.[33]

This paper argues that introduction of legislation for insolvency of TMs will not only spur financing for the aforesaid infrastructure but also will bring about improvements in the conditions imposed by finance commissions, which in turn will bring transparency. Let's start with answering the question, why an insolvency law?

WHY AN INSOLVENCY LAW FOR MUNICIPALITIES

Port Canning Municipality (PCM), established in 1862[34] is the first and possibly the only municipality that went bankrupt in India. The municipality had grand plans for parks, wharves, jetties, tramways, railway stations, dockyards which didn't materialise.

The origins of PCM are interesting. In 1853[35] Bengal Chamber of Commerce feared that the silting of Hooghly River may result in Calcutta Port becoming unnavigable and a search for an auxiliary port ensued. Matla estuary,[36] 45 kms south-east of Calcutta, amongst Sunderbans was chosen where the waters of Bidyádharí, Karatoyá, and Athárabánká rivers converged. Henry Piddington,[37] a storm expert warned that the site is unsuitable for a port as a cyclone may destroy the port. Nevertheless, about 9000 acres of lands was acquired; 8260 acres in the first instance[38] and 650 acres in the second[39]. The port was named after the-then Governor General Charles Canning who subsequently became the Viceroy. The municipality had taken loans and issued debentures worth of ₹1million.[40] A railway line from Calcutta to Port Canning

[32] Stephanie Ben-Ishai, *Local public entities in distress – a critical analysis of the Canadian approach, When liquidation is not an option: A global study on the treatment of local public entities in distress*, INSOL International, Nov. 2022, at 132 – 134.

[33] The Economist, *Boom: towns, why everyone is building new cities*, (Mar. 9-15, 2024), at 66 - 67.

[34] The Calcutta Review, *Cameos of Indian Districts – The Sunderbans*, No. CLXXVIII, Volume LXXXIX, (July 1889), at 295.

[35] *Id.*, at 294.

[36] 11 W.W.Hunter, C.S.I., C.I.E , LL.D. , Director General of Statistics to the Government of India, Pali to Ratia, The Imperial Gazetteer of India, (2nd ed. Trubner & Co., 1886), at 216.

[37] Amitav Ghosh, *Remembering Henry Piddington, Meteorologist Extraordinaire, And His Prophetic Warnings*, Readers Digest, (May 23, 2020).

[38] The Calcutta Review, *supra* note 34, at 294.

[39] W.W.Hunter, *supra* note 36, at 217.

[40] John Besemeres, *Port Canning Problem; A letter to the Right Hon. Lord Stanley, M.P., Revised and Reprinted from the Indian Examiner*, 1868 at 5.

was built for ₹6 million.[41] A company, Port Canning Land Investment, Reclamation and Dock Company (PCC) was incorporated, to undertake work essential to the port with exclusive concessions and rights. PCC thereafter issued equity which had a premium of ₹12,000 in Bombay and ₹10,000 in Calcutta.[42] A number of reasons made the port unviable, and the final nail was the cyclone on November 2, 1867, which destroyed the port.

PCC was put into liquidation in 1870 and PCM faced bankruptcy; suits were instituted by debenture holders, property of the municipality was attached against a decree, debentures were commuted for freehold land rights, some were paid at 50% of value and the Government declared that it had no obligation to fulfil the liability. The whole of Canning municipal estate was attached and put under the charge of the Collector.[43]

An 1873 envelope addressed to The Liquidator of the Port Canning Company

150 years have passed since the Port Canning bankruptcy, but we still await a law on municipal insolvency. Friedrich Meili, a renowned Swiss law professor, put forward a detailed proposal for a law, when four municipalities were on the brink of insolvency in Switzerland. He stated that the main benefit of such a law is that of legal certainty.[44]

The legal certainty arising out of the Insolvency and Bankruptcy Code, 2016 (IBC/ Code) is one of the reasons that has resulted in phenomenal growth of private credit. Similarly, municipal insolvency laws in the first instance will act as a signalling exercise to lenders

[41] *Id.,* at 5.

[42] W.W.Hunter, *C.S.I., C.I.E , LL.D. , Director General of Statistics to the Government of India, Pali to Ratia, The Imperial Gazetteer of India, Volume XI, Second Edition, Trubner & Co., London, 1886 atsupra* note 36, 219.

[43] *Id.*

[44] Lili Liu and Michael Waibel, *Subnational Insolvency: Cross Country Experience and Lessons*, Policy Research Working Paper 4496, The World Bank, at 22 (2008).

that debt restructurings will be predictable and equitable. In contrast, the signal to TMs would be that whilst they must maintain essential services, fiscal profligacy will have consequences.

Importantly, such laws also help to achieve macroeconomic goals. Effective insolvency laws and creditor rights systems lead to efficient capital markets, better risk management, lower borrowing costs, and availability of wider pool of capital for credit; in effect minimizing systemic risk. The aforesaid in turn expand the fiscal space for infrastructure investments, promote fiscal transparency, and deepen financial market reforms.[45]

Good infrastructure will improve productivity in the economy and help India grow faster. On the flip side, bereft of good infrastructure, the cities over a period will start to decline as no one would want to stay in them. A recent example of reaction to poor infrastructure is from the city of Bangalore, where people are contemplating a movement out of the city due to water shortage. Similarly, the post-Covid world showed us glimpses of such an eventuality as the employees were reluctant to return to cities because of poor infrastructure; overcrowded buildings, congested roads, inadequate open spaces, sluggish progress of metro, increased commute times due to traffic congestion, reduced family time, soaring rents and increased cost of living.[46] It is true that most employees will return given the current state of job market, however, if such an eventuality takes place at any time in the future in a better macro environment, the prices of properties will start to decline, with a concomitant effect on the revenues of TMs.

Thus, introduction of municipal law will help kick-start investments in urban infrastructure by giving confidence to lenders to lend at the risk adjusted borrowing costs. Further, in the eventuality of an insolvency, the laws will give confidence to creditors of structured equitable resolution, enabling TMs to re-enter capital markets.[47] Simultaneously, TMs are put on a sustainable path to deliver public services post resolution.

However, before we embark on the nuances of a law of municipal insolvency law a brief overview on the peculiarities of TMs.

PECULIAR CHARACTERISTICS OF MUNICIPALITIES IN INDIA

The boundaries of an insolvency law for municipalities are set by the Constitution. Article 243Q specifies the modus operandi for constituting TMs and Article 243R mandates that the persons forming part of the TMs are to be chosen by direct elections.

In addition, the State may, by law, provide representation of persons having special knowledge or experience in municipal administration. Also, the State may by law under Article 243X authorise TMs to levy, collect and appropriate taxes, duties, tolls, and fees.

As mentioned above, TMs are responsible for eighteen essential duties prescribed under Article 243W read with Twelfth Schedule like urban planning, regulating land use and

[45] *Id.,* at 5, 33-34.
[46] Ashish Kolvalker, *Why a complete return to office may not be the best approach for India Inc., people matters*, (July 6, 2023).
[47] Lili Liu and Michael Waibel, *supra* note 44, at 4.

construction, water supply, health and sanitation, fire services, protection of environment, urban poverty alleviation, slum upgradation etc. Though, not specified in the Constitution or the State laws, whilst providing essential services TMs may or may not charge a fair price, i.e., the cost of providing the services. Currently, the user charges vary across municipalities; at the lower end 8% of revenue expenditure for Chennai and 17% for Kolkata, whereas a high of 82% for Bangalore.[48]

Supreme Court in the case of Hindustan Construction Company[49] while referring to NHAI had said that development and maintenance of national highways is a government function that falls within Entry 23 of List I of the Seventh Schedule to the Constitution of India. It further added that "NHAI is a statutory body which functions as an extended limb of the Central Government and performs governmental functions which obviously cannot be taken over by a resolution professional under the Insolvency Code, or by any other corporate body. Nor can such Authority ultimately be wound-up under the Insolvency Code". Partially, a similar reasoning may apply to TMs as per-se they cannot be liquidated.

Thus, a successful resolution/restructuring must be the outcome of insolvency; in-effect, a debtor-in-possession restructuring with an independent oversight. However, this paper also delves into "municipality-like", Public Private Partnership, (PPP) that may be amenable to liquidation in limited circumstances.

Also, strictly applying the aforesaid judgement may imply that a resolution professional (RP) may not be able to take over the management of TMs. However, as discussed later in the paper, based on current practice in TMs and the fact that TMs are fundamentally different from central statutory bodies, it is possible to take over management of TMs by an (RP) if the person simultaneously works under the directions of the State.

BUILDING BLOCKS OF AN INSOLVENCY LAW FOR MUNICIPALITIES

INSOL International had published a study on local entities in distress in 2022 recommending broad contours of an insolvency law for such entities.

The study acknowledged the fact that laws pertaining to local public entities in distress are heavily, influenced by local traditions, cultures, and history. There is no one-size-fits-all approach and encouraged national legislators to devise principles based on their unique circumstances.[50]

Nevertheless, the study advocated that "in determining the rules applicable to local public entities in distress, domestic legislators should pursue territorial solutions based on the uniform, traditional principles of collectivity and equality of treatment of creditors".

Furthermore, the law should be predictable, fair, transparent, and allow participation of all parties in the process to safeguard their respective interests.

Also, in several other jurisdictions the local entities are in distress because of growing

[48] Ayush Khare et al, *supra* note 13, at 31.
[49] Hindustan Construction Company Limited & Anr. v. Union of India & Ors.; Supreme Court of India; Writ Petition (Civil) No. 1074 of 2019; November 27, 2019.
[50] Catarina Ferraz , *supra* note 23, at 2, 34.

demand from an aging and declining population resulting in dwindling revenues. However, India is not in the same economic cycle. India has a growing population, and a robust municipal insolvency law will impart confidence amongst creditors to lend to municipalities for capital expenditure. As explained, in India, the reasons for decline in revenue are some of the taxes were subsumed into GST, low or no increase in property taxes and user charges, inability to levy new taxes, reluctance on part of States to cede control over revenue streams and the general inefficiency of TMs.

Furthermore, municipalities inherently deal with public interest; an aspect that has been accorded great importance in insolvency laws. UNCITRAL Model Law on Cross Border Insolvency specifically carves out an exception that prevents the court from refusing to take an action if the action would be manifestly contrary to the public policy.

In accordance with the aforesaid limitations as defined by the Constitution, the public interest involved, and the broad guidelines by INSOL International let us embark on creating the nuts and bolts of such an insolvency framework. Experience and concepts of other jurisdictions will be relied upon where applicable. An endeavour would be made to keep the law practical; the best model law is of little use if it is not implementable as is usually talked about of the South African municipal insolvency law.

Who should be included in the definition of municipality?

Nagar Panchayats, Municipal Councils and Municipal Corporations constitute TMs by definition. In addition, any statutory body arising out of District Planning Committee under Article 243ZD of the Constitution, Metropolitan Planning Committee under Article 243ZE of the Constitution and similar bodies under any State law should be included in the definition of TMs.

Similarly, providers of services specified in the Twelfth Schedule in a PPP irrespective of the corporate structure should be subjected to the rules of Municipal Insolvency. This is because such service providers in several cases cannot be liquidated; express consent of municipality should be sought for such liquidations. The only caveat should be that that the legal rights of the municipality, ex post, should be the same as ex ante, in case of an insolvency and restructuring; municipalities' share whether in equity or in kind should continue *in toto*. The private service provider should either rejig the debts or a new more efficient service provider should be brought in as in a corporate insolvency resolution process (CIRP).

Mumbai Metro One Private Limited (MMOPL), is one such example. State Bank of India, IDBI Bank and Indian Bank had filed separate applications for insolvency against MMOPL for nonpayment of bank dues. Reliance Infrastructure Limited (RIL) at the time of filing of insolvency application was a 74% shareholder and Mumbai Metropolitan Regional Development Authority (MMRDA) held the balance 26%.

The company operates the Versova to Ghatkopar metro line and the ridership is high. In case of a CIRP, in absence of a resolution applicant, the company would undergo liquidation and will inconvenience a lot of passengers. MMRDA was aware of the fact and recently got a valuation done of Reliance Infra's share to explore the possibility of buying the same. The

negotiations between MMOPL and MMRDA had been going on since 2020; MMOPL claiming a valuation of ₹40.26 billion and MMRDA pegging the same at ₹23.56 billion.[51] Eventually, the State cabinet allowed MMRDA to purchase RIL stake for ₹40 billion in March 2024.[52] This led to disposal of insolvency applications by the courts. However, the banks were in a quandary as the cabinet reversed its decision to purchase in June 2024.[53] Instead, the cabinet has advised MMRDA to consider a one-time settlement at ₹17 billion.[54] Bereft of a municipal insolvency law the State has to spend its precious resources on a settlement. A municipal insolvency law would have resulted in the restructuring of the private partner's share.

The case of Seven Hills Hospital,[55] specifically in context of the Mumbai hospital[56] is another example. In case a municipal insolvency law was in existence, as proposed in this paper, the case may have been resolved by now which is in limbo for six years. The proposed resolution plan, in CIRP, had not only impinged on the rights of Municipal Corporation of Greater Mumbai (MCGM) by creating a charge for further borrowings but also was overriding MCGM's right and its public duty, and thus was rejected.

Another saga, since the inception of IBC, meandering through the courts, with multiple visits to Supreme Court, wherein a municipal insolvency law may have helped, is that of Jaypee Infratech Limited.[57] The courts have been finding a solution within the four walls of CIRP. A municipal insolvency law would have safeguarded the rights of Yamuna Expressway Industrial Development Authority[58] (YEIDA) and provided clarity on preparation of resolution plan to applicants; an amount of ₹1million had been assigned to YEIDA against its large claim on account of additional compensation of ₹16.89 billion.[59] As a result, the resolution plan though approved in March 23 faced uncertainty *vis-à-vis* implementation. The State Government had not consented to the resolution plan of the successful resolution applicant.[60] Eventually, in May 2024, only after the successful resolution applicant agreed to pay ₹13.34 billion on account of compensation, did the resolution plan move forward.[61] In case the rights of YEIDA

[51] Priyanka Kakodkar, *Panel values R-Infra's 74% stake in Metro-I corridor at 4000 cr*, Sunday Times of India (Mumbai), (Mar. 10, 2024), at 2.

[52] Priyanka Kakodkar, *Cabinet okays buyout of R-Infra stake in Metro-1*, The Times of India (Mumbai), (Mar. 12, 2024), at 3.

[53] Manthan K Mehta, *3 mths on, cabinet does U-turn on buyout of R-Infra stake in Metro-1*, The Times of India (Mumbai), (June 29, 2024), at 3.

[54] Manthan K Mehta, *State not to buy Metro1 but clear its INR 1.7K cr debt*, The Times of India (Mumbai), (July 5, 2024).

[55] Municipal Corporation of Greater Mumbai v. Abhilash Lal & Ors; Supreme Court of India, Civil Appeal No. 6350 of 2019, Nov. 15, 2019.

[56] The Vizag hospital was resolved under insolvency in July 24. MGM Healthcare submitted a resolution plan of INR 1.71Bn against outstanding creditor claims of INR 13.62Bn.

[57] IDBI Bank Limited v. Jaypee Infratech Limited; NCLT Delhi, Company Petition No. (IB)-77(ALD)/2017, Mar. 7, 2023

[58] UP Government has enacted the UP Industrial Development Act 1976, to ensure planned development of industrial and allied activities in the state. Yamuna Expressway Industrial Development Authority has been created under this Act for systematic development of notified area abutting Delhi.

[59] Yamuna Expressway Industrial Development Authority v. Monitoring Committee of Jaypee Infratech Ltd and Suraksha Realty, NCLAT Delhi, Company Appeal (AT) (Insolvency) No. 493 of 2023, Apr. 25, 2023.

[60] Yamuna Expressway Industrial Development Authority v. Monitoring Committee of Jaypee Infratech Ltd through Anuj Jain, Secretary & Ors, NCLAT Delhi, Company Appeal (AT) (Insolvency) No. 493 of 2023 & IA No. 3017, 3703 of 2023, Mar. 6, 2024.

[61] Yamuna Expressway Industrial Development Authority v. Monitoring Committee of Jaypee Infratech Ltd through Anuj Jain, Secretary & Ors, NCLAT Delhi, Company Appeal (AT) (Insolvency) No. 493 of 2023 & IA No. 3017, 3703 of 2023 & 2535, 2548, 2660, 2669 of 2024, May 24, 2024.

would have been protected under a municipal insolvency law, it is likely that the insolvency would have been resolved faster. Moreover, it is likely that YEIDA would have accommodated the successful resolution applicant with additional Floor Space Index (FSI) to make the project viable.

In summary, the definition of who are to be subjected to the municipal insolvency law should be clear without any ambiguity.

Who can file an application for municipal insolvency and the jurisdictional courts?

United States (US) has stringent requirements for filing of an insolvency application by the municipality. Clause 109 (c) of the United States Bankruptcy Code (USBC) states that the municipality should be bankrupt, specifically authorized by its state law to file for insolvency and desires to effect a plan to adjust its debts. Insolvency as per clause 101(32) of USBC means that municipality is either not paying its debt as it becomes due, unless disputed, or unable to pay its debt as they become due.

In India too, when a municipality is filing on its own it should have the authorization of the State. The State is responsible for all related matters like earmarking different municipal areas, assignment of taxes, devolution of duties, nominating members to council etc.

However, given the political-economy scenario, it is going to be the rarest of rare occasion when the TMs will seek such a permission and the State will grant the same. This will result in a delay which will make matters worse for the municipality. Detroit's bankruptcy experience shows that the longer one waits for intervention, the harder it is "For 50 years, Detroit's economy, its physical infrastructure, and its social structure had been on a steady decline. And the political system did nothing whatsoever about it."[62] England requires local authorities CFO to issue a section 114 notice whenever the accounts are in imbalance; however, the fact that the incumbent management will be replaced acts as a disincentive for delaying the notice.[63]

Thus, to circumvent the aforesaid agency problem, in addition, financial and operational creditors[64] too should be allowed to file for insolvency of a municipality in case the dues are unpaid for long; may be a longer period of outstanding, post overdue date, can be prescribed (say 120 days – 180 days). Moreover, such filings will help municipalities that may have inefficiencies. It is explained later in the paper that these inefficiencies can be reduced by appointment of an RP / administrator, resulting in both improved financial and operational performance.

The threshold of default for operational creditors can be further classified into two buckets. A lower amount for medium, small, and micro enterprises, (MSME) say ₹5 million and a higher for others say ₹50 million.

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[62] Kil Huh et al, *After Municipal Bankruptcy – Lessons from Detroit and other local governments, The Pew Charitable Trusts*, Aug. 2015, at 3.

[63] Eugenio Vaccari and Yseult Marique, *Local public entities in distress – a critical analysis of the English approach, When liquidation is not an option: A global study on the treatment of local public entities in distress*, INSOL International, Nov. 2022, at 172.

[64] Operational creditors are the ones who provide goods and services to the municipality.

Project-wise applications should be encouraged.

One should take a leaf out of the real estate insolvencies and allow project-wise filing where the lenders have lent, or the creditors have supplied goods/services, against a particular project. In similar vein, where a municipal bond issued by the municipality has a charge on a particular project, an insolvency application should be restricted to that project. The application will lie against the municipality only where the borrowing is of general nature and cannot be ascribed to a single or a group of projects. This will ensure that working of full municipality is not disturbed and at the same time resolutions can take place in pockets where the distress emanates.

Jurisdictional courts for filing of insolvency application.

The tribunals for municipal insolvency should be the same as under the IBC. Municipal insolvencies are not likely to be a frequent phenomenon and thus having any kind of special tribunals will add to the cost of the exchequer.

Control / Oversight of Municipal Affairs

There are two scenarios in which the question of control / oversight arises when TMs go bankrupt; in the first scenario the municipality itself is insolvent and in the second where either a project of municipality or a public private partnership performing duties on behalf of the municipalities is insolvent.

a. *Municipality is Insolvent.*

Constitutionally, there is no bar to appoint an RP / Administrator to look after the affairs of TMs in case the States choose to appoint the person and designate as an "Administrator".

In March 2024, Brihanmumbai Municipal Corporation (BMC) that controls the city of Mumbai completed two years under an administrator rule; the longest it has functioned without elected representatives in its history. Further, the elections are not expected before October 2024 till the time State elections are over. In this period of two years, bereft of elected representatives, the city issued work orders for ₹1,500 billion;[65] the liabilities of BMC were at an all-time high of ₹1,900 billion.[66]

The aforesaid is not an aberration. Infact, all of Maharashtra's 27 municipal corporations are being run by state appointed administrators since the tenure of elected representatives expired amidst Covid. The combined budget of these 27 municipal corporations is ₹1100 billion.[67] Further, Bengaluru Mahanagara Palike is without an elected body since late 2020; it did not have one between 2006 and 2010. Chennai was without an elected body between 2006 to 2010.[68]

The above incidents clearly depict that an administrator can be appointed by the State to

[65] Pratip Acharya, *Longest period without elected representatives: BMC completes two years under administrator rule*, The Indian Express (Mumbai), Mar. 9, 2024, at 3.
[66] Richa Pinto, *Mumbai: Mega Infra projects push up BMC's liabilities to a record high of 1.9L cr*, The Times of India, Dec. 14, 2023.
[67] Howindialives.com, *The Tyranny of Back-Door Governance*, Mint, 30th Jan. 2024 at 14.
[68] *Id.*

oversee the affairs of the municipality. Thus, an amendment may be carried out to grant insolvency courts power to appoint such an Administrator / RP, on the advice of the State, of requisite qualification, compulsorily in case debt and default is proven to the court. Furthermore, the Constitution does not provide an outer limit of time till which date the municipality can function without an elected body, though, our endeavour should be to define a timeline for the purpose of insolvency resolution.

A few other jurisdictions including United States and Australia have in their armoury the concept of appointing Administrator in case of municipal distress. The Indian insolvency regime have developed its own concept of Administrator for insolvencies of financial institutions wherein the Reserve Bank of India (RBI) nominates an Administrator which is endorsed by the Tribunal to act as an RP. We can model the municipal Administrator on the same lines wherein instead of RBI, the State nominates the person.

In addition, in the insolvency of a financial institution, RBI also appoints a panel of experts to assist Administrator as these insolvencies are complex. The Constitution already has a provision for appointment of experts under Article 243R wherein "the State may provide for the representation in Municipality of persons having special knowledge of experience in Municipal Administration".

Thus, the Administrator in conjunction with knowledgeable experts can be roped-in to advise on the affairs of the municipality when TMs default. The mandate of the Administrator should be to roll out a plan within a defined period (say one year, extendible by another six months) that will obviate the distress of the municipality. In addition, a five-year plan should be prepared. It should be noted that currently, annual budgets of TMs are prepared without a medium-term or long-term time horizon. Thus, forecasts of infrastructure requirement and the associated capital requirements do not exist.[69]

Some of the other immediate steps of the Administrator will be like that of a CIRP; taking control and custody of assets, collate claims, appoint professionals, and form a Committee of Creditors (CoC). In addition, identify wasteful expenditure that can be slashed and embark on preparation of a resolution plan.

The Administrator along with experts can identify sources of distress and alleviate the same in multiple ways. A few of the common actions that may be taken are described below; the truly innovative and novel solutions will belong to the realm of experts in a particular situation.

i. Increasing the number of Public Private Partnerships

More than a hundred years ago, before the Chapter 9 of USBC came into being in the case of *Kaufman v. City of Tallahassee*,[70] the Supreme Court of Florida commented that "a city's functions have become more and more ministerial, in that its duties consist largely, if not entirely, in the management of public utilities such as waterworks and sewerage systems, electric lighting and power plants, gas plants, telephones, and street railways,... for the financial advantage

[69] Janaagraha centre for citizenship and democracy, A Municipal Finance Blueprint for India,
[70] Randal C. Picker and Michael W. McConnell, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*; 60 University of Chicago Law Review 425, (1993).

and profit of the city. According to the court it took 'very little stretching of this doctrine' to say that no municipal function is governmental, a city is not a political subdivision of the state, not a government but purely a business, commercial, proprietary management of local public interests." This was a revolutionary assertion for the time though no courts acted on the aforesaid doctrine.[71]

However, a century later, the assertion that cities have become ministerial does seem to be true. Thus, some of the services provided by TMs may be suitably structured as a business; commercial oriented PPP with TMs holding a 26% share. The service providers will have to adhere to strict Service Level Agreements (SLAs). In case the existing service providers are from private sector better SLAs may be designed or more efficient service providers sought. Infact, some of the areas where the private sector may have better capabilities can be completely outsourced/privatized.

Liberalisation of service delivery, in some but not all areas, will bring in the role of markets to fore which will not only enhance level of service but also will keep prices in check. As an example, the Delhi discoms were privatized in 2002, 51% being held by private player and 49% by Delhi Government. The aggregate technical and commercial losses which were 50% at the time of privatization have come down to about 5% today. PPP / privatization will also help eliminate subsidies and charge a fair price; a task often rendered difficult for politicians in an electoral democracy when TMs are directly providing the service. Moreover, citizens are more amenable to pay a service charge to private players as compared to Government. The reason all service areas would not be considered under PPP is because some authors[72] have argued that in the long-run services suffer if the core capabilities are outsourced.

In addition, PPP's will shift the financing burden to private players freeing up municipal resources; the lenders can create a specific charge on such assets as security. Similarly, the administrative overheads too will reduce on account of a section of activities moving out of municipalities direct remit.

Furthermore, for the services under PPP robust audited accounts will be available in accordance with the conditionalities of the finance commissions which can be rolled up into municipalities accounts to the extent of its share.

ii. Carve out areas as industrial districts

Though, Jamshedpur was not under any distress, the city illustrates how certain areas can be carved out of the municipalities in distress by the Administrators to achieve cost reduction.

In the last week of December 2023, a notification by the Jharkhand government declared that Jamshedpur will be known as Jamshedpur Industrial City. Further, a Jamshedpur Industrial Township Committee (JITC) will be formed with up to 27 members of which 11 were to be from Tata Steel.[73]

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[71] *Id.*

[72] Mariana Mazzucato and Rose Collington, The Big Con, allen lane, 2023.

[73] Abhishek Angad, *Confusion over legality of Jamshedpur Industrial City Notification*, The Indian Express, (Dec. 30, 2023).

The Constitution in the proviso to article 243Q states that

> a municipality under this clause may not be constituted in such urban area or part thereof as the Governor may, having regard to the size of the area and the municipal services being provided or proposed to be provided by an industrial establishment in that area and such other factors as he may deem fit, by public notification, specify to be an industrial township.

Tata Steel had been providing all the amenities in the township for over a century. However, the requisite legal status evaded them as Jharkhand Government had not notified the area as industrial township under the provisions of the Constitution. Now that the same has been carried out, post receipt of all approvals, State and Centre, Tata Steel will formally take over the township.[74]

Carving out such areas will reduce the administrative burden and the associated costs for the municipality.

iii. Expansion of municipal areas for efficiency

At the other end of spectrum from carving out is the expansion of municipal areas. A combination of municipalities has both pros and cons. The pros mostly translate into a financial metric which are important for a distressed municipality; economies of scale, lower administrative overheads, greater financial and technical ability to solve complex problems, specialisation resulting in lower costs, better debt raising capacity and better service delivery.[75]

Examples abound for such mergers. In 2006, ten municipal councils were merged into the Ahmedabad Municipal Corporation (AMC) in Gujarat, and in 2020, another was added to the mix. In 2010, three municipalities were merged into the Coimbatore Municipal Corporation. Similarly, in 2021 Pune Metropolitan Region Development Authority and in 2022 Howrah Municipal Corporation was expanded.[76] A recent example is of the merger of three municipalities of Delhi. Hyderabad too is planning to merge all municipal corporations and municipalities into Hyderabad Greater City Corporation.

In case the rural areas are included into the expansion it may also help enhance revenue due to taxes as well as by higher land value attributed to land in municipality's possession. This land use change, discussed in a later section, in times of deep distress can act as a solace to the lenders. In the last decade many cities such as Prayagraj, Ahmedabad, Vadodara, Surat, Coimbatore, Chennai, Pune etc. have merged villages into their municipal boundaries.[77]

A similar exercise of merging municipal areas seems to be in favour in England too based on independent reports that advocate efficiency and lower costs from merging local entities, as well as by reports commissioned by the Levelling Up, Housing and Communities Committee.[78]

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[74] Pavan Burugula, *Tatas may get admin control of Jamshedpur again*, Mint, (Dec. 19, 2023).
[75] Ramanath Jha, *Assessing the merger of Delhi's Municipal Corporations*, Issue No 362, Observer Research Foundation, (July 20, 2023), at 10.
[76] *Id.,* at 6-7.
[77] *Id.,* at 6.
[78] Eugenio Vaccari, *supra* note 63, at 166.

iv. Exploring the possibility of expansion in prime areas

A variation of the aforesaid expansion theme could be the Administrator requesting the Central Government to release part of the cantonment land to TMs. The request may or may not be granted by the Centre, but an effort can be made. Cantonment land in most cities is now prime land which can fetch handsome revenue. Recently, as a matter of policy, not because of distress the Central Government released 20,000 acres of cantonment land to state local bodies.[79] Municipalities can explore joint development with Ministry of Defence where such a possibility exists without jeopardizing the security needs.

Similarly, several public sector units (PSUs) established in the earlier years of independence have extra land in the heart of urban centres. Also, in some cities single/double railway tracks pass through city centre. The Administrators and TMs can request the Centre and the ministries in control of PSUs for joint development of such land parcels; the rail tracks can be rerouted.

Such actions will not only result in one-time windfall gains to tide over temporary crisis but also will result in constant stream of property taxes, in future.

v. Exploring hitherto unexplored revenue streams in conjunction with savings in recurring costs

Numerous studies, articles and reports have indicated that people at the bottom of the pyramid are the most vulnerable to climate change. The research shows that financial inclusion is one of the best ways to build resilience against the effects of climate change; savings, credit, insurance, money transfers and new digital delivery channels provide a financial buffer as well as aid in recovery and reconstruction.[80] However, we are still struggling to find answers vis-à-vis the process to be adopted for inclusion as well as the time-period. How to deal with devastation brought by climate change if it is an annual event in certain seasons?

A mere seven % of all climate finance goes toward adaptation purposes. Moreover, much of the effort is focused on "planned adaptation", i.e., building resilient infrastructure.[81] Also, the business cases are harder to make for financing investments in adaptation; they do not yield an immediate return, preventing damage is consumption oriented which does not generate revenue and is not amenable to easy cost-benefit analysis since resilience is absence or reduction of climate-induced damage.[82]

To compound matters further a recent judgment[83] the Supreme Court expounded on the fundamental rights of citizens. The Court stated that "the people have a right against the adverse effects of climate change". It is difficult to provide this right in a geographic location where destruction due to climate change is a frequent phenomenon.

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[79] Harikishan Sharma, *Land portions from 10 cantonment boards to be run by local bodies*, The Indian Express, (Apr. 8, 2024), at 1.

[80] Inclusive Green Finance work stream and Inclusive Green Finance working Group, Inclusive Green Finance: A Survey of the Policy Landscape, (2nd ed., Alliance for Financial Inclusion, 2020), at 4.

[81] Zetterli, Peter, *Climate Adaptation, Resilience, and Financial Inclusion: A New Agenda*, Focus Note, Washington, D.C., CGAP, 2023.

[82] *Id.*

[83] MK Ranjitsinh & Ors v. Union of India & Ors; Supreme Court of India, Writ Petition (Civil) No. 838 of 2019 with Civil Appeal No. 3570 of 2022, Mar. 21, 2024.

Municipalities can play an hitherto unexplored role in the aforesaid scenario which also takes into account the rights of citizens. They can play the role of "feet-on-street" for the digital finance providers. Being at the scene, TMs are in a position to adjudge which adaptation investments will be resilient in the years to come and where they would fail in the next climate calamity. TMs can charge a fee to the digital finance providers for such assessment. Moreover, TMs can explore the possibility of "planned-shifting" in the expanded areas of municipality, described above, where year-on-year havoc is near-certain, and the cost-benefit analysis indicates such an outcome. This would not only curtail periodic expenditure but also will be an effort to make another area a thriving economic hub in a planned manner. In addition, it will be in consonance with the directions of the Supreme Court.

vi. **Costs of the insolvency process**

The question of costs will arise on the appointment of the Administrator and the support team. It is a fact that the remit of duties under TMs would require a large team which will be expensive if consultants are employed; Chapter 9 proceedings buttress the fact that proceedings with outside consultants tend to be expensive.

It may not be possible to completely dispense with the consultants, however, in addition other avenues may be explored. One such idea could be to indulge in lateral hiring which has been tried in number of government departments across the country. The core team may be hired to work on the municipal payrolls with a market-benchmarked salary for a minimum period of two years. This team can work in conjunction with existing employees.

It would be argued that qualified people will not join for such a short tenured post as there will be uncertainty post completion of the assignment. However, this may not be true; all the administrators appointed by RBI for financial sector insolvencies were there for a short term. Moreover, exposure to municipal insolvency will result in increase in market value of such individuals as post the assignment they will bring to table a unique set of government institution related skills. This can be gazed from the fact that boards of private sector banks are full of personnel from RBI, Indian Administrative Services, and public sector banks.[84]

b. *The Public Private Partnership is Insolvent.*

In case a PPP is insolvent the process should be like CIRP with a few modifications.

Firstly, in case any portion of the debt of PPP is guaranteed by TMs, an insolvency application cannot be filed without the consent of the municipality. Croatia follows such a practice.[85]

Secondly, the rights and obligations of the municipality in PPP, should remain the same post resolution. In case it is decided to liquidate a PPP, either prior consent of municipality must be obtained or a recommendation for the same by the municipality when the insolvency is initiated; in such instances any rights of municipality too would cease. In Croatia, a filing of insolvency against such entities is usually carried out with the consent of municipality, or local public entity, as called in Croatia.[86]

[84] Gopika Gopakumar, *The silent rise of public sector banker in private bank board*, Mint, (Mar. 6, 2024).
[85] Lidija Šimunoviæ, *Local public entities in distress – a critical analysis of the Croatian approach, When liquidation is not an option: A global study on the treatment of local public entities in distress*, INSOL International, Nov. 2022 at 145.
[86] *Id.*, at 143.

Thirdly, the municipality must get a seat in the CoC to evaluate the resolution plan from a technical perspective. This is because the proposed successful resolution applicant may have been barred or blacklisted earlier by municipality for poor service or may not be capable of performing the service. However, the resolution professional, CoC and TMs may jointly decide to waive blacklisting or any other deficiency with appropriate guarantees and negotiation.

Committee of Creditors, their rights, voting and deliberations

The rights of creditors will vary in accordance with the two scenarios described above. In case of a specific project or PPP being insolvent, the rights and duties will primarily be in accordance with CIRP alongside the tweaks described above incorporated i.e., no variation in rights alongside a seat on CoC for TMs.

However, if the municipality itself is insolvent novel ideas need to be explored though certain basics will stay the same as in CIRP: moratorium, priority to interim finance and insolvency costs, cram- down (51% or 66% as the case maybe), authorized representative in case of bondholders or debenture holders, similarly situated creditors to be treated equally, etc.

The outcome in a municipal insolvency must be a restructuring which implies that bereft of a benchmark on market determined valuation it is difficult to ascertain what is the quantum of distribution the creditors are entitled to.

"The bankruptcy procedures lower the downside risk of borrowing whereas a higher bankruptcy exemption for essential public services could lower the supply of financing. There is thus a trade-off. Where to draw this line is a crucial question in the design of such legislation".[87] The conflicting requirements of maintaining essential services and the creditor's contractual rights implies that the pain of insolvency needs to be shared between lenders and debtors. The insolvency mechanism needs to balance these competing interests.[88]

Similar, was the lesson from the Detroit bankruptcy. All stakeholders – unions, bondholders, pensioners, city employees, nonprofit foundations, business leaders, state, and local lawmakers, and the 690,000 residents accepted cuts; "Grand Bargain, a collection of settlements that emphasized the policy of cooperation and shared sacrifice".[89] This is something that all stakeholders in India too should imbibe.

The base document and the plan for an equitable distribution should be prepared by the Administrator and his team. They should prepare a five-year forecast, as anything beyond that is difficult to forecast with certainty of revenue, expenditure, capital expenditure, and restructuring of operations with a view to identify PPP opportunities and carve out of industrial districts. The forecasts should factor in effects of climate change on infrastructure and financing and iteratively be discussed with CoC for their inputs in the periodic meetings. However, the decision of the Administrator would be final and binding.

Implementation of the aforesaid plan will release free cash over the ensuing years that can be paid to both the financial and operational creditors (OCs) in instalments over an extended

[87] Lili Liu, *supra* note 44, at 15.
[88] *Id.,* at 19
[89] Kil Huh et al, *After Municipal Bankruptcy – Lessons from Detroit and other local governments*, The Pew Charitable Trusts, Aug. 2015, at 5-6.

period, five to seven years, or as decided by Administrator in conjunction with the CoC. Unlike a CIRP, where OCs are usually paid liquidation value, in a municipal insolvency they should be paid as per the plan. This is because some of the vendors may not be able to provide goods/services for the essential public services in case of a drastic reduction of their receivables as their working capital limits from banks will reduce on cancellation of their receivables.

Beyond the aforesaid distribution of the free cash, depending on the situation at each municipality some innovative steps need to be carved out to additionally recompense the financial creditors. A few of such possibilities are detailed below.

Refinancing and Restructuring by Sustainability Linked Bonds.

Refinancing is amongst the first port of call for any professional restructuring the capital structure. However, in case of TMs an added avenue may be tried for reducing the finance cost further i.e., sustainability linked debt. Many multilateral and financial institutions are willing to provide sustainability linked debt with interest reset on specific performance of an environmental benchmark or on bettering the same. Considering that Indian cities have often grown at the cost of environment massive opportunities exist to avail such financing. This will save extra cash beyond what would have been achieved by a plain vanilla refinancing.

Bundling of a Slice of Debt with Privatized or PPP Projects

The administrator whilst carving out projects for privatization or PPP, can assign a portion of debt, with the consent of the lender, to such projects when the request for quotation for such projects is prepared. This will ensure servicing of the debt obligation and will reduce potential haircut for financial creditors (FCs).

Assignment of Land in an Expanded Municipal Territory

If the FCs are institutions and not individual bondholders, and if the geographical location of the municipality permits, it may explore the possibility to include abetting rural areas into itself, acquiring and allocating land in such rural areas to creditors. The land cost post incorporation into municipality would increase. This manoeuvre may save municipality prime land at the same time fulfilling commitment of the creditors. Moreover, if the financial institution decides to use the land for its own purpose, it will help build infrastructure into another area, decongesting the city. Relevant incentives may be given to such creditors to encourage them to use such land.

Resolving stress by granting land in resolution plan is not a novel method, it has taken place in CIRP in the case of Jaypee Infratech wherein 2,594 acres was allotted to FCs.[90]

Other Key Points

There should be a definite timeline for approval of plan, say six months, from the date the final draft is prepared. In addition, a representative of the State should also sign-off on the plan; not only as a key stakeholder bound by it but also to give added assurance to creditors who are to receive deferred payments.

[90] IDBI Bank Limited v. Jaypee Infratech Limited; NCLT Delhi, Company Petition No. (IB)-77(ALD)/2017, Mar. 7, 2023

Post bankruptcy monitoring

In conjunction with the five-year plan prepared by the Administrator an updated five-year plan needs to be prepared, from the date of resolution, for monitoring the commitments.

Detroit also exhibited the importance of post-bankruptcy monitoring. The state of Michigan compelled Detroit to create a financial review commission to oversee the post-bankruptcy plan. The nine-member panel, which includes the Detroit mayor and City Council president were granted powers to approve contracts and borrowing.[91]

Any variation from the plan beyond a specified limit whether in physical or monetary terms should require approval of an independent committee. The committee should have the Administrator as one its members provided s/he consents for the same.

THE PERILS OF EXCESSIVE LEVERAGE FOR BUILDING INFRASTRUCTURE

India is on a growth path as China was a few decades ago. The similarities extend to size of population and rapid urbanisation. However, there is one crucial difference, private sector plays a crucial role in India; China is predominantly state-owned enterprises. Nevertheless, the story of China holds important lessons for what not to do whilst allowing municipalities to borrow.

China's tax reforms of 1994, by then premier Zhu Rongji, centralized taxes, reducing local governments' share of tax revenues; akin to the introduction of GST in India. This despite the fact that China is the world's most decentralised nation in terms of subnational spending. According to International Monetary Fund research, China's local governments are responsible for 85 per cent of general budgetary spending, bearing significant fiscal duties in areas such as pensions, medical care and unemployment insurance".[92] To fulfil the responsibilities, local governments primarily became dependent on land use right transactions.

In 2021, local governments earned 40 % of their total revenue from the sale of land-use rights. Local governments artificially increased price of land, which was used as collateral, for credit from banks for infrastructure projects, some of them unviable.[93] Chinese officials categorize 14 provinces as being in financial crises of the thirty-one provinces and municipalities; in some areas salaries of teachers and employees have not been paid.[94]

Goldman Sachs estimate the debt at USD 23 trillion.[95] The International Monetary Fund estimates that the total outstanding off-balance-sheet government debt is around USD 7 trillion to USD 12 trillion including corporate bonds issued by local-government financing vehicles (LGFV), which borrowed money to build roads, bridges and other infrastructure. No one knows what the actual total is, but debt levels have become unsustainable. Domestic banks' total exposure to LGFV at the end of 2022 was equivalent to USD 6.9 trillion; 13% of the banking sector's total assets.[96]

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[91] Kil Huh et al, *supra* note 89, at 7.
[92] Di Lu, *China's local government credit dilemma,* East Asia Forum, Nov. 3, 2023
[93] Junhua Zhang, *The bankruptcy of Xiconomics,* GIS Reports Online, Oct. 23, 2023.
[94] *Id.*
[95] *Id.*
[96] Rebecca Feng and Cao Li, *China's colossal debt problem is coming to a head,* The Wall Street Journal, (Dec. 5, 2023).

The national goal of high GDP growth and promotion of officials linked to achievement of growth targets further exacerbated the problem. This was compounded by the global financial crisis wherein 70% of the USD 547 billion fiscal stimulus package, was raised by the local government.[97] Simultaneously, investment returns on many projects fell sharply due to overbuilding. For example, return on assets in the power and heat supply sector, fell from around 4% in 2015 to 1.5% in 2022.[98]

Economists say $400 billion to $800 billion of debt is at high risk of default.[99] China's government is undertaking a host of measures to obviate the crisis; special bond issuance, debt swaps, loan rollovers, dipping into the central budget.[100] Local governments are issuing special refinancing bonds to replace some of their off-balance-sheet debt; since October 2023, thirty Chinese provinces and cities have raised the equivalent of around USD 200 billion.[101] Also, local governments have been ordered to halt problematic PPPs and all the PPPs henceforth will be reviewed by Government authorities in Beijing.[102]

However, all these measures are just kicking the can down the road. China will have to moderate its growth expectation and the vicious circle of more debt for infrastructure spending to boost GDP. Simultaneously, it should delink the perverse performance incentive linked to GDP growth for its officials.

The lesson for India is that borrowing is needed to build infrastructure but unbridled borrowing for the same will bring misery; a balance is needed from the current .05% of the GDP on one hand to the extreme case of China on the other.

Also, a watch needs to be kept on any creative practices like the artificial land prices of China. BMC's liabilities are an example of the slippery path we are treading. BMC has liabilities of ₹1,900 billion, against fixed deposit in the bank of ₹870 billion.[103] and an annual budget of approximately ₹600 billion of which ₹280 billion is revenue expenditure.[104] BMC claims that the liabilities can be clawed back from future revenues as the projects being executed are long term in nature.[105] It would be prudent to strictly monitor such an overreach.

Thus, whilst liberalizing municipal borrowing, detailed assessments of projects are an imperative else we will be spending resources on roads and bridges to nowhere and metros and subways connecting ghost cities and colonies. Multiple level checks and balances should be incorporated when municipalities embark on borrowing both whilst budgeting and when monitoring or auditing.

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[97] Di Lu, *supra* note 92.
[98] Nathaniel Taplin, *China's Teetering Local Debt Mountain*, The Wall Street Journal, (Oct. 13, 2023).
[99] Rebecca Feng *supra* note 96.
[100] Kevin Yao and Samuel Shen, *China can no longer 'extend and pretend' on municipal debt*, Reuters, (Aug. 7, 2023).
[101] Rebecca Feng *supra* note 96.
[102] Kevin Yao and Ziyi Tang, *China orders local governments to cut exposure to public-private projects as debt risk rise, Reuters*, (Nov. 14, 2023).
[103] Richa Pinto, *Mumbai: Mega Infra projects push up BMC's liabilities to a record high of 1.9L cr*, The Times of India, (Dec. 14, 2023).
[104] Mustafa Shaikh, *Mumbai civic body announces annual budget with focus on health and infrastructure*, India Today, (Feb. 3, 2024).
[105] Richa Pinto, *supra* note 103.

CONCLUSION

The most important function of the municipal insolvency law will be a signalling exercise both for the lenders and municipalities. Clear rules for insolvency are likely to lower borrowing costs through lower interest rates, longer maturity, or both, and thereby increase market access.[106]

The solution for resolution of insolvency for each municipality will depend based on their peculiar circumstances. However, the Administrator will have to balance the tension between the contractual rights of creditors and the need for maintaining public services. It is also true that some of the actions described above can be taken whilst TMs are not under stress, however, often the politico-economic situation makes it difficult to take such actions during normalcy.

India currently is blessed with favourable demographics, where working population is growing, is expected to peak around 2050[107] and the cities are expanding. This gives a golden opportunity to take debt of five-to-twenty-year duration, build infrastructure, repay the debt, and thereafter just spend on maintenance when the depopulation phase begins.

Delay in creating infrastructure will result in premature decay of TMs, further accentuating the problem of revenue and creating a vicious circle. Timely introduction of municipal bankruptcy law will act as a stimulant for infrastructure, economic growth and will let cities blossom.

[106] Lili Liu, *supra* note 44, at 17.
[107] Esha Roy, *India's population growth rate on a steady decline since 90's*, The Indian Express, (Apr. 21, 2023).

09

PREDICTIVE MODELS FOR DIFFERENT CORPORATE INSOLVENCY RESOLUTION PROCESS (CIRP) TIMES

Sunil Kumar Rajak, Sarvesh Kumar and Santosh Kumar

ABSTRACT

In this research paper, the authors develop predictive models to estimate the start-to-finish process time (time taken in days) for different insolvency and bankruptcy processes administered as per the provisions of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) and amendments thereafter. The predictive models for three corporate insolvency resolution processes (CIRP) of IBC ending in dissolution, liquidation, and resolution, have been developed using multivariate linear regression analysis based on cross-sectional CIRP-related summary output data published by IBBI. The research findings indicate that start-to-finish CIRP times are path-dependent for the same type of insolvency process, and hence have different process times. The unique path in CIRP means who files (financial creditor (FC), operational creditor (OC) or corporate debtor (CD)) the case for insolvency with which National Company Law Tribunal (NCLT) bench, whether the CD is operational or defunct, what is the location of the NCLT bench, etc. The different unique combination of these factors define the unique paths for a given CIRP.This research study quantifies the process time for different unique paths incorporating the influences of CD, OC, FC, operational status of CD, NCLT location, etc. Therefore,the predictive models developed in the research inherently incorporate variations due to CIRP path factors that exhibit direct impact on the length of process times.For policymakers, the research paper provides a quantitative lens to understand the impact of the CIRP path variables on the process length, and take appropriate policy initiatives.

Keywords: Bankruptcy, Insolvency Process Time, CIRP Process Time, CIRP Predictive Model, IBC (2016).

INTRODUCTION

The IBC has established itself as a watershed law enforcement codification for the Indian economy and business ecosystem since its enactment in 2016. In a strong move, the comprehensive IBC legislation has brought together all the relevant laws, rules, and statutes related to insolvency and bankruptcy processes in India under one umbrella while streamlining the various aspects of the resolution processes. In nutshell, the Code is a comprehensive legislation framework that updated and consolidated various laws related to resolution of insolvent and bankrupt individuals, corporate entities, and partnership businesses in India.

Bhandari (2009) and other journalists have studied several cases including the infamous case of Satyam's way of accounting practices related to providing misleading information to authorities and auditors and had strongly argued about plugging such regulatory failures. Several other recent bankruptcy cases in India,viz., Kingfisher Airline, Mafatlal, Jet Airways etc., had been in media glare and raised the demand for a predictable corporate bankruptcy resolution process framework (Ross, 2019).

The IBC marks a paradigm shift in the Indian bankruptcy and insolvency resolution processes landscape by making the creditors (in the form of a committee of creditors (CoC)) take the centre stage as the key driver of the resolution process in contrast to CD (i.e., Debtor-in-Possession (DIP) regime) driving the resolution processes in the preceding legal frameworks. Further, IBC provides strong legal protection to the CIRP by way of moratorium upon its initiation by the honourable NCLT court from any legal interference by any stakeholder.

The primary goals of the IBC are to offer a speedy and effective bankruptcy resolution process that maximizes the value of an insolvent or a bankrupt company's assets and, alternatively ensures fair and transparent disposal for maximum recovery of bad loans of creditors. The IBC has been updated and amended multiple times since it was first passed to improve and expedite the bankruptcy resolution process and handle new issues.

All things considered, the IBC framework is a major overhaul of the country's insolvency and bankruptcy related laws that strives to facilitate a time-bound, speedy, highly effective and efficient handling of insolvency and bankruptcy cases, and thereby try to unlock the inherent entrepreneurial potential of valuable lender's capital and Indian entrepreneurs by efficiently unencumbering the blocked assets. Further, the Code represents a significant reform in India's debt recovery mechanism ensuring efficient sale of insolvent and/or bankrupt entity's assets and enabling maximum recovery of bad debt. In conclusion, IBC represents a significant milestone in the country's journey towards strengthening economic resilience and growth by enforcing contractual agreements among stakeholders.

ISSUES

The timeline of CIRP (Time taken (days)) datasets released by Insolvency and Bankruptcy Board of India (IBBI) display very high variation with a range of zero day for an entity named GNB Technologies (India) Private Limited to 2,297 days for an entity named Schweitzer Systemtek India Private Limited. However, it may be noted that as per section 12(1) of the IBC, the CIRP is expected to be completed within a period of 180 days from the date of admission of the application to initiate such process. The Adjudicating Authority (AA) may grant a one-time extension of 90 days. Therefore, the maximum time within which CIRP has to be mandatorily completed, including any extension or litigation period, is 330 days (FAQs on CIRP, IBBI). Further, a recent study (Ram Mohan, et al, 2023) emphasises that CIRP do have opportunity costs in addition to direct costs. And this opportunity costs accentuate as the CIRPs inherently tend to lengthen. In this context, the research study strives to quantify variations in time taken (days) attributable to different CIRP elements and CD attributes and thereby develop predictive models using quantitative method like multivariate linear regression analysis.

RESEARCH METHODOLOGY AND ANALYTICAL TOOLS

For the empirical research, the authors have used multivariate linear regression methodology for analysing the cross-sectional data released by IBBI. They have used both the categorical and numerical data available on the website of IBBI. These datasets have been captured since the implementation of IBC in November, 2016, and have been used in the study to develop predictive models for determining the start-to-finish time taken in days for different CIRPs. The end results of different CIRPs are either dissolution, liquidation or resolution.

SOURCES AND TYPES OF DATA AND INFORMATION

As stated above, the data used for conducting this research is based on the data sets released by IBBI periodically on their website. The authors have used the datasets released by IBBI for the period ending December 31, 2023. The following three datasets have been used in the empirical research and analysis:

1. Voluntary liquidation processes ending with order of dissolution, i.e., cases related to dissolution,
2. Corporate insolvency resolution processes ending with order of liquidation,i.e., cases related to liquidation, and
3. Corporate insolvency resolution processes yielding resolution plans i.e., cases related to resolution.

Some of common terms used in the study and as referenced from IBC are as below –

1. Amount due to creditors: The amount due (in rupees crore) to the creditors of the concerned CD.
2. Amount paid to creditors: The actual amount paid (in rupees crore) to the creditors of the concerned CD.
3. Corporate Debtor (CD):A CD is a corporate person who owes a debt to any person. A legal entity against which CIRP has been initiated by an AA in an NCLT court.
4. Corporate Insolvency Resolution Process (CIRP): CIRP is the process of resolving the corporate insolvency of a CD in accordance with the provisions of the Code.CIRP may be initiated by a FC under section 7, an OC under section 9 and corporate applicant of CD under section 10 of the Code.
5. Date of commencement of dissolution: The date on which the concerned NCLT court accepts the application for dissolution of the CD.
6. Date of order of dissolution: The date on which the concerned AA, viz., NCLT bench or the NCLAT (National Company Law Appellate Tribunal) court declares the completion of dissolution of the CD.
7. Financial creditor (FC): Any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to.
8. Financial debt: It means a debt along with interest, if any, disbursed against

consideration of time value of money. It also includes those enumerated in section 5(8)(a) to (i) of the Code, such as money borrowed against the payment of interest, amount of any liability in respect of any lease or hire purchase contract, any amount raised for a transaction having commercial effect of borrowing such as amount raised from allottee under a real estate project etc.

9. Liquidation expenses: The amount expended (in rupees crore) to meet various liquidation processes for the concerned CD.

10. Operational creditor: Any person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred.

11. Operational debt: It means claim arising in relation to supply of goods and services. It also includes claims in relation to employment or dues payable to Central Government, State Government or any local authority.

12. Process time or time taken for dissolution:The number of days lapsed between the "date of commencement of dissolution" and "date of order of dissolution".

13. Realisation of assets: The value realised from the assets (in rupees crore) of the concerned CD.

14. Surplus: The surplus amount (in rupees crore) is the excess of "realisation value of assets" over the "amount paid to the creditors" and the associated liquidation expenses" for the concerned CD.

15. Total admitted claims: It is total of admitted claims of the respective FC and OCs of the concerned Corporate Debtor.

As indicated above, three different CIRP cases, i.e., CIRP ending in dissolution, CIRP ending in liquidation and CIRP ending in resolution. The details related each process are presented below –

VOLUNTARY LIQUIDATION PROCESSES ENDING IN DISSOLUTION (VLP)

In this section the authors study, analyse and develop the predictive model for the Voluntary Liquidation Processes (VLP) ending with order of dissolution. In VLP ending in dissolution,a solvent company, with no defaults, can voluntarily initiate the liquidation process.

Data variables

The dependent variable or the response variable of study is time taken (days) for the VLP process time, defined as below:

1. Time taken (days) or process time: Number of days between the date of NCLT order approving resolution (end date) and date of commencement of insolvency (start date).

    a. Data transformation: As seen above, the VLP process time has a wide range of 55 to 2,357 days. So, in order to improve the regression model the dependent variable has been transformed by taking its logarithm to the base 10. So, the dependent variable used in our research analysis is Log10 (time taken (days)).

Following is the list of independent variables used in our empirical research and analysis work:

1. Recovery Rate: It is the ratio of realisation of assets to the sum of amount paid to creditors and liquidation expenses as reported in the dataset by IBBI.

    a. In the analysis the authors have used recoveryrate greater than zero (recovery rate>0) to assess the impact of excess amount, i.e., surplus of value of realisation from the assets over the amount paid to creditors and liquidation expenses.

    b. Amount paid to creditors: The amount paid to creditors as per the due amount to them.

    c. Liquidation expenses: All expenses admissible as per the provisions of IBC (2016) related to liquidation process for the CD.

2. Realisation of assets: It is the amount realised from the disposal of the assets of the CD, as per the provisions of IBC.

3. Amount due to creditors: The amount found to be due to the creditors of the CD, as per the provisions of IBC.

Thus,the variables are Log_{10} (Time Taken (Days)), Recovery Rate (>0), Realisation of Assets and Amount due to Creditors.

Data used in the analysis

A total of 721 cases of CDs opted for voluntary liquidation across the country resulted in VLP ending with the order of dissolution as of December 31, 2023. However, one case has been excluded due to insufficiency of data available. The balance 720 cases have been used in our study for the multivariate linear regression analysis to find out the required predictive model.

Descriptive statistics

The central focus of this research is “Time Taken (Days)”, i.e., the process time for different VLPs. In present case, it is time taken (days) for the VLP process ending in dissolution.However, as indicated above, in order to improve the regression model the dependent variable has been transformed by taking its logarithm to the base 10. So, the dependent variable used in our research analysis is Log10 (time taken (days)).

The process time data for the VLP ending in dissolution process, as represented by the data, is highly skewed towards right side of the mean value of 689.36 days. However, its median value of 587.50 days is lower than the mean value of 689.36. This indicates that that time taken (days) is more on the longer period than the median values. Further, its skewness and kurtosis values are 1.26 and 1.55, which are much higher than for a normal distribution curve. This further indicate that a large number of cases of VLP ending in Dissolution process ends up taking up more days than the mean value. Not surprisingly this dataset has a large range of 55 to 2,357 days. The left hand panel of Table 1 gives a summary descriptive statistics for the nominal data, while the right hand panel gives the summary descriptive statistics for

the standardized data for the 720 voluntary liquidation / dissolution cases studied in our research.

Table 1: Descriptive Statistics based on Normal and Standardised Data for VLP ending in Dissolution

The normal distribution curves for the absolute data and standardized data are presented in Figure 1 and 2. Both the bell curves clearly show that data is skewed and far-tailed towards right side. This clearly indicate that there is inherent tendency in the VLP ending in Dissolutionthattends to be towards a longer dissolution process time.

Time Taken (Days)		Std. Time Taken (Days)	
Mean	689.36	Mean	-0.00
Standard Error	15.06	Standard Error	0.04
Median	587.50	Median	-0.25
Mode	473.00	Mode	-0.54
Standard Deviation	404.21	Standard Deviation	1.00
Sample Variance	1,63,384.04	Sample Variance	1.00
Kurtosis	1.55	Kurtosis	1.55
Skewness	1.26	Skewness	1.26
Range	2,313.00	Range	5.72
Minimum	44.00	Minimum	-1.60
Maximum	2,357.00	Maximum	4.13
Sum	4,96,342.00	Sum	-0.00
Count	720.00	Count	720.00
Largest(1)	2,357.00	Largest(1)	4.13
Smallest(1)	44.00	Smallest(1)	-1.60
Confidence Level (95.0%)	29.57	Confidence Level (95.0%)	0.07

Figure1: Normal distribution of Time Taken (days) for the VLP ending in Dissolution cases

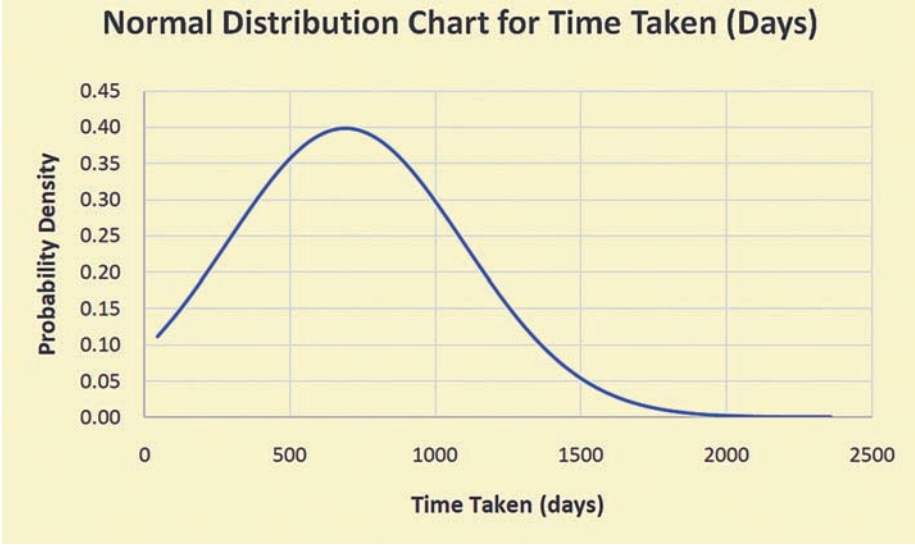
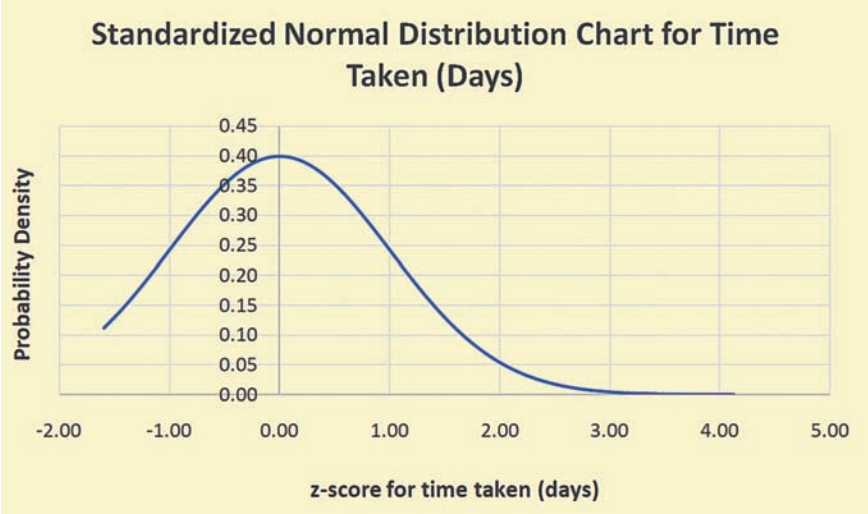


Figure 2: Standardized Normal distribution of Time Taken (days) for the VLP ending in Dissolution cases



Predictive Equation / Model for the time taken (days)

The predictor equation for Log_{10} (Time Taken (days)) obtained from the multivariate regression analysis conducted for the three independent variables is as below:

Log_{10} (Time Taken (days)) = 2.6486 + 0.1235 * Recovery Rate (>0) + (-0.0002) * Realisation of Assets + 0.0338 * Amount due to Creditors ***- Equation no.1***

The three independent variables used to build the predictor equation for the *logarithm (to the base of 10) of Time Taken in days are Recovery Rate (>0), Realisation of Assets, and Amount due to Creditors*. The default or the baseline independent variables are Recovery Rate (<0), nil Realisation of Assets and nil Amount due to Creditors.

Statistical significance of the predictive / Regression model

The multivariate regression equation no. 1 has moderately weak relation as explained by a moderate Multiple R of 13.06%, R Square of 1.70% and Adjusted R Square of 1.29%. However, the model has a relatively significant value of standard error of 0.2521. These statistics are not surprising given the skewed database we have at our disposal. Nevertheless, these statistics provide relevant insights into the dissolution process time. However, low standard errorand high standard deviation indicate mean to have good predictive power, though with somewhat high variability.These values are given in the Table 3.

Table 2: Regression Statistics of the multivariate regression equation for the VLP ending in Dissolution process.

Regression Statistics	
Multiple R	0.1306
R Square	0.0170
Adjusted R Square	0.0129
Standard Error	0.2521
Observations	720

Analysis of variance

The model has a moderate value of F-statistics at 4.1387 and negligible value of significance F indicates statistically moderately significant relation between the dependent and independent variables. These details are given at Table 3.

Table 3: ANOVA (Analysis of Variance Analysis) details

ANOVA

	df	SS	MS	F	Significance F
Regression	3	0.789386819	0.26312894	4.138712785	0.006368684
Residual	716	45.52147748	0.063577483		
Total	719	46.31086429			

Statistical significance of individual independent variables

The independent variables used in the analysis are Recovery Rate (>0), Realisation of Assets, and Amount due to Creditors. Given small p-value of 0.43%, Recovery Rate (>0) is a positive significant variable with strong effect on the predictive model, while Realisation of Assets and Amount due to Creditors are insignificant with their p-values more than 5%. The regression output data with coefficients, standard errors, t-statistics, p-values, and confidence intervals are detailed in the Table 4.

Table 4: Regression coefficients and other statistics for independent variables

Variables	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	2.6486	0.0420	63.0250	0.0000	2.5661	2.7311
Recovery Rate (>0)	0.1235	0.0431	2.8630	0.0043	0.0388	0.2082
Realisation of Assets	-0.0002	0.0001	-1.7459	0.0813	-0.0004	0.0000
Amount due to Creditors	0.0338	0.0212	1.5916	0.1119	-0.0079	0.0754

Unique paths of the VLP ending in dissolution predictive model

Unique paths of VLP ending in dissolution are defined by different states of independent variables, viz., Recovery Rate, Realisation of Assets, and Amount due to Creditors. In this section we discuss such unique paths and understand the impact on the dependent variable, i.e., time taken (days).

1. Defining unique paths of VLP process ending in dissolution – There are two different states for each of the three independent variables, viz., Recovery Rate, Realisation of Assets and Amount due to Creditors. These different states of three independent variables lead to eight (8) unique VLP process paths. Each of these unique paths have different process time.

2. The eight unique VLP paths ending in dissolution are detailed below:

   a. Unique VLP Path#1: Recovery Rate (>0)+Realisation of Assets (>0) +Amount due to Creditors (>0)

   b. Unique VLP Path#2:Recovery Rate (>0)+Realisation of Assets (>0)+Amount due to Creditors (<=0)

   c. Unique VLP Path#3:Recovery Rate (>0)+Realisation of Assets (<=0)+Amount due to Creditors (>0)

   d. Unique VLP Path#4:Recovery Rate (>0)+Realisation of Assets (<=0)+Amount due to Creditors (<=0)

   e. Unique VLP Path#5: Recovery Rate (<=0) + Realisation of Assets (>0) + Amount due to Creditors (>0)

   f. Unique VLP Path#6: Recovery Rate (<=0) + Realisation of Assets (>0) + Amount due to Creditors (<=0)

   g. Unique VLP Path#7: Recovery Rate (<=0) + Realisation of Assets (<=0) + Amount due to Creditors (>0)

   h. Unique VLP Path#8: Recovery Rate (<=0)+ Realisation of Assets (<=0) + Amount due to Creditors (<=0)

3. The default case of VLP ending in dissolution – It is the case of VLP ending in dissolution in which the VLP hasrecovery rate less than equal to zero, nil realisation of assets and nil amount due to their respective creditors. This is unique VLP path no.8 discussed below. There are 27 such default cases. The prediction equation for such cases is as below:

   Log_{10} (Time Taken (days)) = 2.6486 + 0.1235 * Recovery Rate (>0) + (-0.0002) * 0 + 0.0338 * 0

   For such cases of VLP ending in dissolution / voluntary liquidation, the predicted value of Log_{10} (Time Taken (days)) is 2.6486. In absolute term, the predicted value of default case of VLP proceedings ending in dissolution for time taken (days) is 445.23 (~ 446) days.

4. The longest and shortest unique VLP process paths ending in dissolution: These eight unique VLP paths have been studied and predicted values based on multivariate regression model coefficients have been computed and presented at Table 5. The authors find that the unique VLP path involving a positive recovery ratio, zero or no realisation of assets and a positive amount due to creditors, has the longest VLP process time (i.e., unique path no. 3), followed by the unique VLP path involving a positive recovery ratio, a positive realisation of assets and a positive amount due to creditors, has the second longest VLP process time (i.e., unique path no.1). On the other hand, the unique VLP path involving a zero or less than zero recovery ratio, a positive realisation of assets and zero amount due to creditors, has the lowest VLP process time (i.e.,

unique path no.6), followed by the unique VLP path involving a zero or less than zero recovery rate, zero realisation of assets and zero amount due to creditors, has the second lowest VLP process time (i.e., unique path no.8, i.e., the default case). For VLP ending in dissolution processes, the longest VLP process time (time taken (days), the second longest VLP process time, the lowest VLP process time and the second lowest VLP process time are ~640 days, ~640 days, ~446 days and ~446 days respectively. It may be noted cases involving a positive realisation of asset has marginally lower process time and that's why the lowest and second lowest unique VLP paths ending in dissolution have almost same days of process time.

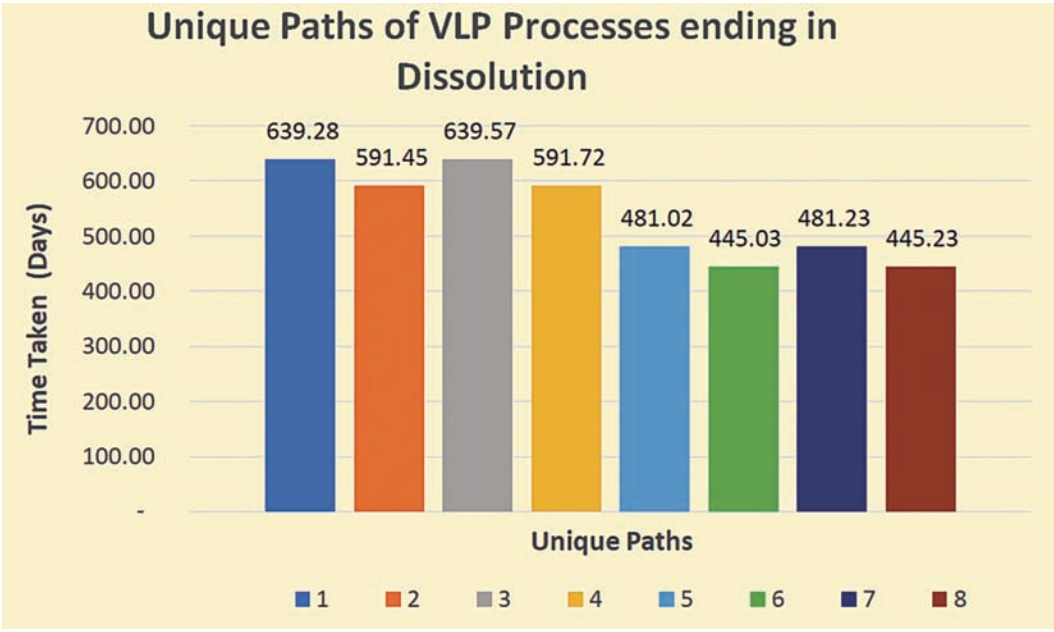
The following Table 5 and Figure 3 give details about all the eight unique VLP paths ending in dissolution.

Table 5: Eight Unique Paths of VLP Processes ending in Dissolution

Unique Paths of CIRP Processes ending in Dissolution (Voluntary Liquidation)									
Path No. →		1	2	3	4	5	6	7	8
Variables	Coefficients	Recovery Rate (>0)				Recovery Rate (<=0)			
Intercept	2.6486	1	1	1	1	1	1	1	1
Recovery Rate (>0)	0.1235	1	1	1	1	0	0	0	0
Realisation of Assets	-0.0002	1	1	0	0	1	1	0	0
Amount due to Creditors	0.0338	1	0	1	0	1	0	1	0
Log_{10} (Time Taken (Days))		2.81	2.77	2.81	2.77	2.68	2.65	2.68	2.65
Time Taken (Days)		639.28	591.45	639.57	591.72	481.02	445.03	481.23	445.23

It is noteworthy that with positive Recovery Rate (>0) the VLP process gets longer by ~150 days across all unique paths.

Figure 3: Time Taken (Days) for Unique Paths of VLP Processes ending in Dissolution



Thus, the authors find that when Recovery Rate >0 and Amount due to Creditors > 0, then Time Taken (Days) for VLP ending in Dissolution goes up by ~36 to ~48 days. This indicates that there is some inter-stakeholder friction between the CD and FC or the CD and OC.As these are beyond the scope of current research study, the subject of another research could be to study processes related to Realisation of Assets associated with Recovery Rate and mechanism of due amount payment to Creditors deeply.

CORPORATE INSOLVENCY RESOLUTION PROCESSES ENDING IN LIQUIDATION

In this section the authors study, analyse and develop the predictive model for the CIRPsending in Liquidation. This process is initiated upon a default of ₹1 Cr. In absence of any viable resolution plan, liquidation process is initiated.

Data variables

The dependent variable or the response variable of study is time taken (days) for the CIRP process time, and defined as below:

1. Time taken (days) or process time: Number of days between the date of NCLT order approving resolution and date of commencement of insolvency.
    a. Data transformation: However, in order to improve the regression model the dependent variable has been transformed by taking its logarithm to the base 10. So, the dependent variable used in the research analysis is Log_{10} (time taken (days)).

For the research study, the authors have identified several factors which may have impact on the dependent variable, time taken (days). Such factors are – who initiates the CIRP, what is the operational status of the CD, what is the value of recovery rate, and the location of the NCLT bench where the CIRP has been initiated.

The following list further delineates the identifiedindependent variables used in our empirical research and analysis work:

1. Triggered by: CD, Financial Creditor (FC), and OC.
2. Defunct: Yes or No, i.e., whether the CD is defunct or operational.
3. Recovery rate: It is the ratio of liquidation value to the total admitted claims, as defined below
    a. Resolution value proposed: The highest resolution value proposed in the Committee of Creditors approved resolution plan.
    b. Total admitted claims: It is total of admitted claims of the respective FC and OCs of the concerned CD.
4. NCLT Bench:There are 15 NCLT benches in which insolvency and bankruptcy including CIRP related proceedings are carried out. These are Allahabad (43 cases), Bengaluru (92 cases), Chennai (335 cases), Hyderabad (174 cases), Kolkata (267 cases), Mumbai (558 cases), New Delhi (420 cases), Ahmedabad (237 cases), Amaravati (29 cases),

Chandigarh (89 cases), Jaipur (34 cases), Kochi (32 cases), Cuttack (21 cases), Guwahati (13 cases), and Indore (9 cases).

Thus, variables included in this part of analysis are Time Taken (Days), Triggered by, Defunct, Recovery Rate and NCLT Bench.

Data used in the analysis

A total of 2,376 cases of CDs admitted with various NCLT benches across the country resulted in CIRP ending with the order of Liquidation as of December 31, 2023. On further examination 23 of these 2,376 CDs have been excluded from the analysis for want of data sufficiency and the rest 2,353 cases were used for the multivariate linear regression analysis.

Descriptive statistics

As the central focus of this research is "Time Taken (Days)", i.e., the process time for different CIRP processes. In present case, it istime taken (days) for the CIRPs ending in Liquidation.The process time for the liquidation CIRP process, as represented by the data, is highly skewed towards right side of the mean value of 483.05 days. Its skewness and kurtosis values are 1.69 and 3.32, which are much higher than for a normal distribution curve. This indicate that a large number of cases of CIRPsending in liquidation ends up taking up more days than the mean value. Not surprisingly this dataset has a large range of 0 to 2,297 days. The left hand panel of Table 6 gives a summary descriptive statistics for the nominal data, while the right hand panel gives the summary descriptive statistics for the standardized data for the 2,353 cases studied in the research.

Table 6: Descriptive Statistics

Time Taken (Days)		Std. Time Taken (Days)	
Mean	483.05	Mean	-0.00
Standard Error	6.65	Standard Error	0.02
Median	384.00	Median	-0.31
Mode	350.00	Mode	-0.41
Standard Deviation	322.79	Standard Deviation	1.00
Sample Variance	1,04,195.68	Sample Variance	1.00
Kurtosis	3.32	Kurtosis	3.32
Skewness	1.69	Skewness	1.69
Range	2,297.00	Range	7.12
Minimum	-	Minimum	-1.50
Maximum	2,297.00	Maximum	5.62
Sum	11,36,628.00	Sum	-0.00
Count	2,353.00	Count	2,353.00
Largest(1)	2,297.00	Largest(1)	5.62
Smallest(1)	-	Smallest(1)	-1.50
Confidence Level (95.0%)	13.05	Confidence Level (95.0%)	0.04

The normal distribution curve for the absolute data and standardized data are presented in Figure 4 and Figure 5. Both the bell curves clearly show that data is skewed and far-tailed towards right side. This clearly indicate that there is inherent tendency in the CIRPs ending in liquidation towards a longer process time. However, the data distribution despite having low standard error and relatively low standard deviation, CIRP-Liquidation has highest values of kurtosis and skewness amongst all the three processes studied in this research paper.Further, such high kurtosis and skewness indicate presence of idiosyncratic process attributes associated with CIRP-Liquidation.

Figure 4: Normal distribution of Time Taken (days) for the dissolution CIRP cases

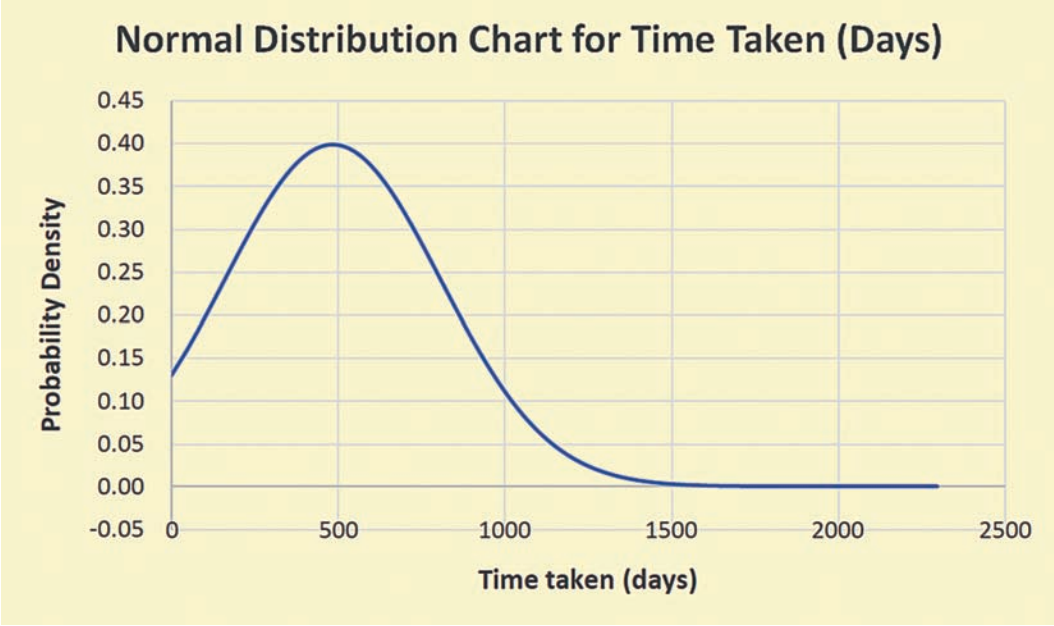
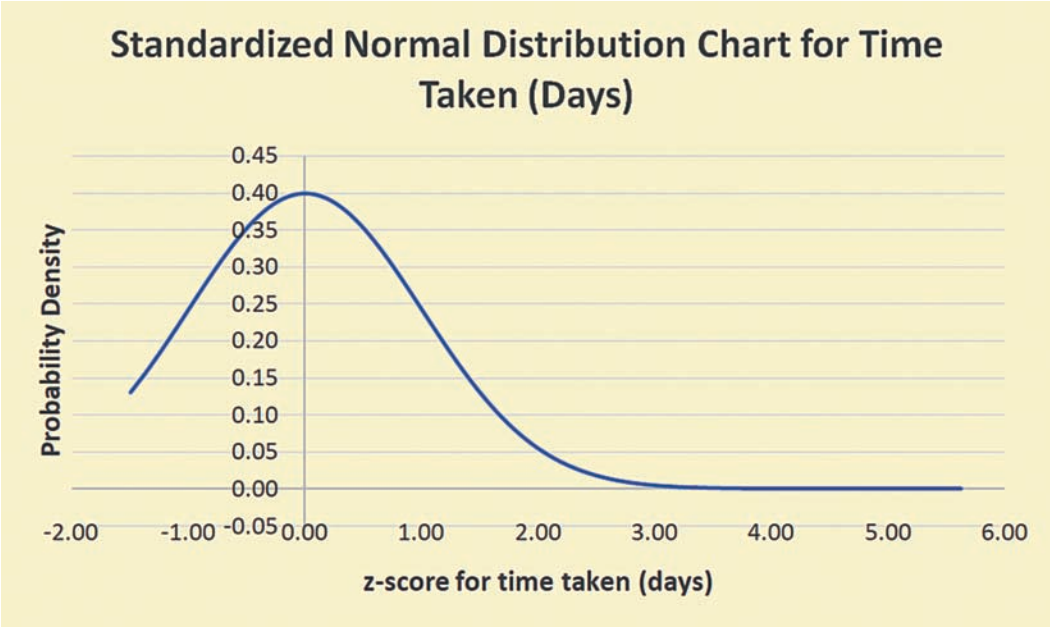


Figure 5: Standardized Normal distribution of Time Taken (days) for the dissolution CIRP cases



Predictive equation / Model for the time taken (days)

The predictor equation / model for time taken (days) obtained from the multivariate regression analysis conducted for the 16 independent variablesis as below:

Log_{10} (Time Taken (days)) = 2.492 + 0.0847 * FC + 0.0785 * OC + (-0.0534) * Defunct + 0.1675 * Recovery Rate + 0.0668 * Ahmedabad + 0.1923 * Allahabad + 0.0114 * Amaravati + (-0.0904) * Bengaluru + 0.0747 * Chandigarh + 0.0129 * Chennai + 0.0172 * Hyderabad + 0.1292 * Jaipur + 0.0487 * Kochi + 0.0077 * Kolkata + 0.1541 * Mumbai + 0.0921 * New Delhi - Equation no.2

The 16 independent variables used to build the predictor equation for the dependent variable *–logarithm (to the base of 10) of Time Taken in days are FC (Financial Creditor) and OC (Operational Creditor) for the factor Triggered by, Defunct (Yes), Recovery Rate for the realisation value achieved through liquidation to the total admitted claim value, and for location factor - Ahmedabad NCLT bench, Allahabad NCLT bench, Amaravati NCLT bench, Bengaluru NCLT bench, Chandigarh NCLT bench, ChennaiNCLT bench, Hyderabad NCLT bench, Jaipur NCLT bench, Kochi NCLT bench, Kolkata NCLT bench, Mumbai NCLT bench, and New Delhi NCLT bench.*

The default or the baseline independent variables are CD – *Corporate Debtor* for Triggered by, No for Defunct, and Cuttack, Guwahati, and Indore for NCLT benches.

Statistical significance of the predictive / regression model

The multivariate regression equation / model above has moderately strong relation as explained by a high multiple R of 30.25%, R square of 9.15% and Adjusted R Square of 8.53%. The strength is further exhibited by a quitesmall value of standard error of 0.2573. These values are given in the Table 7.

Table 7: Regression Statistics of the first cut multiple regression equation.

Regression Statistics	
Multiple R	0.302466034
R Square	0.091485701
Adjusted R Square	0.085263001
Standard Error	0.257348271
Observations	2353

Analysis of variance

The model has a high value of F-statistics at 14.7019 and nil value of significance F indicate statistically strong relation between the dependent and independent variables. These details are given at Table 8.

Table 8: ANOVA (Analysis of Variance Analysis) details

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	16	15.57890053	0.973681283	14.70192867	7.36911E-39
Residual	2336	154.708918	0.066228133		
Total	2352	170.2878186			

Statistical significance of individual independent variables

The FC, OC and recovery rate have significant positive coefficient of 0.0847, 0.0785 and 0.1675 respectively and the operational status of defunct has significant negative coefficient of -0.0534 and so they have impact on predictive model. The independent variables like FC (Financial Creditor), OC (Operational Creditor), Defunct operational status, Recovery Rate, and NCLT benches of Allahabad, Bengaluru, Jaipur, Mumbai and New Delhi are all statistically significant with their p values less than 0.05 (except Bengaluru, which is a borderline case). Other NCLT benches like Ahmedabad, Amaravati, Chandigarh, Chennai, Hyderabad, Kochi and Kolkata, are having p-values more than 0.05. But that does not mean that they are statistically insignificant in predicting a meaningful value for the Time Taken (Days) for that particular NCLT bench, as all of them are having small standard errors. The regression output data with coefficients, standard errors, t-statistics, p-values, and confidence intervals are detailed in the Table 9.

Table 9: Regression coefficients and other statistics for independent variables

Variables	*Coefficients*	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	2.4920	0.0426	58.5211	-	2.4085	2.5755
FC	0.0847	0.0185	4.5838	0.0000	0.0484	0.1209
OC	0.0785	0.0186	4.2223	0.0000	0.0420	0.1149
Defunct	-0.0534	0.0129	-4.1393	0.0000	-0.0787	-0.0281
Recovery Rate	0.1675	0.0304	5.5080	0.0000	0.1079	0.2271
Ahmedabad	0.0668	0.0428	1.5619	0.1184	-0.0171	0.1507
Allahabad	0.1923	0.0556	3.4579	0.0006	0.0833	0.3014
Amaravati	0.0114	0.0621	0.1831	0.8547	-0.1105	0.1332
Bengaluru	-0.0904	0.0476	-1.8965	0.0580	-0.1838	0.0031
Chandigarh	0.0747	0.0479	1.5596	0.1190	-0.0192	0.1686
Chennai	0.0129	0.0419	0.3067	0.7591	-0.0693	0.0950
Hyderabad	0.0172	0.0440	0.3900	0.6966	-0.0691	0.1034
Jaipur	0.1292	0.0593	2.1780	0.0295	0.0129	0.2456
Kochi	0.0487	0.0606	0.8040	0.4215	-0.0701	0.1675
Kolkata	0.0077	0.0425	0.1817	0.8559	-0.0756	0.0910
Mumbai	0.1541	0.0410	3.7621	0.0002	0.0738	0.2344
New Delhi	0.0921	0.0415	2.2215	0.0264	0.0108	0.1734

Unique paths of the CIRPs ending in liquidation predictiveequation / model

1. Default case of CIRPs ending in liquidation – It is the case of CIRP ending in liquidation in which the CIRP has been applied by the CD, the applicant CD is Operational (Defunct

– No), and the process has been tried in one of these NCLT benches – Amaravarit, Cuttack, Guwahati, and Indore, and has no Resolution Value, i.e., no resolution plan has been received by the AA (the concerned NCLT bench).So, these are cases where operational (Defunct – No) Corporate Debtors (CD) who have filed for insolvency and bankruptcy with either of Amaravarit, Cuttack, Guwahati, or Indore NCLT benches, and did not receive any resolution plan during the CIRP process before the order of liquidation was passed by the concerned. The prediction equation for such default cases is as below:

$$\mathbf{Log_{10}(Time\ Taken\ (days)) = 2.492 + 0.0847 * 0 + 0.0785 * 0 + (-0.0534) * 0 + 0.1675 * 0 + 0.0668 * 0 + 0.1923 * 0 + 0.0114 * 0 + (-0.0904) * 0 + 0.0747 * 0 + 0.0129 * 0 + 0.0172 * 0 + 0.1292 * 0 + 0.0487 * 0 + 0.0077 * 0 + 0.1541 * 0 + 0.0921 * 0}$$

For such default cases of CIRP ending in Liquidation, the predicted value of Log10(Time Taken (days)) is 2.492. In absolute term, the predicted value of Time Taken (Days) is 310.45 (~ 311) days.

2. Unique paths of CIRP process ending in Liquidation for each NCLT Bench – There are three different states for the independent variable "Triggered by" – FC, OC and CD (default), two different states for "Defunct" – Yes and No (default), and two different states for "Recovery Rate" – Yes and No (default). These different states lead to 12 unique CIRP process paths for any given NCLT bench. Each of these unique paths have different process time.

These 12 unique CIRP paths for a given NCLT bench are as below:

a. Unique CIRP Path#1: Triggered by FC + Defunct CD + Recovery

b. Unique CIRP Path#2: Triggered by FC + Defunct CD + No Recovery

c. Unique CIRP Path#3: Triggered by FC + Not Defunct CD + Recovery

d. Unique CIRP Path#4: Triggered by FC + Not Defunct CD + No Recovery

e. Unique CIRP Path#5: Triggered by OC + Defunct CD + Recovery

f. Unique CIRP Path#6: Triggered by OC + Defunct CD + No Recovery

g. Unique CIRP Path#7: Triggered by OC + Not Defunct CD + Recovery

h. Unique CIRP Path#8: Triggered by OC + Not Defunct CD + No Recovery

i. Unique CIRP Path#9: Triggered by CD + Defunct CD + Recovery

j. Unique CIRP Path#10: Triggered by CD + Defunct CD + No Recovery

k. Unique CIRP Path#11: Triggered by CD + Not Defunct CD + Recovery

l. Unique CIRP Path#12: Triggered by CD + Not Defunct CD + No Recovery

These 12 unique CIRP paths for Mumbai and New Delhi NCLT benches have been studied and predicted values based on regression model coefficients have been computed and presented

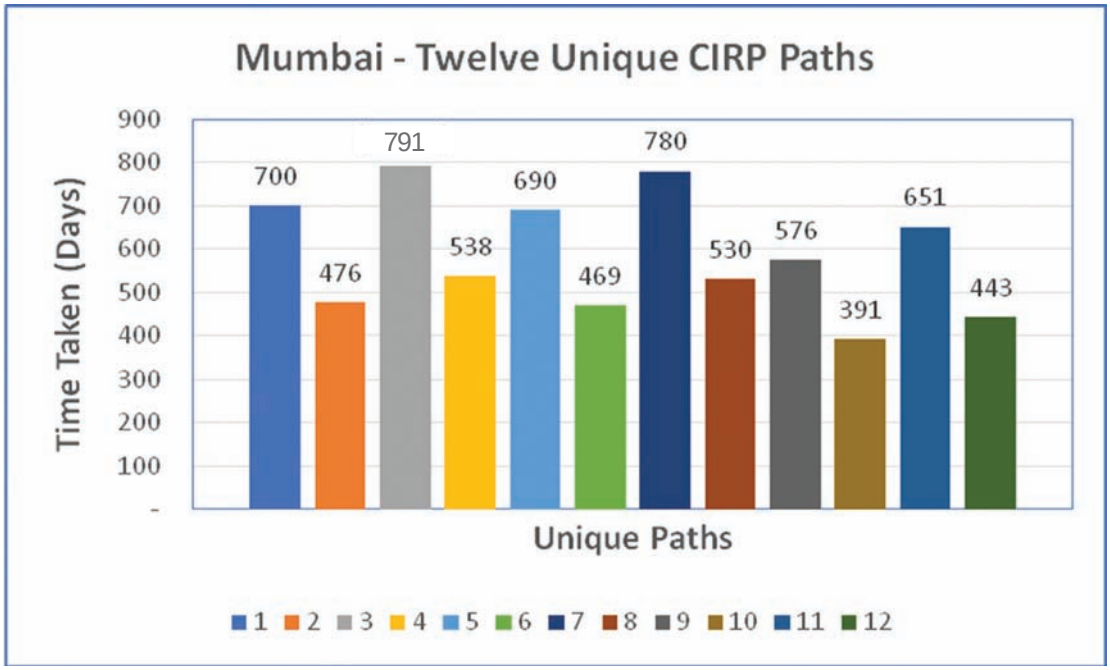
at Table 10 and 11. The authors find that the unique CIRP path triggered by FC for a Non-Defunct CD with positive recovery ratio has the longest CIRP process time (i.e., unique path no.3), followed by the unique CIRP path triggered by OC for a Non-Defunct CD with positive recovery ratio has the second longest CIRP process time (i.e., unique path no.7). On the other hand, the unique CIRP path triggered by CD itself for a Defunct CD with no Recovery has the lowest CIRP process time (i.e., unique path no.10), followed by the unique CIRP path triggered by CD itself for a Non-Defunct CD with no recovery has the second lowest CIRP process time (i.e., unique path no.12). For Mumbai NCLT bench the values (rounded up to the next day for practical purpose) for the longest CIRP process time (time taken (days), the second longest CIRP process time, the lowest CIRP process time and the second lowest CIRP process time are ~792 days, ~780 days, ~392 days and ~443 days respectively.

The following tables and figures are giving details about all the 12 unique CIRP paths for Mumbai and New Delhi.

Table 10: Predicted values of Time Taken (Days) for 12 Unique Paths for CIRP ending with Liquidation at Mumbai NCLT bench

Mumbai NCLT Bench													
Path No. →		1	2	3	4	5	6	7	8	9	10	11	12
Variables	Coefficients	Triggered by FC				Triggered by OC				Triggered by CD			
Intercept	2.4920	1	1	1	1	1	1	1	1	1	1	1	1
FC	0.0847	1	1	1	1	0	0	0	0	0	0	0	0
OC	0.0785	0	0	0	0	1	1	1	1	0	0	0	0
Defunct	-0.0534	1	1	0	0	1	1	0	0	1	1	0	0
Recovery Rate	0.1675	1	0	1	0	1	0	1	0	1	0	1	0
Ahmedabad	0.0668	0	0	0	0	0	0	0	0	0	0	0	0
Allahabad	0.1923	0	0	0	0	0	0	0	0	0	0	0	0
Amaravati	0.0114	0	0	0	0	0	0	0	0	0	0	0	0
Bengaluru	-0.0904	0	0	0	0	0	0	0	0	0	0	0	0
Chandigarh	0.0747	0	0	0	0	0	0	0	0	0	0	0	0
Chennai	0.0129	0	0	0	0	0	0	0	0	0	0	0	0
Hyderabad	0.0172	0	0	0	0	0	0	0	0	0	0	0	0
Jaipur	0.1292	0	0	0	0	0	0	0	0	0	0	0	0
Kochi	0.0487	0	0	0	0	0	0	0	0	0	0	0	0
Kolkata	0.0077	0	0	0	0	0	0	0	0	0	0	0	0
Mumbai	0.1541	1	1	1	1	1	1	1	1	1	1	1	1
New Delhi	0.0921	0	0	0	0	0	0	0	0	0	0	0	0
Log_{10} (Time Taken (Days))		2.84	2.68	2.90	2.73	2.84	2.67	2.89	2.72	2.76	2.59	2.81	2.65
Time Taken (Days)		699.57	475.70	791.08	537.93	689.65	468.95	779.86	530.30	575.66	391.44	650.96	442.64

Figure 6: Twelve Unique CIRP Paths Displaying High Variation in Time Taken (Days) for Mumbai NCLT Bench

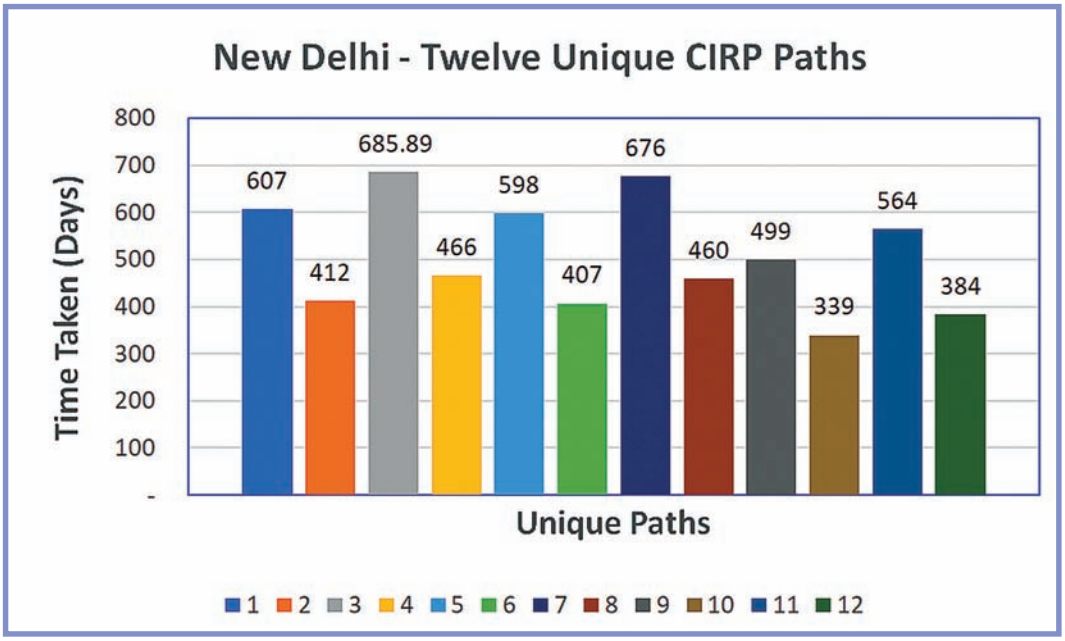


Whereas for New Delhi NCLT bench, the values for the longest CIRP process time (time taken (days), the second longest CIRP process time, the lowest CIRP process time and the second lowest CIRP process time are ~686 days, ~677 days, ~340 days and ~384 days respectively.

Table 11: Predicted values of Time Taken (Days) for 12 Unique Paths for CIRP ending with Liquidation at New Delhi NCLT bench

		New Delhi											
Path No. →		1	2	3	4	5	6	7	8	9	10	11	12
Variables	Coefficients	Triggered by FC				Triggered by OC				Triggered by CD			
Intercept	2.4920	1	1	1	1	1	1	1	1	1	1	1	1
FC	0.0847	1	1	1	1	0	0	0	0	0	0	0	0
OC	0.0785	0	0	0	0	1	1	1	1	0	0	0	0
Defunct	-0.0534	1	1	0	0	1	1	0	0	1	1	0	0
Recovery Rate	0.1675	1	0	1	0	1	0	1	0	1	0	1	0
Ahmedabad	0.0668	0	0	0	0	0	0	0	0	0	0	0	0
Allahabad	0.1923	0	0	0	0	0	0	0	0	0	0	0	0
Amaravati	0.0114	0	0	0	0	0	0	0	0	0	0	0	0
Bengaluru	-0.0904	0	0	0	0	0	0	0	0	0	0	0	0
Chandigarh	0.0747	0	0	0	0	0	0	0	0	0	0	0	0
Chennai	0.0129	0	0	0	0	0	0	0	0	0	0	0	0
Hyderabad	0.0172	0	0	0	0	0	0	0	0	0	0	0	0
Jaipur	0.1292	0	0	0	0	0	0	0	0	0	0	0	0
Kochi	0.0487	0	0	0	0	0	0	0	0	0	0	0	0
Kolkata	0.0077	0	0	0	0	0	0	0	0	0	0	0	0
Mumbai	0.1541	0	0	0	0	0	0	0	0	0	0	0	0
New Delhi	0.0921	1	1	1	1	1	1	1	1	1	1	1	1
Log_{10} (Time Taken (Days))		2.78	2.62	2.84	2.67	2.78	2.61	2.83	2.66	2.70	2.53	2.75	2.58
Time Taken (Days)		606.55	412.45	685.89	466.40	597.95	406.60	676.16	459.78	499.11	339.39	564.40	383.78

Figure 7: Twelve Unique CIRP Paths Displaying High Variation in Time Taken (Days) for New Delhi NCLT Bench



Thus, the impact of location is easily identifiable when we look at CIRP-Liquidation times with similar characteristics at Mumbai and Delhi NCLT benches –there us a difference of 52 to 105 days. That is with change in the location from Mumbai NCLT to Delhi NCLT bench, the CIRP processes ending in Liquidation gets shorter by a whopping 52 - 105 days (almost 2 to 3 months). Further, on an average, the time taken for OC triggered cases is 80+ days and 8+ days longer than CD and FC triggered processes.This indicates inter-stakeholder frictions.Hence, it becomes imperative to study location and inter-stakeholder interaction specific process characteristics deeply.

Such 12 unique CIRP paths also exist for other NCLT benches. The prediction model / equation no. 2 can be used to identify these paths and find the respective predictive values.

CORPORATE INSOLVENCY RESOLUTION PROCESSES YIELDING RESOLUTION PLANS

In this section the authors study, analyse and develop the predictive model for the CIRP processes ending in Resolution Plan.This process is initiated upon a default of ₹1 Cr. A viable resolution plan approved, which is implemented thereafter.

Data variables

The dependent variable or the response variable of study is time taken (days) for the CIRP process ending in resolution plan, defined as below:

1. Time taken (days) or process time: Number of days between the date of NCLT order approving resolution and date of commencement of insolvency.

    a. Data transformation: However, in order to improve the regression model the dependent variable has been transformed by taking its logarithm to the base 10.

So, the dependent variable used in our research analysis is Log10 (time taken (days)).

Following is the list of independent variables used in our empirical research and analysis work:

2. Triggered by: CD, FC, and OCs.

3. Defunct: Yes or No, i.e., whether the CD is defunct or operational.

4. Recovery rate: It is the ratio of the total realisable amount to the total admitted Claims, as defined below

   a. Total realisable amount: It is total of realisable amounts by the respective FCs and OCs of the concerned CD.

      i. Realisable amount by FCs: It is the realisable amount by the respective FCs of the concerned Corporate Debtor.

      ii. Realisable amount by OCs: It is the realisable amount by the respective OCs of the concerned Corporate Debtor.

   b. Total admitted claims: It is total of admitted claims of the respective FC and OCs of the concerned Corporate Debtor.

5. NCLT Bench: Ahmedabad, Allahabad, Amaravati, Bengaluru, Chandigarh, Chennai, Cuttack, Guwahati, Hyderabad, Jaipur, Indore, Kochi, Kolkata, Mumbai, and New Delhi.

Thus our variables are time taken (days), Triggered by, Defunct, Recovery Rate and various NCLT Bench locations.

Data used in the analysis

A total of 891 cases of CDs admitted with various NCLT benches across the country resulted in CIRP ending with the order of approvedresolution plan as of December 31, 2023. 15 of these 891 Corporate Debtors have been excluded from the analysis for want of data sufficiency and the rest 876 cases were used for the multivariate linear regression analysis and development of predictive model / equation.

Descriptive statistics

Like in two above CIRP processes (dissolution and liquidation), the central focus of this research is “Time Taken (Days)”, i.e., the process time for different CIRP processes. In present case, it is time taken (days) for the CIRP process ending in approved resolution plan.

The process time data for the resolution CIRP process, as represented by the data, is highly skewed towards right side of the mean value of 666.00 days. Its skewness and kurtosis values are 1.17 and 1.21, which are higher than for a normal distribution curve. This indicate that a large number of cases of resolution CIRP process ends up taking up more days than the mean value. Not surprisingly this dataset has a large range of 119 to 2,227 days. However, comparatively low standard error with relatively low standard deviation, predictability power of mean is better. In comparison to VLP and CIRP-liquidation, CIRP-resolution has lower values of kurtosis and skewness, indicating more normal bell curve than VLP and CIRP-Liquidation processes.The left hand panel of Table12 gives a summary descriptive statistics

for the nominal data, while the right hand panel gives the summary descriptive statistics for the standardized data for the 876 cases studied in our research.

Table 12

Time Taken (Days)		Std. Time Taken (Days)	
Mean	666.00	Mean	0.00
Standard Error	12.36	Standard Error	0.03
Median	563.00	Median	-0.28
Mode	420.00	Mode	-0.67
Standard Deviation	365.86	Standard Deviation	1.00
Sample Variance	1,33,855.81	Sample Variance	1.00
Kurtosis	1.21	Kurtosis	1.21
Skewness	1.17	Skewness	1.17
Range	2,108.00	Range	5.76
Minimum	119.00	Minimum	-1.50
Maximum	2,227.00	Maximum	4.27
Sum	5,83,412.00	Sum	0.00
Count	876.00	Count	876.00
Largest (1)	2,227.00	Largest (1)	4.27
Smallest (1)	119.00	Smallest (1)	-1.50
Confidence Level (95.0%)	24.26	Confidence Level (95.0%)	0.07

The normal distribution curve for the absolute data and standardized data are presented in Figure 8 and 9. Both the bell curves clearly show that data is skewed and far-tailed towards right side. This clearly indicate that there is inherent tendency in the resolution of CIRP towards a longer process time. However, CIRP-Resolution bell curves are less skewed, which indicates the process is relatively more controlled than other two processes.

Figure 8: Normal distribution of Time Taken (days) for the dissolution CIRP cases

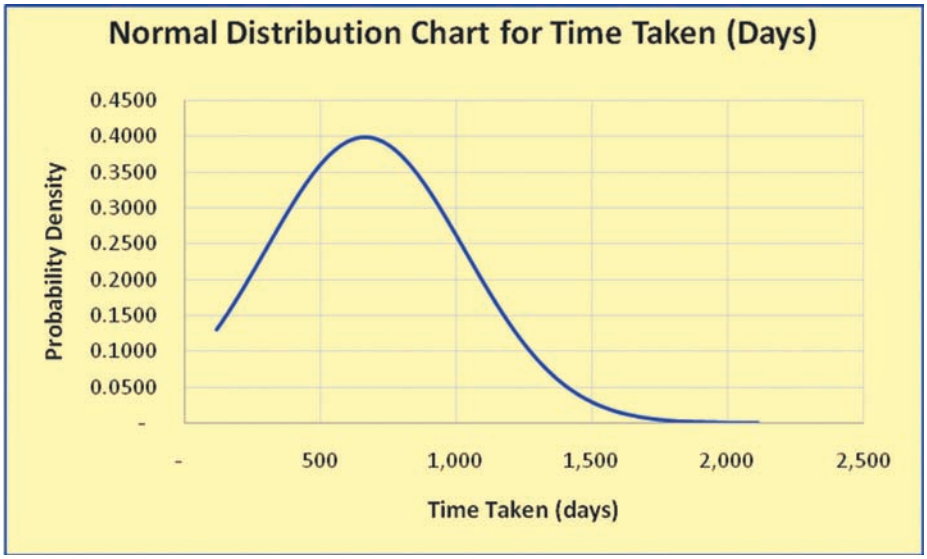
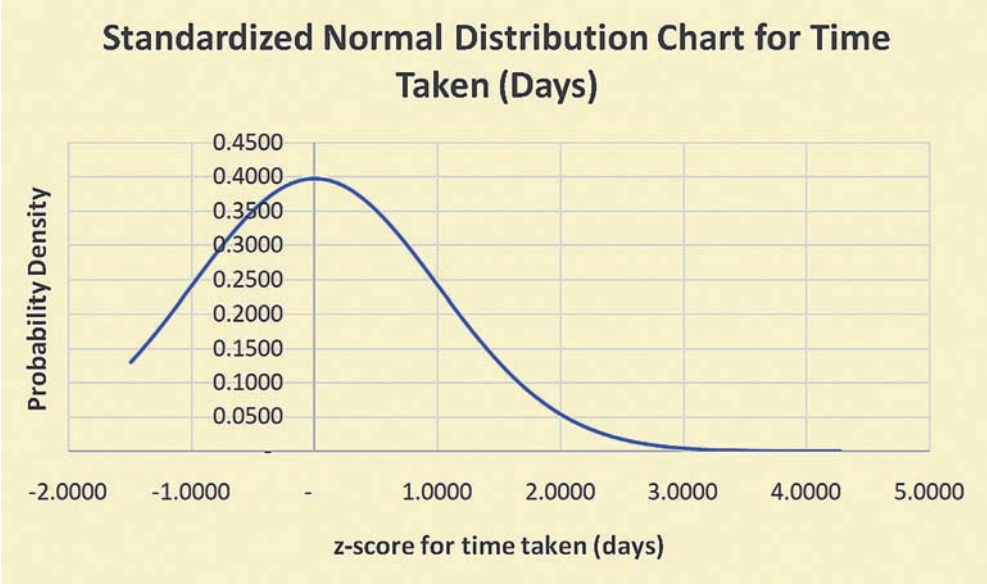


Figure 9: Standardized Normal distribution of Time Taken (days) for the dissolution CIRP cases



Predictive equation / Model for the time taken (days)

The predictor equation for the log10 (time taken (days)) obtained from the multivariate regression analysis conducted for the 16 independent variables is as below:

Log_{10} (Time Taken (days)) = 2.5726 + 0.0762 * FC + 0.0864 * OC + (-0.0002) * Defunct + (-0.1034) * Recovery Rate + 0.1411 * Ahmedabad + 0.2434 * Allahabad + 0.001 * Bengaluru + 0.1809 * Chandigarh + 0.1182 * Chennai + 0.2252 * Cuttack + 0.0961 * Hyderabad + 0.0069 * Jaipur + 0.0306 * Kochi + 0.0831 * Kolkata + 0.2253 * Mumbai + 0.1971 * New Delhi ***- Equation no.3***

The 16 independent variables used to build the predictor equation for the logarithm (to the base of 10) of Time Taken in days are FC (Financial Creditor) and OC (Operational Creditor) for the factor Triggered by, Defunct (Yes), Recovery Rate for the realisation value achieved through liquidation to the total admitted claim value, and for location factor - Ahmedabad NCLT bench, Allahabad NCLT bench, Bengaluru NCLT bench, Chandigarh NCLT bench, Chennai NCLT bench, Cuttack NCLT bench, Hyderabad NCLT bench, Jaipur NCLT bench, Kochi NCLT bench, Kolkata NCLT bench, Mumbai NCLT bench, and New Delhi NCLT bench.

The default or the baseline independent variables are CD – Corporate Debtor (Triggered by), No (Defunct), and NCLT benches – Amaravati, Guwahati, and Indore.

Statistical significance of the predictive / Regression Model

The multivariate regression equation above has strong relation as explained by a high multiple R of 34.17%, R Square of 11.68% and Adjusted R Square of 10.03%. The strength is further exhibited by a quite small value of Standard Error of 0.2194. These values are given in the Table 13.

Table 13: Regression Statistics of the first cut multivariate regression equation.

Regression Statistics	
Multiple R	0.3417
R Square	0.1168
Adjusted R Square	0.1003
Standard Error	0.2194
Observations	876

Analysis of variance

The model has a high value of F-statistics at 7.0970 and negligible value of significance F indicates statistically strong relation between the dependent and independent variables. These details are given at Table14.

Table 14: ANOVA (Analysis of Variance Analysis) details

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	16	5.468374695	0.341773418	7.096999229	1.33279E-15
Residual	859	41.36725353	0.048157455		
Total	875	46.83562823			

Statistical significance of individual independent variables

Model factors like FC and OC have significant positive coefficients of 0.0762 and 0.0864 respectively and recovery rate has significant negative coefficient -0.1034. Thus, these factors have significant impact on predictive model. Further, these independent variables like FC, DC, Recovery Rate, and NCLT benches of Ahmedabad, Allahabad, Chandigarh, Chennai, Cuttack, Hyderabad, Mumbai and New Delhi are all statistically significant with their p values less than 0.05. Other variables like Defunct, and NCLT benches like Bengaluru, Hyderabad, Jaipur, Kochi and Kolkata, are having p-values more than 0.05 and therefore are statistically not significant. The regression output data with coefficients, standard errors, t-statistics, p-values, and confidence intervals are detailed in the Table 15.

Table 15: Regression coefficients and other statistics for independent variables

Variables	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	2.5726	0.0519	49.5828	0.0000	2.4707	2.6744
FC	0.0762	0.0285	2.6753	0.0076	0.0203	0.1322
OC	0.0864	0.0298	2.8988	0.0038	0.0279	0.1449
Defunct	-0.0002	0.0155	-0.0146	0.9883	-0.0307	0.0303
Recovery Rate	-0.1034	0.0254	-4.0717	0.0001	-0.1532	-0.0535
Ahmedabad	0.1411	0.0497	2.8373	0.0047	0.0435	0.2386
Allahabad	0.2434	0.0655	3.7138	0.0002	0.1148	0.3720
Bengaluru	0.0010	0.0619	0.0165	0.9868	-0.1205	0.1225
Chandigarh	0.1809	0.0547	3.3092	0.0010	0.0736	0.2883
Chennai	0.1182	0.0518	2.2806	0.0228	0.0165	0.2199
Cuttack	0.2252	0.0823	2.7369	0.0063	0.0637	0.3867
Hyderabad	0.0961	0.0499	1.9245	0.0546	-0.0019	0.1941
Jaipur	0.0069	0.0718	0.0961	0.9235	-0.1340	0.1478
Kochi	0.0306	0.0796	0.3842	0.7009	-0.1256	0.1868
Kolkata	0.0831	0.0489	1.7018	0.0892	-0.0127	0.1790
Mumbai	0.2253	0.0468	4.8118	0.0000	0.1334	0.3172
New Delhi	0.1971	0.0478	4.1267	0.0000	0.1033	0.2908

Predictive equation / Model for and unique paths of the CIRPs ending in resolution

1. Default case of CIRPs ending in Liquidation – It is the case of CIRP ending in resolution in which the CIRP has been applied by the CD, the applicant CD is operational (Defunct – No), and the process has been tried in one of these NCLT benches – Amaravarit, Guwahati, or Indore, and has no zero Recovery Rate as the realisable amount underlying asset is nil. So, these are cases where operational (Defunct – No) Corporate Debtors (CD) has filed for insolvency and bankruptcy with either of Amaravarit, Guwahati, or Indore NCLT benches, and nil Recovery Rate. The prediction equation for such cases is as below:

   Log_{10} (Time Taken (days)) = 2.5726 + 0.0762 * 0 + 0.0864 * 0 + (-0.0002) * 0 + (-0.1034) * 0 + 0.1411 * 0 + 0.2434 * 0 + 0.001 * 0 + 0.1809 * 0 + 0.1182 * 0 + 0.2252 * 0 + 0.0961 * 0 + 0.0069 * 0 + 0.0306 * 0 + 0.0831 * 0 + 0.2253 * 0 + 0.1971 * 0 = 2.5726

   For such cases of CIRP ending in liquidation, the predicted value of Log_{10} (Time Taken (days)) is 2.5726. In absolute term, the predicted value of Time Taken (Days) is 373.74 (~ 374) days.

2. Unique paths of CIRP process ending in Liquidation for each NCLT Bench – There are three different states for the independent variable "Triggered by" – FC, OC and CD (default), two different states for "Defunct" – Yes and No (default), and two different states for "Recovery Rate" – Yes and No (default). These different states lead to 12 unique CIRP process paths for any given NCLT bench. Each of these unique paths have different process time.

These 12 unique CIRP paths for a given NCLT bench are as below:

a. Unique CIRP Path#1: Triggered by FC + Defunct CD + Recovery

b. Unique CIRP Path#2: Triggered by FC + Defunct CD + No Recovery

c. Unique CIRP Path#3: Triggered by FC + Not Defunct CD + Recovery

d. Unique CIRP Path#4: Triggered by FC + Not Defunct CD + No Recovery

e. Unique CIRP Path#5: Triggered by OC + Defunct CD + Recovery

f. Unique CIRP Path#6: Triggered by OC + Defunct CD + No Recovery

g. Unique CIRP Path#7: Triggered by OC + Not Defunct CD + Recovery

h. Unique CIRP Path#8: Triggered by OC + Not Defunct CD + No Recovery

i. Unique CIRP Path#9: Triggered by CD + Defunct CD + Recovery

j. Unique CIRP Path#10: Triggered by CD + Defunct CD + No Recovery

k. Unique CIRP Path#11: Triggered by CD + Not Defunct CD + Recovery

l. Unique CIRP Path#12: Triggered by CD + Not Defunct CD + No Recovery

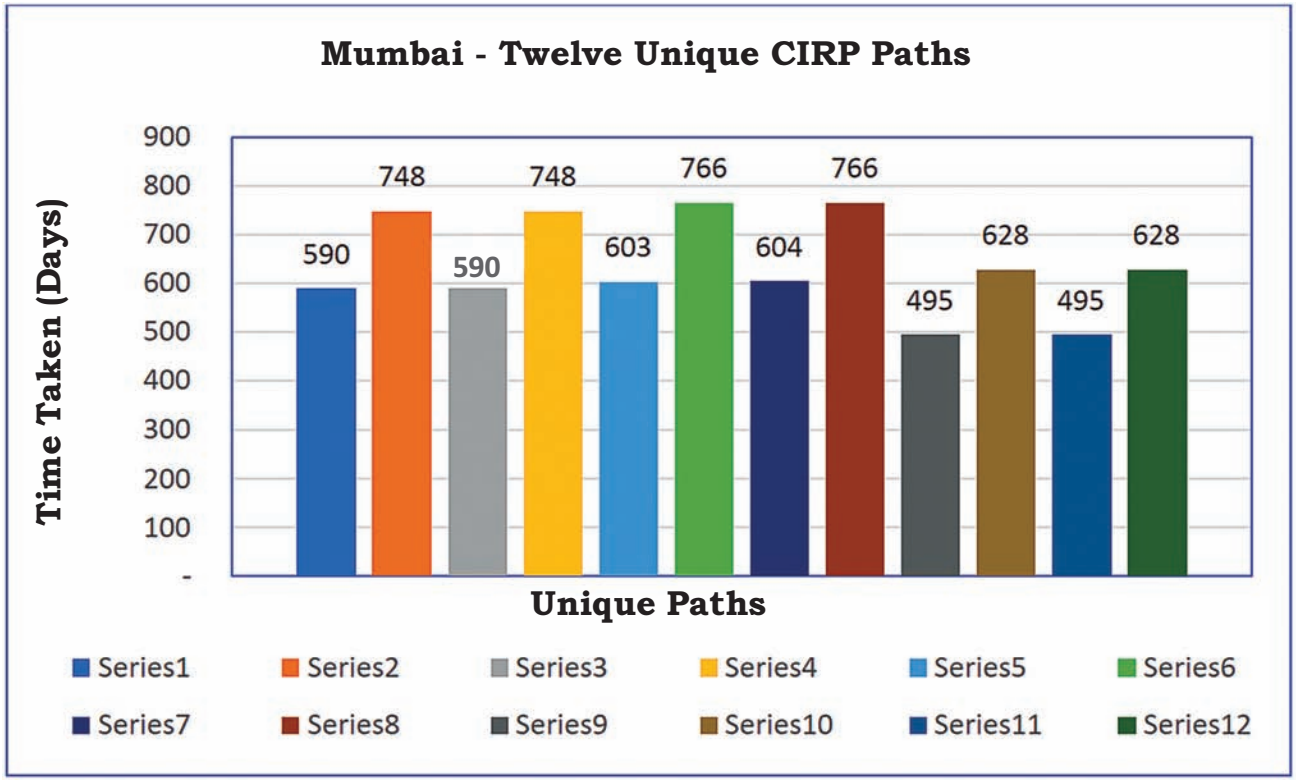
These 12 unique CIRP paths for Mumbai and New Delhi NCLT benches have been studied and predicted values based on regression model coefficients have been computed and presented at Table 16 and 17 respectively. We find that the unique CIRP path triggered by OC for a Non-Defunct CD (operational entity) with zero Recovery Ratio has the longest CIRP process time (i.e., unique path no.8), followed by the unique CIRP path triggered by OC for a Defunct CD with zero Recovery Ratio has the second longest CIRP process time (i.e., unique path no.6). On the other hand, the unique CIRP path triggered by CD itself for a Defunct CD with Recovery has the lowest CIRP process time (i.e., unique path no.9), followed by the unique CIRP path triggered by CD itself for a Non-Defunct CD with Recovery has the second lowest CIRP process time (i.e., unique path no.11). For Mumbai NCLT bench the values (rounded up to the next day for practical purpose) for the longest CIRP process time (Time Taken (Days), the second longest CIRP process time, the lowest CIRP process time and the second lowest CIRP process time are ~767 days, ~766 days, ~495 days and ~495 days respectively.

The following tables and figures are giving details about all the 12 unique CIRP paths for Mumbai and New Delhi.

Table 16: Predicted values of Time Taken (Days) for 12 Unique Paths for CIRP ending with Liquidation at Mumbai NCLT bench

Mumbai NCLT Bench													
Path No. →		1	2	3	4	5	6	7	8	9	10	11	12
Variables	Coefficients	Triggered by FC				Triggered by OC				Triggered by CD			
Intercept	2.5726	1	1	1	1	1	1	1	1	1	1	1	1
FC	0.0762	1	1	1	1	0	0	0	0	0	0	0	0
OC	0.0864	0	0	0	0	1	1	1	1	0	0	0	0
Defunct	-0.0002	1	1	0	0	1	1	0	0	1	1	0	0
Recovery Rate	-0.1034	1	0	1	0	1	0	1	0	1	0	1	0
Ahmedabad	0.1411	0	0	0	0	0	0	0	0	0	0	0	0
Allahabad	0.2434	0	0	0	0	0	0	0	0	0	0	0	0
Bengaluru	0.0010	0	0	0	0	0	0	0	0	0	0	0	0
Chandigarh	0.1809	0	0	0	0	0	0	0	0	0	0	0	0
Chennai	0.1182	0	0	0	0	0	0	0	0	0	0	0	0
Cuttack	0.2252	0	0	0	0	0	0	0	0	0	0	0	0
Hyderabad	0.0961	0	0	0	0	0	0	0	0	0	0	0	0
Jaipur	0.0069	0	0	0	0	0	0	0	0	0	0	0	0
Kochi	0.0306	0	0	0	0	0	0	0	0	0	0	0	0
Kolkata	0.0831	0	0	0	0	0	0	0	0	0	0	0	0
Mumbai	0.2253	1	1	1	1	1	1	1	1	1	1	1	1
New Delhi	0.1971	0	0	0	0	0	0	0	0	0	0	0	0
Log_{10} (Time Taken (Days))		2.77	2.87	2.77	2.87	2.78	2.88	2.78	2.88	2.69	2.80	2.69	2.80
Time Taken (Days)		589.54	747.95	589.85	748.34	603.48	765.63	603.80	766.03	494.61	627.51	494.87	627.84

Figure 10: Twelve Unique CIRP Paths Displaying High Variation in Time Taken (Days) for Mumbai NCLT Bench

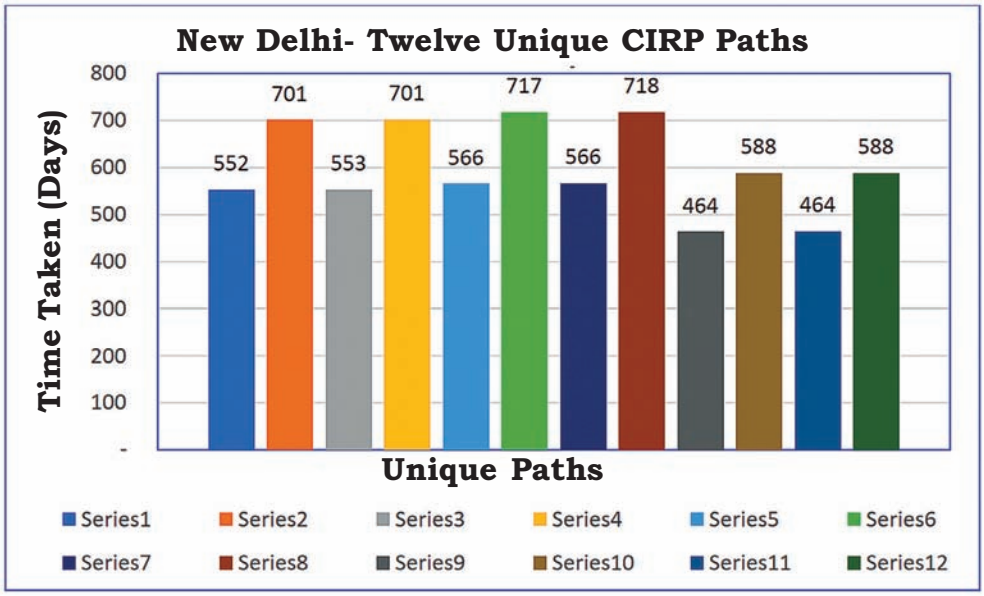


Whereas for New Delhi NCLT bench these values for the longest CIRP process time (Time Taken (Days), the second longest CIRP process time, the lowest CIRP process time and the second lowest CIRP process time are ~718 days, ~717 days, ~464 days and ~464 days respectively.

Table 17: Predicted values of Time Taken (Days) for 12 Unique Paths for CIRP ending with Liquidation at New Delhi NCLT bench

New Delhi NCLT Bench													
Path No. →		1	2	3	4	5	6	7	8	9	10	11	12
Variables	Coefficients	Triggered by FC				Triggered by OC				Triggered by CD			
Intercept	2.5726	1	1	1	1	1	1	1	1	1	1	1	1
FC	0.0762	1	1	1	1	0	0	0	0	0	0	0	0
OC	0.0864	0	0	0	0	1	1	1	1	0	0	0	0
Defunct	-0.0002	1	1	0	0	1	1	0	0	1	1	0	0
Recovery Rate	-0.1034	1	0	1	0	1	0	1	0	1	0	1	0
Ahmedabad	0.1411	0	0	0	0	0	0	0	0	0	0	0	0
Allahabad	0.2434	0	0	0	0	0	0	0	0	0	0	0	0
Bengaluru	0.0010	0	0	0	0	0	0	0	0	0	0	0	0
Chandigarh	0.1809	0	0	0	0	0	0	0	0	0	0	0	0
Chennai	0.1182	0	0	0	0	0	0	0	0	0	0	0	0
Cuttack	0.2252	0	0	0	0	0	0	0	0	0	0	0	0
Hyderabad	0.0961	0	0	0	0	0	0	0	0	0	0	0	0
Jaipur	0.0069	0	0	0	0	0	0	0	0	0	0	0	0
Kochi	0.0306	0	0	0	0	0	0	0	0	0	0	0	0
Kolkata	0.0831	0	0	0	0	0	0	0	0	0	0	0	0
Mumbai	0.2253	0	0	0	0	0	0	0	0	0	0	0	0
New Delhi	0.1971	1	1	1	1	1	1	1	1	1	1	1	1
Log_{10} (Time Taken (Days))		2.74	2.85	2.74	2.85	2.75	2.86	2.75	2.86	2.67	2.77	2.67	2.77
Time Taken (Days)		552.48	700.92	552.76	701.29	565.54	717.50	565.83	717.87	463.52	588.06	463.76	588.37

Figure 11: Twelve Unique CIRP Paths Displaying High Variation in Time Taken (Days) for New Delhi NCLT Bench



Significance of location is easily identifiable when we look at CIRP-Resolution times with similar characteristics at Mumbai and Delhi NCLT benches - a difference of 31 to 48 days. On an average, the time taken for OC triggered cases is 95+ days and 15+ days longer than CD and FC triggered processes. This again indicates inter-stakeholder frictions. With change in the location from Mumbai NCLT to Delhi NCLT bench, the CIRP process ending in resolution gets shorter by 31-48 days. Hence, it will be worthwhile to study location specific process characteristics deeply and find out reasons for such variations.

Such 12 unique CIRP paths also exist for other NCLT benches. The prediction model / equation no. 3 can be used to identify these paths and find the respective predictive values.

LIMITATIONS OF THE STUDY

The research study provide predictive models for the time taken in days for different CIRPs. Additionally, the research study provides quantum of variations in time taken (days) across different CIRP process paths. Some of key limitations of the research study are mentioned as below:

1. In the research study authors have found path dependency for the dependent variable time taken (days). However, they have not investigated the specific factors and reasons that drive this phenomenon as they are beyond the scope of our current research.

2. The three datasets also exhibited high right hand side skewness. Researching the reasons for such far-tailed distribution of time taken (days) for CIRP processes will throw new insights for policy making.

3. The research study has found that even for a given NCLT bench the CIRP process durations for different unique paths are quite widespread. This indicates high degree of frictions across the stakeholders. Researching sources of such inter-stakeholder frictions will help in identifying causes for process delays.

Thus, to further understand the sources of variations in time taken (days) calls for additional research study. Such a research study will identify different factors of CIRP process contributing to the observed variations and thereby enable policymakers to plug such identified sources of process variations. In depth study of processes and mechanisms related realisation of assets will be helpful in identifying sources of process delays. Whereas audit of VLP and CIRPs at different NCLT locations will help the authors in identifying sources of process delay at different locations. Lastly, study of sources of friction and/or information asymmetry between various stakeholders, viz., FC, OC & CD will also provide some answers to minimise process delays.

CONCLUSION

The research study provides predictive models for the time taken in days for different VLP and CIRPs administered as per the provisions of IBC.The research study establishes that the dependent variable, viz.,time taken (days) is a path dependent function. It further brings out that all the three CIRPs (Dissolution, Liquidation and Resolution) have skewed and right hand side far-tailed distribution. Stated in other words, these processes inherently tend to

be quite lengthening in nature. Through the empirical research based on the CIRP-related summary output data authors have developed predictive models for predicting time taken (days) for CIRP processes with different CD attributes and conducted at different NCLT benches across the country. The research findings indicate high variance in time taken (Days) along two major axes – one across different attributes of the applicant like FC, CD, OC, defunct or operational, positive or nil recovery rate, etc. for a given NCLT bench and the other across various NCLT benches for the same set of applicant attributes.The study quantified variations in time taken (days) attributable to different attributes of the applicant like triggered by FC, OC, or CD, defunct or operational, and recovery or no recovery, resulting in twelve unique CIRP paths for a given NCLT bench. Similarly, the study quantified variations in time taken (days) attributable to different NCLT benches for a given set of attributes of CD (the twelve unique CIRP paths).The research study establishes that the response variable, Time Taken (Days) is a path function of type of trigger (FC, OC, CD), Operational status of CD (Defunct or not), Recovery Rate & various locations.For example, for same unique paths of CIRP-Resolution process, predicted values between Mumbai and Delhi locations differ by 31 to 48 days. On the other hand, for various unique paths of CIRP-Liquidation, the difference in Time Taken at Mumbai and Delhi is 52 to 105 days.Similarly, impacts of different triggers (FC, OC, and CD), operational status and recovery rate have significant impact on the process time taken, in the range of 15 to 95 days.The research lays strong foundation for further studies and policy intervention to streamline CIRP processes for achieving model timeline of 180 days to 330 days, including extensions.

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ROLE OF CRITICAL FACTORS IN DISTRESSED COMPANY VALUATION: A SECTOR-SPECIFIC CASE STUDY

Seema Sharma and Deepika Dhingra

ABSTRACT

The Insolvency and Bankruptcy Board of India (IBBI) offers a robust framework to provide a supportive platform for struggling companies owing to financial distress. Under this framework, the investor companies are enabled to develop and implement the resolution plans efficiently within a set timeframe, minimising the financial losses of the distressed companies and facilitating timely reorganisation.When a stressed company fails to attract potential buyers, its chances of revival diminish, often leading to liquidation. In other words, if no bidder emerges, the stressed company faces liquidation, potentially resulting in substantial losses for creditors, which will be paid off through piecemeal asset sales.

Valuing companies in decline is difficult, with traditional methods often falling short due to their focus on financially stable firms. Researchers discuss the limitations of traditional methods for distressed companies. Existing literature overlooks the influence of sector-specific factors on stressed company valuations, beyond methodology. Those factors are reasons for the distress of a particular company. Addressing these factors is crucial for accurate valuations and requires in-depth study for effective solutions.

This study aims to investigate the valuation regime concerning distressed companies within the thermal power sector. Using a case study methodology, the research will conduct a financial analysis to determine the valuation of the case company. Utilising Discounted Cash Flow (DCF), the study will assess the company's enterprise value (EV) assuming resolution of underlying issues in one scenario and their persistence in another. Scenario analysis has been conducted to discern the impact of various factors on the valuation of the case company. The findings of the study reveal that in the case of the thermal power sector in India, apart from the valuation methodology, the capacity of the bidder to resolve the underlying issues of the plant impacts the EV of the same. To obtain the optimal valuation of the case company, the issues of distress should be resolved fully or partially, depending on the capacity of the bidder.

Keywords*:* Valuation, Distressed company, Thermal Power Sector, Case Study, Recovery Rate, Scenario Analysis

INTRODUCTION

Insolvency occurs when a person or business cannot repay their debts on time, due to insufficient funds. This situation typically happens when the income or cash generated by the business is significantly low, while the debts and financial obligations are too high to be managed effectively. Therefore, insolvency is caused by financial distress which eventually results in bankruptcy.Explaining further, that if the financial distress continues, the firm has to undergo a legal process called bankruptcy, where assets may be liquidated to repay the creditors. It provides a structured framework for resolving financial difficulties and offering relief to debtors while ensuring fair treatment for creditorsthroughthe sale of assets,either piecemeal or bulk sale.

Insolvency can significantly influence an organisation, affecting its financial health, reputation, relationships with creditors, workers, stakeholders, and the capacity to function or continue business activities. To manage the adversities, insolvency frequently requires restructuring initiatives or legal actions to overcome financial difficulties and restore solvency. It is generally preferable to maintaining a going concern status as it supports stability, preserves value, fosters confidence among stakeholders, and provides the flexibility needed for long-term success and sustainability.To rescue distressed companies from going into bankruptcy, the Insolvency and Bankruptcy Code (IBC/Code) of 2016 came into effect. The IBC is a detailed law that provides a fast and precise process for addressing insolvency matters. It has significantly transformed the bankruptcy resolution process in India, allowing each aspect of the law's execution to have a significant impact on the country's business environment. Under the code, a financial creditor (FC), operational creditor (OC), or the corporate debtor (CD) himself can initiate the corporate insolvency resolution process (CIRP) by filing an application with the National Company Law Tribunal (NCLT), the adjudicating authority.A distressed firm faces two possible outcomes: resolution or liquidation.The objective of IBC is to facilitate the resolution of distressed companies and thereby maximise the value of the assets.

Asset valuation is one of the core features of the CIRP under IBC. It is rightly said that in cases of resolution, the value of assets will be far better than the liquidation value. From the experience of all the interest in resolution plans being received by resolution professionals (RP), it is evident that liquidation values, being more on the conservative side, have been largely driving down the valuation of the assets of the corporate debtors. As a result, the resolution professional (RP) puts effort into creating a successful resolution plan. Resolution preserves the going concern surplus, while liquidation destroys it. The RP invites Expression of Interest (EOI) wherein the resolution applicants(RA) submit their resolution plans.

Committee of creditors (CoC) is a crucial decision-making body in insolvency resolution, comprising creditors with significant debt stakes. It evaluates resolution plans, negotiates debt restructuring terms, and oversees the voting process. The CoC must engender competitive resolution plans through appropriate enhancements to push up the resolution value. The CoC is authorised to select the resolution plan based on several considerations aimed at the better functioning of the firm post-resolution. If none of the resolution plans are received, the CoC is forced to choose the option of liquidation, eventually reducing the value of the assets

of the insolvent company. On the part of the CoC, effective communication, transparency, and prudent decision-making are essential for successful insolvency proceedings.

There are concerns that companies entering formal insolvency under the IBC often experience avoidable value destruction.The reason is a delay in initiating the resolution process and the slow insolvency proceedings most of the times. Looking at the data in the past,the number of cases filed in the IBC and cases resolved or finally liquidated, shows that very few resolution plans were accepted, leading to the destruction of the value of the assets of the distressed firm. Probably one reason is the lack of a good number of bidders (in the form of resolution applicants) coming with a good price. This results in a delay in the CIRP as well, wherein the value of the company gets eroded with each passing day. The registered valuers' valuation of these companies is so low that it forces both the creditors and the owner to accept a significant loss. In most cases, whatever the level of stress of the firm is, whether high or low, the distressed firm could sustain itself within the sector against all odds, as the decline is reversible in most cases

However, some companies do respond to the EOI, and finally, a few bid for the distressed asset. Moreover, out of those few, a small number can arrange the required funds and make provisions to acquire such companies. It has been noted that despite analysing the financials of the distressed firm, assessing chances of revival, and considering necessary commitments, the resolution applicant opts not to participate and withdraws from the bidding process. This eventually results in further loss of value for the distressed firm, pushing it into liquidation. Therefore, it can be stated that the potential of the bidders to resolve the underlying issues has an impact on the valuation of distressed firms. The perception and valuation of the distressed firm directly depend on the competency and resources of the resolution applicant.

The above-mentioned problem and aspect of the valuation of distressed companies have not been studied so far. To improve the valuation figures, the researchers worked more on the methodology, ignoring this aspect completely. In the context of India, no study aligning with this idea has been taken up as evident from the extant literature. The study attempts to fill this research gap. The objective of the study is to assess the impact of the capacity of the bidder on the valuation of a distressed thermal power plant using a case study method through the application of scenario analysis.

The remaining paper is organised as follows: It first discusses the literature review and then provides an idea about the sector that has been studied. This is followed by the methodology which is explained in detail.The next part discusses the theme of the paper–case study. The valuation of the case company under each scenario is analysed, followed by the discussion and conclusion. Additionally, the theoretical, and practical implications are highlighted, along with the limitations and future scope of the study.

LITERATURE REVIEW

Distressed company valuation has been a difficult and complex task. It has been a subject of interest for academics and professionals specialising in turnaround management, restructuring, and distressed investing for years. Given the importance of this field in corporate finance and restructuring, it is reasonable to assume that the volume of research on this

topic will continue to grow. Researchers, practitioners, and stakeholders continually seek to refine their understanding of valuation methodologies and adapt to evolving market conditions, making it a dynamic and active area of research and analysis. A lot of studies have been conducted across the globe on the topic of valuation; however, research in this field is meagre in the Indian context.

The literature has referred to many studies that focus on the valuation methodology and techniques for valuing distressed companies. Distressed firm valuation has been a challenging topic wherein many traditional assumptions and methodologies of valuation do not work (Damodaran, 2009).The foreign literature speaks about the inefficiency of the traditional methods of valuing companies (Atte Jortikka 2019), (Ian Ratner 2010), (Mads Klarskov Woidemann 2017), (Michael Crystal 2005), (Milan Hrdy 2006), (Michela 2015), (Fabio Buttignon 2020).

A few studies have analysed the reasons and consequences of financial distress. Kaplan and Stein attribute the increasing number of default cases to inadequately structured capital and incentive systems. The study points out economic crises and regulatory processes as the main reasons for financial default (Gregor Andrade & Steven N. Kaplan, 1998). A research team emphasised the importance of examining the internal and external reasons as well as the repercussions of troubled enterprises' demise before delving into the valuation process (Milan Hrdy & Bohuslav Simek, 2012).

In a study, Emily Favaretto investigated the company's decline, attributing it to technical changes and economic disruptions (Emily Favaretto 2009). A team of academics thoroughly analysed the elements that impact the financial hardship of insurance businesses in Ethiopia. The study uses balanced panel data from eleven insurance companies, covering the period from 2008 to 2019. The study utilises a quantitative technique and an explanatory design to accomplish its goals (Yonas Nigussie Isayas, 2021).

Damodaran, the father of valuation, argues that traditional valuation techniques fail to accurately assess distressed firms. He utilised a case study approach to achieve an over-optimistic valuation, addressing divestiture follies, book capital, and dealing with distress. Damodaran also highlights the limitations of the relative valuation method for valuing declining companies. Analysts can develop probability distributions, adjust expected cash flows and discount rates, and value the firm as a going concern, considering the likelihood of distress. This approach helps avoid the undervaluation of distressed firms (Aswath Damodaran 2000).

Academics like Michela Casale argue that traditional valuation methods are insufficient for assessing troubled enterprises. Distressed companies operate differently from healthy ones, making income and market methodologies insufficient. The author suggests changing traditional valuation methods to fit distressed enterprises' specific conditions, assumptions, and conduct. Option pricing valuation using the binomial lattice approach is included in the study, which also discusses operational and financial crises and their corresponding actions. Both income and market methodologies are considered insufficient for evaluating troubled companies. The article delves extensively into operational and financial crises, as well as the corresponding actions taken in response, such as restructuring or liquidation. The article

gives an outline of conventional valuation techniques and approaches for modifying them as required (Michela Casale 2017).

Buttignon discusses the valuation process for distressed firms, which involves analyzing historical financial records, reviewing reorganisation plans, and estimating EV.The DCF is sensitive to some assumptions, and the valuers should explicitly use these assumptions to derive the expected cash flow (Fabio Buttignon 2020), (Edward Altman et al. 2019). Most researchers in the domain have employed the DCF method for valuation, (Sebastian Afflerbach 2014), (Damodaran 2009), (Fabio Buttignon 2014).The researchers emphasised the need for adjustments to be made in the DCF method for appropriate valuation calculating debt and equity values and adjusting valuation based on negotiation outcomes. He argues that traditional valuation models work efficiently for distressed firms with the necessary adjustments (Buttignon, 2015). He emphasised the going concern value and compared it with potential values under new ownership, partnerships, and liquidation, calculating debt and equity values, and adjusting valuation based on negotiation outcomes.

The authors emphasised the importance of accurate valuation, particularly for financially distressed companies, cautioning against reliance on traditional techniques that may overlook explicit features of such firms. This may result in incorrect valuations for those companies (Mads Klarskov Woidemann & Peter Willemoes Helms, 2017). Researchers have also evaluated the effect of financial distress on the valuation of troubled companies. The study aims to quantify the impact of financial distress on firm value, aiming to provide more accurate valuation outcomes. Quantitative analysis shows that financial distress leads to a 4–7% reduction in firm value, and observers may fail to consider specific characteristics of these companies. This could lead to inaccurate pricing for those companies (Mads Klarskov Woidemann & Peter Willemoes, 2017).A team of researchers identified two widely used valuation approaches: relative valuation (comparable company and comparable transaction values) and discounted cash flow models. The comparable company approach is widely used due to its simplicity and the large number of publicly traded firms. However, it can build in market errors. The comparable transactions approach, also known as comparable M&A analysis, uses prices from recent acquisitions of similar companies. However, it has limitations, such as limiting the number of relevant transactions and reflecting a “control premium.” (Edward I. Altman et al, 2019).Assessing the worth of struggling enterprises necessitates a nuanced approach combining subjective and scientific modifications to conventional valuation methods. (Kristian D. Allee et al., 2020) suggest that companies with negative EBITDA in the past year may need to modify traditional valuation methods for calculating operating cash flows.

The literature from the perspective of India is scarce in the domain of the valuation of distressed companies . Most of the studies in the Indian context undertaken by researchers are mostly confined to the critical issues and legalities of IBC 2016. In India, the valuation of distressed companies has received very little attention. Dr. Prashant Sarangi highlights the growing importance of valuation for asset managers and regulators, but challenges persist in the consensus on methodologies. Incorporating historical volatility can improve accuracy and reduce bias, which is generally not considered in traditional valuation methodologies (Prashant Sarangi, 2019).Dr. S. K. Gupta’s study on distressed company valuation emphasised the

complexity of the process and recommended strengthening court processes and banking regulations for timely bankruptcy resolution, long-term lending, and economic stability. (S. K. Gupta, 2019). He proposed DCF and relative valuation models as appropriate methods, however, he suggested being cautious about the complexities of valuation.

The extant literature has extensively discussed the valuation methodologies concerning distressed companies with the help of a case study analysis. The studies have contributed to the valuation domain, wherein the researchers have provided suggestions focusing on adjustments to the traditional valuation methods applicable to a specific case study. In the context of India, research in this field is quite negligible and demands a comprehensive examination. This study aims to fill the gap by extrapolating the impact of a bidder's capability to resolve the underlying issues of a distressed case company on the valuation. The idea of analysing and evaluating the capability of the bidder on the EV of a distressed firm apart from the valuation methodology is completely novel and will enrich the literature in the domain.

IMPORTANCE OF THE POWER SECTOR AND SUCCESSFUL STORIES OF RESOLUTION UNDER IBC 2016

Modern societies rely on the power sector and power-generating companies to supply the essential electricity required for industries, businesses, and households to function efficiently. Moreover, as the world grapples with environmental challenges, power companies are increasingly shifting towards renewable energy, but the share of power generation by thermal power plants cannot be subdued. Thermal power plants remain a significant contributor to global electricity supply due to their reliability and scalability. According to a standing committee report presented in Lok Sabha, a list of 34 coal-based 'Thermal Power Projects', mostly private, totalling 40,130 MW, was considered 'Stressed' by the Ministry of Power on March 22, 2017, Prachee Mishra, (2019). This resulted in the creation of huge NPAs for banks and financial institutions. Since many thermal power plants faced financial distress in the past due to various reasons, the Government of India emphasises the revival of the already existing ones. Hence, a few distressed power plants went through the IBC route and established a successful revival.

The IBC in India aims to provide a comprehensive framework for insolvent entity resolution in a time-bound manner. The Code plays a significant role in addressing financial distress and resolving insolvency issues faced by thermal power plants. Under the framework, a thermal power plant that is facing financial distress can be subject to insolvency proceedings initiated by either the creditor or the debtor. The NCLT appoints an IP to manage the plant's assets and operations once it enters the insolvency process. The objective is to maximise the value of assets and ensure a fair distribution of proceeds to creditors. In India, there have been several instances of successful resolution of thermal power plants under the IBC. A few notable examples are Essar Power's Mahan Thermal Power Plant in Madhya Pradesh, which faced financial distress due to various factors, including fuel supply issues and regulatory challenges. The NCLT approved a resolution plan under the IBC in 2019. Adani Power led a consortium that took over the plant and implemented measures to improve operational efficiency and financial viability as part of the resolution.

The bid for GMR Chhattisgarh Energy Limited's 1,370-megawatt thermal power plant was won by Adani Power through a competitive bidding process. Adani Power is committed to reviving the plant's operations, securing fuel supply, and optimising its performance to ensure long-term sustainability. Another such case of KSK Mahanadi Power Company Limited can be quoted here, wherein JSW Energy emerged as the successful bidder and acquired the plant. In the mentioned cases of resolution, successful resolution of thermal power plants under the IBC is achievable through strategic restructuring, stakeholder collaboration, and innovative solutions. Distressed thermal power assets can undergo rehabilitation by addressing underlying financial and operational issues, identifying viable resolution plans, and attracting capable investors, thereby contributing to the stability and growth of the energy sector. These successful resolutions also highlight the importance of the IBC framework in facilitating transparent and time-bound insolvency proceedings, which are essential for restoring confidence among investors and stakeholders in the power sector.

RESEARCH METHODOLOGY

Case study methodology

This study employs a methodology that aims to provide a robust framework for data collection, analysis, and interpretation, thereby ensuring the reliability and validity of the findings. This section outlines the research design, data collection methods, and research methodology to address the research objectives. The study has utilised the case study method to conduct a comprehensive analysis of the identified problem in the preceding section. Case study research is probably the most suitable method when it comes to producing a thorough, in-depth examination of contemporary circumstances where the researcher has limited control over the events being studied (Robert K. Yin, 1994). It assists the researcher in exploring real-life situations in the context of individual cases in their natural settings. The study aims to uncover fundamental issues faced by the case company that pushed it into insolvency with the help of the case study method.

Sources of data

The study will employ a secondary source of data. The financial statements of the company have been curated using a database – CMIE Prowess. NCLT and National Company Law Appallete Tribunal (NCLAT) order judgements have been used to obtain some additional information about the resolution of the case company. Some information was available in the public domain.

Case company: SKS Power Generation Limited

The study has picked a recent case of athermal power company that has gone through the IBC route and successfully resolved. The SKS Power Generation insolvency case is a notable event in the Indian energy sector, highlighting the challenges faced by power generation companies in the country. The plant is based in Chhattisgarh and is one of the leading players in the power generation industry in India.

The insolvency proceedings against SKS Power Generation were initiated in an attempt to resolve the company's debt issues and salvage its operations. Under the IBC framework, an

RP was appointed to oversee the insolvency process and facilitate discussions between the creditors and the company's management.

Scenario analysis

Scenario analysis involves the systematic evaluation of potential future events or circumstances, aiming to anticipate and assess their likely outcomes. Within financial modelling, this method is frequently employed to forecast variations in a business's value or cash flow, particularly when there are foreseeable positive or negative developments that might influence the company. Three scenarios reflecting optimistic, pessimistic, and realistic outcomes were developed, highlighting key assumptions and findings from each. During the analysis, these scenarios encompass distinct assumptions regarding the reasons for the distress of SKS like coal supply issues, power purchase agreement (PPA) issues, cost overruns, delaying of project commissioning, and a huge debt burden. The researcher has made assumptions in all three scenarios, respectively, as explained below:

i) Best-Case Scenario: All the issues were successfully addressed and fully resolved

ii) Worst-Case Scenario: None of the issues were addressed or resolved

iii) Base-Case Scenario: Issues were partly addressed and resolved

The resolution applicants bid based on their capacity to resolve the underlying issues faced by SKS Power. The best-case scenario represents a situation when all the problems or issues were properly addressed by the resolution applicant. Based on their strengths,problems are resolved successfully eventually assigning an optimistic enterprise valuation to SKS Power. The worst-case scenario foresees a condition representing the case company's status quo. The company will remain in the same financial position, and the cash flow will continue to decline. This means that none of the problems or issues of the case company were addressed,resulting in the lowest EV. The base-case scenario embodies a situation wherein the EV of the case company will be calculated by taking the assumption that the problems faced by the company are partly resolved depending on the capacity of the bidder to overcome them in due course of time.

CASE STUDY

SKS Power Generation (Chhattisgarh) Limited

About the case company

SKS Power Generation (Chhattisgarh) Limited was originally promoted by SKS Ispat and Power Ltd (51% subsidiary of SKS Ispat and Power Limited) for the development of a 1200-MW (4 x 300 MW) thermal power project, in two phases of 600 MW (2 x 300 MW) capacity each, in the Raigarh district of Chhattisgarh (CG).

Brief Project History-

1) SKS Power Generation (Chhattisgarh) Limited, was incorporated on March 18, 2008, under the provisions of the Companies Act, 1956, and has its registered office in Mumbai. The proposed capacity of the project was 1200 MW, comprising 4 units of 300 MW each.

2) The company achieved the Commercial Operation Date (COD) for the two units (2x300 MW) developed under Phase I in October 2017, and April 2018, respectively.

3) Project works for the 600 MW Phase-II (2x300 MW) project got stalled due to a financial crisis.

4) Due to delayed execution and a significant escalation in project costs, the company was unable to service its debt obligations on time.

5) As a result, following the RBI circular on the resolution of stressed assets, the lenders opted for an open bidding process to change management.

6) On November 12, 2018, Singapore-basedAgritrade Resources Limited (ARL) entered into a definitive agreement with its lenders to acquire SKS Power Generation (Chattisgarh) in a one-time settlement of ₹2170 crore, and subsequently, post compliance with the condition precedents and on receipt ofthe OTS amount transaction closed on March 18, 2019.

7) With its headquarters in Singapore and a listing in Hong Kong, Agritradewas a leading provider of energy solutions. The company is the first to introduce large-scale, fully mechanized underground coal mining in Indonesia.

8) Accordingly, the proposal of ARL, a company listed on the Hong Kong stock exchange, was accepted and comprised payment of ₹2,170 crores towards the purchase of shares, assignment of loans, and top-up of the outstanding Bank Guarantee (BGs) with 100% cash margins.

9) Subsequently, the management control of SKS was passed to ARL through its step-down wholly-owned subsidiary, Entwickeln India Energy Pvt Ltd (EIPL), on March 18, 2019.

10) EIPL had financed the acquisition amount of ₹2,170 crores through ₹1,600 crore rupee term loan and the rest through equity and compulsory convertible debentures (CCDs). ARL has provided an unconditional and irrevocable corporate guarantee to all the borrowers of SKS.

11) Agritrade encountered financial difficulties, rendering it unable to fulfil its loan obligations.Finally, SKS Power was admitted into the CIRP on April 29, 2022. The development came after SKS Power's FC, Bank of Baroda, filed a petition against the company, claiming a default of about ₹110.52 crore.

Details of the Power Purchase Agreements (PPA) and coal linkages of SKS Power

1) The company has a Fuel Supply Agreement (FSA) with South Eastern Coalfields Limited (SECL) for 2.6 million MTPA per annum for 25 years against Phase-I capacity. Thermal power plants are base load power plants and are planned to operate round the clock and achieve an annual Plant load factor (PLF) of 85% or more. To achieve normative operations in Phase I, the coal requirement was 2.86 MTPA. 2.6 MTPA of coal was sufficient to achieve ~78% PLF.

2) In terms of the coal linkage policy of the Ministry of Coal, the trigger level was kept at 75%, i.e., the coal company is mandated to supply 75% of the annual contracted quantity of fuel under the Fuel Supply Agreement. This forced SKS to arrange coal from the open market to meet the 25% shortfall in coal.

3) Further, linkage coal is supplied in proportion to the capacity tied up through long-term and medium-term PPA signed by the power generating company. SKS Power has executed a long-term PPA for 25 years for the supply of 100 MW power to Rajasthan Discom, wherein the power supply is expected to commence by April 2020. Also, as per the terms of the Chhattisgarh state policy, 5% of the capacity is supplied to the state. Hence, the non-availability of long-term and medium-term PPAs forced SKS to face the challenge of fuel availability and fuel price risks for continuing plant operations. Long-term and medium-term PPAs secured by SKS are as follows:

   i) Medium-term PPAs signed for 3 years for the tie-up of balance plant capacity-

      a) PPA with Chhattisgarh State Power Transmission Co. Ltd. (CSPTCL) for (30 MW) from June 2018

      b) As per the prevailing policy of the State Government to promote the setting-up of power projects in the state of Chhattisgarh, it will purchase 5% of the net generated power at the energy charge rate for 25 years from the project COD.

   ii) PPA with Power Trading Corporation (PTC) India Limited (PSA1 75 MW and PSA2 225 MW) in October 2018

      a) PPA signed with PTC India Ltd. on October 26, 2018, for 3 years, for the supply of 75 MW power to Bihar Discom and 225 MW power to Haryana Discom. The supply to Haryana Discom commenced in May 2019, and the supply to Bihar Discom commenced in July 2019.

      b) A medium-term PPA (for 16 months) was signed to supply 100 MW of power to Noida Power Company Ltd., which commenced in December 2018.

Major Challenges faced by SKS Power Generation Ltd.

Table 1: Underlying issues faced by SKS case company

Sr. No.	Issues faced by SKS Power	Description
1	Delay in project commissioning	• The project's first phase, 2x300 MW, was commissioned in October 2017 and April 2018 respectively,as opposed to the anticipated commissioning in July 2015 i.e. a delay of more than two years.
2	Coal supply issues	• Coal linkage was granted under the 11th Plan of Power project. Due to a delay in the commissioning of the project beyond March 2015; coal linkage got cancelled and

		transferred to 12th plan projects that were expected to be commissioned within their original schedule. • Further, in the absence of a long-term PPA, the plant is unable to source linkage coal. • Coal quantity has to be arranged from open markets, i.e. e-auction conducted by coal companies, coal traders, and coal imports. The price of coal procured through these routes is much higher than the Fuel Supply Agreements (FSA) coal. • Recently, SKS Power has been getting linkage coal from SECL for a long-term PPA of 100 MW with Rajasthan Discom only. • With lower coal availability, achieving 85% annual availability is not possible, and hence, recovery of 100% capacity charges/fixed charges under the PPAs is not possible.
3	Power Purchase Agreement for surplus capacity	• Out of 600 MW, long-term PPA is available for only 100 MW, and medium-term PPA is available for 330 MW. There is a surplus available capacity of 170 MW. The company is forced to sell this power under short-duration contracts or operate the power plant inefficiently at lower capacity levels (lower PLFs). • As per the prevailing policies of the Ministry of Coal, for the sale of power under short-duration contracts, the project owner will have to make its coal arrangements.
4	Cost overruns	• SKS Power announced in July 2015 that they were seeking a new investor to raise additional debts and maintain the project's viability. This decision came after the withdrawal of private equity investor Blackstone from the project in January 2014, with project cost escalations severely impacting SKS finances. • The annual report for 2013–14 noted the project costs for the project's first phase (2×300 MW) had risen to ₹4,750 crore, whereas the entire project cost (4×300 MW) of the plant had been earlier estimated at ₹5,100 crore. Neha Bothra & Pranav Nambiar (2015).
5	Payment of monthly bills for the supply of power under the PPA	• Power distribution companies in India have poor financial health, so payments to the power-generating companies are delayed. This directly impacts the working capital requirements of the company. Also, power distribution companies do not maintain enough of the required payment

		security mechanisms to ensure payment will be made to the generators.
6	Unsustainable debt burden	• Weak financial profile of SKS's promoter, Agritrade Resources Limited (ARL), which was facing provisional liquidation proceedings in Bermuda. • Lack of long-term PPAs for nearly 500 MW capacity and the counterparty risk associated with the remaining capacity, as the ultimate off-takers are state-owned distribution utilities with weak financial profiles, are the main issues. • Due to all these issues, the company's revenue and cash flow were adversely impacted, and the company started defaulting on loan repayment obligations. • SKS Power owns a total of ₹1890 crore in debt from the Bank of Baroda. • The debt burden was not major, outstanding, but not sustainable due to the above reasons.

Source: Author

Resolution Process

1) The resolution process started in 2022 after SKS Power was admitted into NCLT in April 2022.

   i) In May 2022, to "tackle the power crisis," it was decided that NTPC would be entrusted to operate the 2 x 300 MW plant. Mayur Shetty, (2022)

   ii) Lenders, particularly the two state-owned specialised power sector lenders, Power Finance Corp. (PFC) and Rural Electrification Corporation Ltd. (REC), were contemplating bidding for the distressed power asset to avoid significant losses on their loans during the resolution process. Lenders, particularly the two state-owned specialised power sector lenders, PFC and REC were contemplating bidding for the distressed power asset to avoid significant losses on their loans during the resolution process (Deepa Jainani, (2022)). They had even proposed to float a consortium of lenders and state-run power sector entities (CPSEs) with technical know-how in the sector to acquire and operate such stressed assets. In July 2022, SKS Power Generation reportedly became the first dormant power plant to start operations following a directive by the central government. State-owned National Thermal Power Corp. (NTPC) had been tasked with operating and maintaining the plant until lead lender Bank of Baroda (BoB) found a buyer. Bankers were hoping that a running plant with all agreements in place would give them better valuations for their dues.

2) SKS Power was admitted to NCLT in 2022

a) Initially, 23 EOIs were received, but most parties did not bid as they were not confident they would be able to resolve operational issues.

b) Reliance Industries Ltd., Adani Group, NTPC Ltd., Torrent Power Ltd., Jindal Power Ltd., Sarda Energy & Minerals Ltd., and Vantage Point Asset Management from Singapore were competing to purchase the struggling company.

c) Their initial resolution plans were in the range of ₹1,400 crore to 1,600 crore ($171.64 million to 196.16 million).

d) Only four parties, namely Sarda Energy & Minerals from Nagpur, Jindal Power from Delhi, Torrent Power from Gujarat, and Vantage Point Asset Management from Singapore, submitted competitive bids with minimal variation between them.

e) The company has a debt of ₹1,890 crore to the Bank of Baroda and the State Bank of India. Bankers anticipated recovering all outstanding debts and insolvency procedure expenses of over ₹200 crore due to the high demand for the operational power plant, which was a rare working asset available for purchase.

f) Previously, SKS Power attracted interest from preliminary bidders such as the Adani Group and Reliance Industries. However, both companies eventually withdrew from the process.

g) SEML (Sarda Energy and Minerals Limited) submitted the winning bid of ₹3 crore/MW (Rs 1,800 crore) that covers 100% of the outstanding dues of the lenders of the company, as approved by the CoC.

h) SEML made an aggressive bid for the company due to its ownership of coal mines near SKS Power's power plants, ensuring convenient fuel access and cost-effective power production.

i) Singapore's Vantage Point Asset Management also submitted a bid of ₹3 crore/ MW-₹1800 crore.

j) Gujarat-based Torrent Power submitted a bid of 2.98 crore/MW (₹1793 crore), a difference of just 7 crore from the winning bidder.

k) The plant had both fuel and purchase agreements in place and only needed a capital injection to start operations which BoB had provided with ₹125 crore of funding.

Valuation of the case company

Table 2: Valuation of SKS Power under Resolution Process and Recovery Rate

Year	Party	Bid Amount (Rs Cr)	Valuation Multiplier*	Valuation Multiplier	Recovery Rate**
2023	Sarda Energy and Minerals Limited	1800	EV/MW	3x	95.24%
2023	Singapore's Vantage Point Asset Management	1800	EV/MW	3x	95.24%
2023	Gujarat-based Torrent Power	1793	EV/MW	2.98x	94.87%

Source: Author

Note:

*i) *The standard valuation multiplier = (EV/ MW) was used for the case company. This multiplier has been used in the case of power generation companies as per the industry practices.*

*ii) **The recovery rate indicates the percentage of the debt that bankers or lenders will receive from a distressed company on resolution. The recovery rate is calculated by dividing the bid amount by the total debts.*

From Table 2, the following points can be listed: -

1. Almost a 100% recovery rate could be achieved since the 600 MW plant was operational by M/s NTPC in July 2022.
2. The plant had both fuel and purchase agreements in place and only needed a capital injection to start operations.
3. A better valuation could be achieved due to the low debt burden.

Furthermore, the information from Table 2 clearly explains that the three resolution applicants who bid aggressively for the case company were Sarda Energy & Minerals Limited (SEML), Singapore's Vantage Point Asset Management, and Gujarat-based Torrent Power. The bidding amounts are the same in the cases of the first two companies and marginally lower in the third case. For the reasons mentioned above, the recovery rate is quite high in all cases. During CIRP, at this stage, the CoC is empowered to evaluate the prospects of the distressed company in terms of its financial growth, profit earning, cash flows, and running status in the future. The viability and profit-making prospects of the distressed company depend on the capacity and strength of the resolution applicant. The study attempts to highlight the crucial aspect that the resolution applicant or bidder quotes a bid value after analysing the distressed company's issues and evaluating its strength or capacity to resolve them may be fully or partially taking certain assumptions for the same with the objective of the revival of the company. At the same time, the bidder examines the debt obligations and the need for funds to invest as capital expenditures to continue the project.

The CoC is entitled to approve the resolution plan with a consensus vote of 66% as recommended by section 30(4) of the IBC. Considering the maximisation of the value of assets and the

benefit to all the stakeholders, CoC approved the resolution plan of SEML. The next paragraph emphasised the strength and capacity of Sarda Energy to resolve the underlying issues at SKS Power.

A brief introduction of Sarda Energy &Minerals Limited (winning bidder)

About the company

i) SEML was established in 1973 and is the main firm of the Sarda Group. The company is listed on both the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The promoters own 72.64% of the company, which is a vertically integrated steel production with its own captive iron ore source. The company is a specialized producer and exporter of manganese-based ferroalloys, focusing on autonomous power generation through waste heat and coal.

ii) SEML is a highly cost-effective steel company specialising in various products such as Sponge Iron, Billets, Ferro Alloys, Mining, Power, Pellets, Iron Ore, Wire Rod Mill, and Eco Bricks. Additionally, it is one of the leading makers and exporters of ferro alloys in India.

iii) For the past thirty years, the company has consistently expanded its range of products to include numerous unique value-added items. The company strongly values high product quality, customer-centered approach, attention to people, ethical business methods, and good corporate citizenship. SEML has established itself as the preferred supplier for several customers in over 60 countries, based on these principles.

iv) SEML distinguishes itself from other companies by not simply being a typical steel firm. It predicted the significance and rise of energy and minerals as crucial components for rising economies, especially for India.

v) Synergy in energy became the foundation for all its future efforts. Currently, SEML has achieved full self-sufficiency in energy needs and is progressing towards attaining the same in other mineral resources.

vi) The corporation has obtained iron ore and manganese mines in India and is aggressively seeking mineral resources globally.

vii) Several successful acquisitions have become notable comeback stories.

viii) In 2009-10, the company gained majority control of two organisations: one for a hydropower business and another for a thermal power plant. This boosted the overall number of subsidiaries and controlled businesses from seven to nine. In 2013, SEML acquired Natural Resources Energy Pvt. Ltd.

ix) The company acquired a 29.98% stake in Godawari Natural Resources Limited to participate in the coal mines auction.

x) The company made additional investments through its wholly owned subsidiary, Sarda Energy Limited, to acquire 100% ownership in Chhattisgarh Hydro Power LLP.

IMPACT OF RESOLUTION OF ISSUES ON THE VALUATION OF SKS POWER

Valuation methodology

Adopting a valuation methodology for distressed companies presents challenges because of their unique circumstances. The prevailing and preferred approach for evaluating distressed assets is the discounted cash flow (DCF) analysis. This method entails estimating the present value of a company's anticipated future cash flows while factoring in adjustments pertinent to distressed enterprises. In the present study, DCF was used to evaluate the EV of the case company in all three scenarios, along with adjustments encompassing revenue, coal cost, and PLF alterations. By incorporating these factors, DCF analysis provides a comprehensive assessment of the value of stressed assets, aiding in informed decision-making during resolution processes.

Note: It is important to understand the following technical words

1. **Plant Load Factor (PLF):** PLF is a key measure of a power plant's efficiency, comparing its actual production to its maximum potential output over a given period. For thermal power stations, assessing PLF is crucial. It's calculated as the ratio of total power generated to the contracted capacity, multiplied by the duration in hours. Over the years, the national average PLF has declined from 78.6% in 2007–08 to 56.01% in 2019–20 (Alok K Tripathi, 2021).

2. **Gross Calorific Value (GCV)**: The calorific value represents the amount of energy contained in a fuel. It is defined as the total heat generated when a unit of fuel is burned in the presence of oxygen. When the energy released from the condensation of water vapour is considered, this value is known as the gross or higher calorific value (HCV). The calorific value is crucial for engine performance because it is directly linked to efficiency.

3. **Auxiliary Consumption (AUX):**"Auxiliary Energy Consumption" (AUX) for a generating station refers to the energy used by auxiliary equipment, including plant and machinery operation, switchyard, and transformer losses. It is expressed as a percentage of the total gross energy generated at the generator terminals of all units in the station (CERC, 2019).

4. **Operation and Maintenance Expenses (O & M)**: O & M expenses refer to the costs incurred for operating and maintaining a project. This includes expenditures on manpower, maintenance, repairs, spare parts, consumables, insurance, overheads, and non-generation fuel.

Best-case scenario: All the issues were successfully addressed and fully resolved

Using the DCF method, the EV of SKS is ₹3,065 crore, assuming all issues were resolved.

Assumptions considered:

1. The life of the project is 25 years from COD.

2. PLFhas been considered at 90% which is allowed in the standard power purchase

agreement issued by the Ministry of Power, Govt of India. It can be assumed that the new management will be capable of resolving the underlying issue with respect to the availability of the plant and increasing the PLF to the required level mentioned in the standard bidding documents.

3. Debt will not be paid as the existing cash flow (without haircut) will not be sustainable and cannot be afforded by the existing cash flow. It is assumed that the lenders and all the other stakeholders will be taking a reasonable haircut (80%).

4. The quality of coal in terms of GCV, price of coal and dependency on e-auction coal will be resolved to the full extent. In this case, GCV is around 4000 Kcal/ kWh (average GCV of G9 to G13, as prescribed by Coal India Limited (CIL)). The coal price cost is considered ₹2283/ ton (average benchmarked price for G9 to G13 coal).

5. Auxiliary consumption is considered at 5% which is at par with the standard power purchase agreement issued by the Ministry of Power, Government of India. It is possible with the change of management as the new management will be capable of maintaining the plant in a manner to minimise the auxiliary consumption at the lowest level.

6. In this scenario, SKS will be able to recover full variable cost as it will be able to avail good quality coal supply. It may also be noted that the revenue stream is already fixed as the power sale tie-ups are under the tariff-based competitive bidding process. Therefore, the upside arising from the recovery of variable expenses will be charged through the fixed charges. The fixed charges will increase to ₹2.65/ KwH.

7. Operating and maintenance expenses are considered to be ₹20.26 Lakhs/ MW, which is at par with the CERC-allowed regulatory norms prescribed in their Multi-Year Tariff Regulations.

8. WACC – 12.00% for EV computation.

Table 3: Financial Projection of SKS assuming resolution of all issues

Best- Case Scenario								
Fiscal Year	Units	2024	2025	2026	2027	2028	2029	2041
Capacity	MW	600	600	600	600	600	600	600
PLF	%	90.00%	90.00%	90.00%	90.00%	90.00%	90.00%	90.00%
GCV	Kcal	4,000	4,000	4,000	4,000	4,000	4,000	4,000
Aux Consumption	%	5%	5%	5%	5%	5%	5%	5%
Availability of domestic coal	%	90%	90%	90%	90%	90%	90%	90%
Generation for sale	MU	4,494	4,506	4,494	4,494	4,494	4,506	4,506
Sale Price	Rs/u	5.23	5.33	5.43	5.53	5.65	5.77	7.82
Revenue	Rs Cr	2,352	2,403	2,439	2,487	2,538	2,602	3,522
Coal Cost	Rs/u	2.53	2.64	2.74	2.85	2.97	3.09	5.03
Gross Margin	Rs/u	2.70	2.69	2.69	2.68	2.68	2.68	2.79

Gross Margin	%	51.61%	50.51%	49.52%	48.49%	47.47%	46.42%	35.71%
O&M expenses	Rs Cr	144.51	149.60	154.87	160.32	165.96	171.80	260.21
EBITDA	Rs Cr	852.49	845.34	833.32	824.35	815.76	810.15	740.41
EBITDA Margin	%	18.75%	20.27%	24.22%	37.32%	36.25%	35.18%	34.16%

Source: Author

Inferences from Table 3

a. Resolution of underlying issues would allow the asset to perform normally and generate profit.

b. SKS would generate a decent gross margin and EBITDA, which could be used to repay debt and reward equity holders.

c. Cash balance would gradually build up with an increase in revenue billed and collected.

Worst-Case Scenario: None of the issues were addressed or resolved

Using the DCF method, the EV of SKS is ₹715crore, assuming none of the issues were resolved.

Assumptions considered: -

1. The life of the project is 25 years from COD.

2. PLF would remain at a poor level of 65-67% throughout the life of the asset as the capability to resolve the underlying issue in respect of non-availability of long/ medium term power sale agreement.

3. Debt is not being paid as the existing cash flow (without haircut) will not be sustainable and cannot be afforded by the existing cash flow. This is primarily due to the fact the capex per MW is significantly high (₹7.9 crore/ MW)

4. JPL would continue to source poor quality expensive coal leading to very poor recoveries in variable cost. In this case, GCV is around 3250 Kcal/ kWh with the coal price cost of ₹3465/ ton (CIL benchmarked price for G14 grade coal).

5. Auxiliary consumption is considered at 8% which is at par with the CERC-allowed regulatory norms prescribed in their multi-yeartariff regulations

6. Unable to recover full variable cost as JPL fails to avail good quality coal supply. It may also be noted that the revenue stream is already fixed as the power sale tie-upis under the tariff-based competitive bidding process.

7. Operating and maintenance expenses are considered to be ₹20.26 Lakhs/ MW, which is at par with the CERC-allowed regulatory norms prescribed in their multi-yeartariff regulations

8. WACC – 12.00% for EV computation

Table 4: Financial Projection of SKS assuming no resolution of issues

Worse – Case Scenario								
Fiscal Year	Units	2024	2025	2026	2027	2028	2029	2041
Capacity	MW	600	600	600	600	600	600	600
PLF	%	67.00%	67.00%	67.00%	67.00%	67.00%	67.00%	67.00%
GCV	Kcal	3,250	3,250	3,250	3,250	3,250	3,250	3,250
Aux Consumption	%	8%	8%	8%	8%	8%	8%	8%
Availability of domestic coal	%	75%	75%	75%	75%	75%	75%	75%
Generation for sale	MU	3,240	3,249	3,240	3,240	3,240	3,249	3,249
Sale Price	Rs/u	6.21	6.36	6.51	6.67	6.84	7.02	9.98
Revenue	Rs Cr	2,012	2,065	2,109	2,161	2,216	2,281	3,242
Coal Cost	Rs/u	3.76	3.92	4.07	4.24	4.41	4.59	7.45
Gross Margin	Rs/u	2.45	2.44	2.43	2.43	2.43	2.43	2.53
Gross Margin	%	39.39%	38.37%	37.40%	36.44%	35.50%	34.57%	25.33%
O&M expenses	Rs Cr	144.51	149.60	154.87	160.32	165.96	171.80	260.21
EBITDA	Rs Cr	480.91	473.78	463.46	454.99	446.69	440.18	351.66
EBITDA Margin	%	17.34%	18.64%	22.48%	24.90%	23.90%	22.94%	21.98%

Source: Author

Inferences from Table 4

a. As the issues remain unresolved, SKS is unable to generate adequate profit and cash flows. EBITDA is also low and would continue to deteriorate because of the inability to recover coal costs.

b. Cash andbank balances would initially increase due to the absence of debt repayment but would gradually decline with time.

Base-Case Scenario: Issues were partly addressed and resolved

Using the DCF method, SKS's EV is ₹1801crore, assuming none of the issues were resolved.

Assumptions taken: -

1. The life of the project is 25 years from COD.
2. PLF has been considered at 70%, close to the Indian national average.
3. Debt will be paid after considering that the existing lenders and all the other stakeholders have taken a haircut of 95%.
4. The quality of coal in terms of GCV, price of coal and dependency on e-auction coal will be resolved to a large extent. In this case, GCV is assumed to be 3850 Kcal/ kWh (slightly lower than the average GCV of G9 to G13, as prescribed by Coal India Limited).

This is due to the fact that NTPC can arrange the G12 grade coals from domestic sources. As per the Ministry of Coal, the GCV for G12 grade coal ranges between 3700 to 4000 kcal/ kwH. The coal price cost is considered ₹2283/ ton (CIL benchmarked price for G12 coal).

5. It is assumed that SKS will be able to procure 90% of the total coal requirement from the domestic source considering the fact the production of CIL is increasing and dependency on thermal power plants is decreasing due to higher penetration of renewable power.
6. Auxiliary consumption is considered at 8% which is at par with the CERC-allowed regulatory norms prescribed in their multi-yeartariff regulations.
7. In this scenario, SKS will be able to recover the full variable cost as it will be able to avail good quality coal supply. It may also be noted that the revenue stream is already fixed as the power sale tie-ups are under the tariff-based competitive bidding process. Therefore, the upside arising from the recovery of variable expenses will be charged through the fixed charges. The fixed charges will increase to ₹2.63/ KwH.
8. Operating and maintenance expenses are considered to be ₹20.26 Lakhs/ MW, which is at par with the CERC-allowed regulatory norms prescribed in their multi-year tariff regulations.
9. WACC – 12.00% for EV computation.

Table 5: Financial Projection of SKS assuming partial resolution of issues

Base - Case scenario								
Fiscal Year	Units	2024	2025	2026	2027	2028	2029	2041
Capacity	MW	600	600	600	600	600	600	600
PLF	%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%
GCV	Kcal	3,850	3,850	3,850	3,850	3,850	3,850	3,850
Aux Consumption	%	8%	8%	8%	8%	8%	8%	8%
Availability of domestic coal	%	90%	90%	90%	90%	90%	90%	90%
Generation for sale	MU	3,627	3,637	3,627	3,627	3,627	3,637	3,637
Sale Price	Rs/u	4.92	5.01	5.08	5.17	5.26	5.36	7.00
Revenue	Rs Cr	1,785	1,820	1,842	1,874	1,907	1,950	2,546
Coal Cost	Rs/u	2.24	2.33	2.41	2.50	2.60	2.70	4.23
Gross Margin	Rs/u	2.68	2.67	2.67	2.66	2.66	2.66	2.77
Gross Margin	%	54.45%	53.41%	52.51%	51.55%	50.61%	49.60%	39.57%
O&M expenses	Rs Cr	144.51	149.60	154.87	160.32	165.96	171.80	260.21
EBITDA	Rs Cr	656.52	650.00	639.56	631.53	623.79	618.41	549.78
EBITDA Margin	%	17.93%	19.32%	23.20%	37.82%	36.77%	35.71%	34.71%

Source: Author

Inferences from Table 5

a. Resolution of some of the underlying issues would allow the asset to perform normally.

b. PLF and generation of power would increase with time.

c. SKS would generate decent EBITDA which could be used to repay debt and reward equity holders.

d. Cash balance would gradually build up with an increase in revenue billed and collected.

RESULTS AND DISCUSSION

SKS Power Generation Company suffered from financial distress due to several reasons. It was engulfed in problems like a severe coal supply crunch, coal linkages, poor quality coal, and a huge debt burden. Despite having a long-term PPA for 100 MW, the company had to sell power under short-duration contracts due to its inability to meet its coal requirements. Due to the delay in the commissioning of the project, coal linkage was cancelled, forcing the company to undergo the CIRP. As a result, bidding for SKS was initiated, which was finally won by SMEL. SMEL submitted an aggressive offer for the company, motivated by its ownership of coal mines close to SKS power's plants. This ensured easy fuel access and efficient, affordable power generation. SEML is the most economical manufacturer as it possesses ownership of iron ore, mining, power, sponge iron, etc. The company has a good hold on the steel industry and is self-sufficient in energy and mineral resources as well.

In this worst-case scenario, if no underlying issues with the SKS power generation company had been resolved, the company could have fetched only ₹715 crore. The lenders had to take a huge haircut. Simultaneously, in the best-case scenario, assuming all the issues with SKS were resolved, the proposed model provides a value equal to ₹3,065 crore, which is quite a high valuation. The realistic case scenario provides the optimum value, assuming the resolution of a few issues but not all of them. SMEL might have assumed to supply coal to SKS through SECL mines with the resolution of power off-take through long-term PPA, thereby enabling recovery of variable costs up to the extent of power off-take under these agreements.

The EV of SKS in the realistic case scenario stands at ₹1801 crore, which is based on the assumption of partial resolution of the underlying issues by SMEL. SKS's state of insolvency can be reversed if the bidder's capacity to handle the underlying issues of the distressed firm can reverse the decline.

In the NCLT proceedings, SMEL emerged victorious by bidding with almost a 100% recovery rate. SEML's advantage lies in its proximity; it owns coal mines near SKS Power's plants. This strategic location promises convenient access to fuel and facilitates cost-effective power production. Following the successful bid acquisition, SMEL could leverage the assets and infrastructure of SKS to augment its operational capacity.

Hence, in all three scenarios, the turnaround cashflows were calculated based on the capacity of the resolution applicant to resolve a particular issue wholly or partly. The DCF model provided an amount of cash flow based on the assumption of the resolution applicant for a particular issue, say coal cost or PPA linkage, and so forth. Thus, the turnaround cash flow

was estimated after assuming all the issues individually, depending on the capacity to resolve them. One with a better capacity to handle and resolve the underlying issues quotes a higher value for the stressed company. CoC, by its empowerment, examines the bid value and the strength of the resolution applicants to decide the winning bidder.

CONCLUSION AND FINDINGS OF THE STUDY

The present study aims to evaluate the impact of the resolution applicant's capacity to resolve the issues or reasons for the distress of a thermal power plant on its valuation. The study attempts to analyse and quantify the effect on the EV of the distressed firms brought by the resolution applicants after assessing their capacities to handle those issues effectively. The study reveals that the resolution applicant's quoted bid value mirrors their self-assessed projection of turnaround cash flows. The calculation of the bid value does not rely only on the valuation methodology used to value distressed companies but also on the assumptions taken by them to obtain the optimal EV. With the help of the case study of SKS Power Generation Ltd., the author made an effort to achieve the objectives of the study and establish that the value assigned to a distressed firm is not the result of choosing and applying a particular valuation approach or methodology. By and large, it symbolises the capacity and strength of a resolution applicant or bidder to resolve the underlying issues of a distressed firm wholly or partly, as demonstrated by the scenario analysis.

The case study of SKS Power Generation reflected the following findings:

i) The study identified the reasons for the stress of the case company SKS Power Generation.

ii) The level of stress in the case company was low and the decline could be reversible.

iii) The valuation methodology used for calculating the EV of the case company was the DCF model in all the scenarios. However, the resolution of underlying issues in each scenario basis the capacity of the bidder brought a difference in the valuation of the case company.

iv) The more a bidder has the capacity and potential to resolve the underlying issues, more will be the optimised EV.

v) The resolution of underlying issues and the capacity of the bidder to resolve them impacts the valuation of a distressed firm in the case of the thermal power generation sector in India.

THEORETICAL AND PRACTICAL IMPLICATIONS, LIMITATIONS AND FUTURE SCOPE OF RESEARCH

The study concentrates on the valuation of distressed companies in India's power sector. Since there is a dearth of studies in the domain in the context of India, the present study will contribute to the literature with novel ideas and findings. The study will be a guiding light for future researchers to delve deep into the area of valuation and investigate other sectors too. It contributes to theoretical frameworks by elucidating the complexities involved in distress valuation and emphasising the need to go beyond traditional methodologies for better returns

to all stakeholders. It sheds light on how these drivers or issues interact and influence the valuation process, providing valuable insights for academics and practitioners alike. Investors, restructuring companies, bidders, and financial institutions can leverage insights from the study to make informed investment decisions in distressed companies, considering both financial metrics and non-financial drivers of value. The study provides practical guidance on assessing risk and potential returns in distressed situations, aiding investors in navigating complex valuation landscapes.

Valuation practitioners, registered valuers, financial analysts, and consultants can leverage theoretical frameworks and practical recommendations to effectively value distressed companies. Professionals in finance, accounting, and valuation can enhance their expertise by integrating insights from the study into their practice. Like every research article, this study also has its limitations. The study focuses on the valuation dynamics of the power sector, in particular thermal power plants. Other sectors are not in the scope of this study, as it is a sector-specific case study. The proposed valuation methodology can work for other sectors too, provided the underlying issues or reasons of distress for them are identified clearly. Future researchers can explore similar studies for other sectors as well, for the greater benefit of all. This will help to facilitate timely distress recognition, resolution, and restructuring while ensuring transparency and accountability in the process. Regulatory bodies can collaborate with industry experts and academia to develop guidelines and best practices for distress valuation, thereby promoting consistency and reliability in valuation outcomes.

Note: *The words resolution applicant and bidder have been used alternately in the manuscript.*

Caveat: The CIRP of SKS Power Generation Limited ended in resolution with a decision of the CoC to approve the resolution plan of SEML vide order dated June 8, 2023. Torrent Power moved an application u/s 60 (5) of the IBC filed on 03.08.2023 seeking intervention in the Plan Approval Application in the case of SKS Power Generation Ltd. and requested to defer the order in the Plan Approval Application until disposal of the present application. The NCLT bench has remitted the resolution plan approval order back to CoC on 06.10.2023. The final order is still pending. The author has chosen SKS Power Generation as a case company without knowing the recent developments. Hence, the bid values were considered as quoted at the first instance by the bidders and accordingly, the EV was calculated. The change in the final 'winning' bidder does not impact the results and the findings of the study.

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11

SSFs AND THE IBC: A SYMBIOTIC RELATIONSHIP FOR SPEEDING UP NPL RESOLUTION IN INDIA

Anushree Srivastava and Vardaan Mahajan

ABSTRACT

Non-performing loans (NPLs) pose a significant threat to the stability of the Indian financial system. This research paper explores the potential of Special Situation Funds (SSFs) as a transformative force in mitigating systemic risks associated with NPLs. With their expertise in distressed debt management and turnaround strategies, SSFs can accelerate NPL resolution, inject fresh capital into stressed businesses, and enhance market discipline. The paper employs a qualitative approach, analysing legal frameworks, research studies, and real world examples of SSF involvement in Indian NPL resolution cases. Under the Insolvency and Bankruptcy Code, 2016 (IBC/Code), SSFs can actively participate in debt resolution by submitting restructuring plans for distressed companies, influencing turnaround efforts, and expediting debt recovery processes. The study highlights how SSF involvement can complement existing resolution measures, potentially speeding up resolutions and maximising stakeholder value. Additionally, SSFs can acquire stressed debt or distressed assets through IBC auctions, providing liquidity to banks and potentially rescuing struggling businesses. However, the paper emphasises the importance of responsible SSF participation to prevent predatory practices, market concentration, and conflicts of interest. The research examines the impact of SSFs; actions within insolvency proceedings on the rights and interests of other stakeholders, such as existing creditors and minority shareholders. Furthermore, the paper discusses regulatory frameworks that can encourage responsible SSF participation and ensure a balanced and effective approach to NPL resolution in the Indian financial system. This research will employ a qualitative methodology, drawing on diverse primary and secondary data sources to support its investigation into SSFs; role in mitigating NPL-related systemic risks in the Indian financial system. Primary sources include legal documents, regulatory reports, and financial data on SSFs and NPLs. These will provide a foundation for understanding the legal frameworks, regulatory gaps, and market dynamics shaping SSF participation. Secondary data will be derived from research papers, news articles, and case studies, offering insights into specific insolvency proceedings involving SSFs. Theoretical frameworks will guide the analysis, encompassing concerns about predatory practices, market concentration, regulatory gaps, and potential benefits associated with

SSF participation. Analytical tools will include existing research models and critical perspectives on NPL resolution and SSFs, allowing for a nuanced examination of their impact on stakeholders and the broader financial ecosystem. By employing a qualitative approach and utilising diverse data sources, the research offers a comprehensive understanding of the multifaceted dynamics surrounding SSF involvement in NPL resolution in the Indian financial system. Furthermore, the research highlights the evolving landscape as SSF involvement intensifies and advanced algorithms are integrated. This technological synergy streamlines asset assessment and strengthens SSFs; efficacy in formulating and executing robust turnaround strategies. The findings suggest that fostering a collaborative ecosystem characterised by transparent communication and joint initiatives could enhance the positive impact of SSFs on NPL resolution, thereby contributing to the resilience and stability of the Indian financial system. SSFs growing role in Indian NPL resolution yields both opportunities and challenges. For lenders, SSFs provide liquidity and expedite resolution, yet risks include lower recovery and loss of control. Borrowers gain turnaround prospects but face potential predatory practices. Minority shareholders may see increased value recovery but risk ownership dilution and limited information. Balancing these dynamics is essential to comprehensively assess the impact on NPL resolution in the Indian financial landscape.

INTRODUCTION

In the intricate financial fabric of India, the rise of NPLs has posed significant challenges to the stability of the banking system. As part of the strategic response to this issue, SSFs, under the regulatory umbrella of the Securities and Exchange Board of India (SEBI), have emerged as a pivotal instrument. SSFs, categorized as a subset of Alternative Investment Funds (AIFs), are specifically designed to invest in distressed assets, including stressed loans. These funds have carved a niche for themselves by possessing the acumen to navigate the complex terrain of distressed assets, fostering a conducive environment for the rehabilitation of NPLs and providing a buoyant impetus for economic recovery.

The regulatory landscape that empowers SSFs to operate effectively is shaped by a constellation of policy frameworks and guidelines, which include the SEBI (AIFs) Regulations, 2012, and various directives from the Reserve Bank of India (RBI). By enabling SSFs to acquire stressed loans, typically from the banks' balance sheets, these funds introduce fresh liquidity into the system, thereby assisting banks in managing and eventually reducing their NPL exposure. This process is facilitated by the SSFs' proficiency in restructuring and turning around the fortunes of the distressed entities they invest in. Moreover, the potential for SSFs to acquire stressed loans both during and after the resolution process under the IBC or other RBI stipulated frameworks further amplifies their role in the resolution of NPLs.

The relationship between SSFs and NPL resolution is thus marked by a strategic alignment of investment expertise and regulatory support, which construct a robust mechanism for managing the NPL crisis. This alignment is further refined by recent amendments proposed

by SEBI, aiming to streamline the definition of special situation assets and enhance investor eligibility, thereby ensuring that SSFs and their underlying investors are well-equipped to address the nuances of NPLs effectively.

As this paper unfolds, it will dissect the mechanisms through which SSFs contribute to the reduction of NPLs in the Indian banking sector, examine the regulatory scaffolding that supports such endeavors, and analyze the implications of recent developments in SEBI's policies on the functioning and efficacy of SSFs.

> As at September, 2021, GNPA of banks was at INR 4,53,145 crore and that of the top 30 NBFCs, including HFCs stood at around INR 84,000 crore. Out of these loans, In 2019-20, the amount recovered as per cent of the amount involved under IBC was 45.5 per cent, followed by 26.7 per cent for ARCs. While the amount recovered through ARCs as per cent of amount involved was significantly higher in the initial years of their inception, in the recent years, it has dipped below 30 per cent except for a spurt in 2017-18.[1]

The IBC has been an essential reform for the two decades since its enactment in 2016 and it has now become a fundamental pillar of India's financial and legal landscape by providing a single solution to challenges of insolvencies and bankruptcies. The IBC will, therefore, endeavor to facilitate a speedier resolution of the problem, unearth the value of non-performing assets (NPAs), and promote possibilities in entrepreneurship. Its put [into] effect has been manifested through NPL resolution improving the debtor's situation in the timely manner and protecting the creditor's interests. Notably,[2] of the total 13,884 cases disposed of by various NCLT benches, 7,365 were under the IBC. This reform has significantly enhanced India's position in the World Bank's Ease of Doing Business index, particularly in the "resolving insolvency" parameter, where the recovery rate improved nearly threefold from 25.7% in 2016 to 71.6% [3] in 2019.

SSFs may be considered as one type of investment tool which are not only capable of resourcing NPLs effectively but also other types of assets in distress. To start with, a scenario of SSFs playing the role of a fair route that allows banks to deal with NPAs by selling them to SSFs, could be a remedial measure which perhaps banks can agree to helping them in managing the pressure of doing this on their balance sheets. The ability of the SSFs to create a resolution framework within NPLs depends greatly on their propensity to bring in liquidity in the market, raise recover rates of the assets, and facilitate restructuring programs especially for businesses in default.

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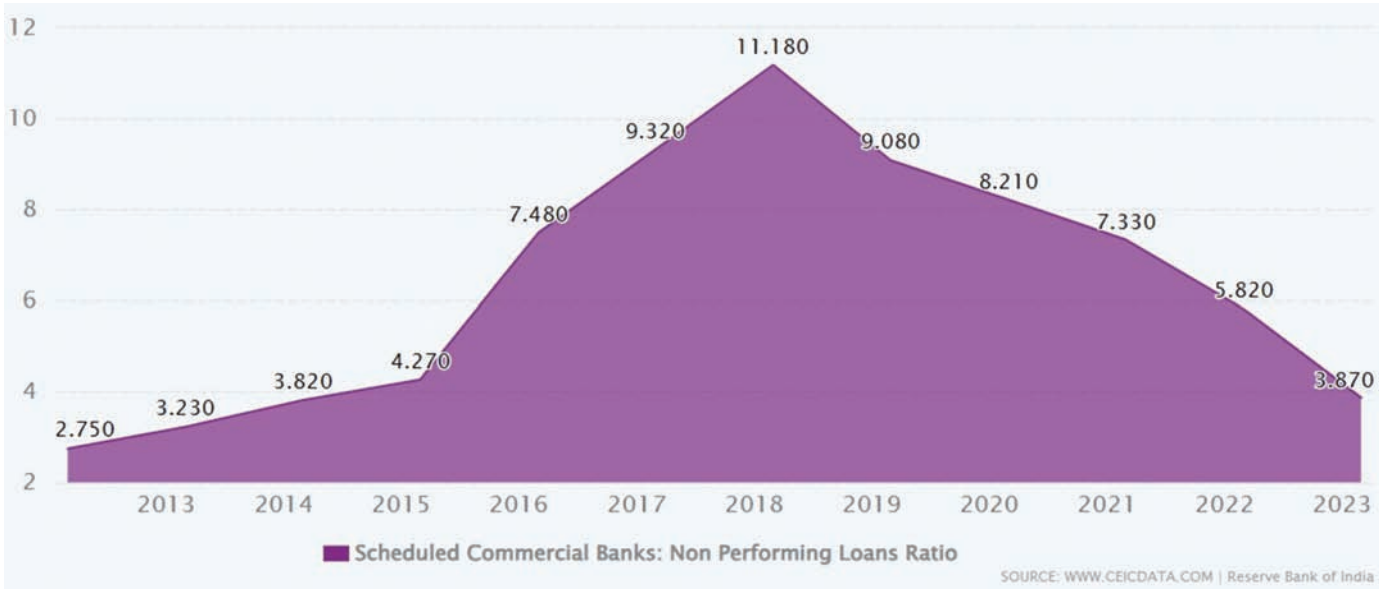
[3] F Ahmed, *Assessing the effectiveness of insolvency and bankruptcy code, Indusedu.org.*, https://indusedu.org/pdfs/IJREISS/IJREISS_3750_79235.pdf.

Fig 1: India's Non Performing Loans Ratio (2018)



Source: Ceicdata.com; https://www.ceicdata.com/en/indicator/india/non-performing-loans-ratio (April 01, 2024).

The NPL ratio in the above graph saw a gradual increase from 2013, starting at 2.75%, and reached a peak in 2018 at 11.18%. This rise could be indicative of several factors, including economic downturns, changes in lending practices, or a relaxation of credit standards during this period. After 2018, there is a notable decrease in the NPL ratio, dropping significantly to 3.87% by 2023. This downward trend might reflect a combination of tightened credit standards, better risk management by banks, economic recovery, or the effects of regulatory changes such as the IBC implementation in 2016. The decrease in NPLs from a peak in 2018 could also be associated with the introduction of specialized mechanisms such as Special Purpose Securitization Funds (SSFs) for dealing with distressed assets and the overall improved health of the banking sector. The sharp peak and subsequent decline suggest effective regulatory interventions and possibly a cyclical nature of the NPLs, where they tend to increase during economic booms due to aggressive lending and decrease as banks start to clean up their balance sheets during busts or under regulatory pressure. The source for this data is CEICDATA and the RBI, which is a reliable source for such financial data.

In that direction, the research will apply a mixed-method technique, which will include quantitative analysis of trends, the efficiency of business considerations, and IBC case studies along with qualitative evaluation of their consequences to the finance system. Primary sources, which the authors will gather from RBI reports, case studies related to IBC, and data from the financial sector, will be the main sources of information. Secondary data would include publications, industrial tools, and expert interviews. The report should be given some insights into the effectiveness of SSFs and the IBC in solving NPL difficulties and identifying problems and recommendations would be included. It will, however, add to the knowledge and resource base on financial stability which will include asset resolution frameworks, and they will restrict the growth of financial risks. Furthermore, the RBI's reports evaluate high-level

risks and analyse issues of resilience and the link between monetary policy tightening and financial sector stress. Tata Steel-Bhushan Steel and JSW Steel-Monnet Ispat[4] & Energy are the prime examples in terms of the steel industry, to emphasize the success stories.

The study would be aimed at outlining whether players of the IBC and SSFs are playing their role in dealing with high level of NPLs, as well as providing possible solutions. The book will address the wider issues concerning financial stability, asset resolution frameworks and their real impact on regulatory reforms and financial risks control.

When it comes to addressing troubled loans in the Indian banking system, its important to understand the distinction between NPLs and NPAs. NPLs, or non-performing loans, refer to the broader category of loans where the borrower has failed to make interest or principal payments for at least 90 days. This encompasses a wide range of impaired loans. While NPL resolution is governed by various regulatory guidelines issued by the RBI, NPA resolution is addressed through the comprehensive legal framework provided by the IBC. The resolution mechanisms also differ - NPL resolution can involve restructuring, refinancing, or out-of-court workouts, while NPA resolution under the IBC follows a more formal insolvency process that may lead to asset sales, debt restructuring, or even liquidation. The stakeholder involvement is also broader in NPA resolution, with the National Company Law Tribunal (NCLT), resolution professionals, creditors, and other interested parties playing pivotal roles. Ultimately, the key distinction lies in the scope, regulatory framework, and the resulting resolution outcomes, with the IBC providing a more structured approach to addressing the critical issue of NPAs in the Indian financial system.

LITERATURE REVIEW

"Distressed assets" are investments in undervalued assets often caused by borrowers defaulting on their loans. Investing in stressed loans means putting money into the debts of companies facing financial trouble, usually because they've borrowed too much money. These companies might have good businesses but struggle to pay their debts, so their value drops. Investors in distressed debt hope these companies will recover financially. They might try to take control of the company during its tough times to help with its restructuring or buy its debts when it's bankrupt. The distressed debt market tends to grow when the economy slows down.

An investor may, therefore, take the following positions

- Restructure a distressed company
- get a controlling position and influence the restructuring process Bankruptcy of a distressed company
- resolution applicant i.e. purchasing claims under IBC Selling of such stressed loans to other investing companies (mostly ARCs) i.e. holding these assets as a part of a diversified portfolio.[5]

[4] Satya Sontanam, *A Look at Two Successful IBC Cases in the Steel Industry*, Hindu Businesslin, February 15, 2019, https://bloncampus.thehindubusinessline.com/b-learn/insight/a-look-at-two-successful-ibc-cases- in-the-steel-industry/article26281699.ece.

[5] *Supra note 3.*

Figure 2: View of A Literature Review of Non-Performing Loan

The SEBI had, through its notification dated January 24, 2022, introduced a significant update to the SEBI (AIFs) Regulations, 2012, by defining a new investment vehicle known as SSFs. A paper by Metaxas,[6] demonstrates that the primary causes of NPLs in the Greek banking sector are macroeconomic factors (such as GDP, unemployment, interest rates, and public debt) and managerial qualities.

The RBI working paper[7] provides detailed analysis showing how bad loans or NPLs, act through economic cycles, in Indian banks. The bank researchers found out that there is a 4.3% jump in bad loans for the long term for every 1% lending increase by banks with the effect being additional during the economics booms. The paper moreover investigates how sensitive those bad loan ratios are to the variance of interest rates and GDP growth. The research lays bare the health and stability of the Indian financial system and serves as a useful guide.

Khairi, Bahri, and Artha (2021) highlighted the alarming increase in NPLs following the global financial crisis of 2008-2010, underscoring the necessity for banks worldwide to scrutinize asset quality more rigorously. The authors advocate for regulatory and accounting enhancements to promote precise evaluations of loan portfolios, a critical measure amidst dwindling interest rates and bank profitability. Their comprehensive review of 21 scholarly articles aimed to unearth factors influencing NPLs, revealing an absence of research on policy-related variables, thus suggesting a new direction for future inquiries. Kauko (2012) investigates the interplay between national current account balances and NPLs amid financial crises, prioritizing macroeconomic indicators over banking sector resilience as primary factors of analysis. Zhang et al. (2015)[8] find a significant impact of NPLs on bank behavior, suggesting how banks' strategic responses to NPLs can influence their operational decisions. Boumparis

[6] D Louzis, A Vouldis and VMetaxas, *Macroeconomic and bank-specific determinants of nonperforming loans in Greece: A comparative study of mortgage, business and consumer loan portfolios*, Journal of Banking & Finance, 36(4):1012-1027, 2012.

[7] Reserve Bank of India - Publications , Org.in. : https://www.rbi.org.in/scripts/PublicationsView.aspx?id=17400 (April 13, 2024).

[8] D Zhang, J Cai, D G Dickinson and A M Kutan, *Non-performing loans, moral hazard and regulation of the Chinese commercial banking system*, Journal of Banking & Finance, 2015.

et al. (2019)[9] and Grigoli et al. (2018) contribute by linking NPLs to sovereign credit ratings and economic contractions, respectively, highlighting how external economic pressures and fiscal health directly influence bank loan performance.

The paper on NPLs in Vietnam by Dung, Nguyen Anh, primarily focuses on understanding the factors that lead to the rise in NPLs and their impact on the economy and banking sector. It highlights how economic conditions, sector-specific challenges, and government policies such as those enacted by the State Bank of Vietnam influence the quality and management of loans. For instance, the paper discusses the detrimental effects of economic downturns on sectors like real estate and the broader implications for loan performance, emphasizing the role of government and regulatory frameworks in managing these NPLs. This analysis is critical for understanding how similar factors might influence NPLs in India, especially considering the role of the RBI and policies like the IBC.

Additionally, the paper delves into bank-specific practices in managing credit and the role of Asset Management Companies (AMCs) in Vietnam, discussing how these entities help manage distressed assets. Drawing from international comparisons and recovery and resolution practices, the study by Nguyen Anh Dung (as presented in his thesis for Arcada University) provides a detailed comparative analysis of the NPL landscape. This framework offers a valuable perspective for analyzing India's approach to NPL management, comparing it with global trends and identifying effective strategies for recovery and resolution, including the use of AMCs and the impact of regulatory measures on banking stability and economic growth. Such an approach can inform a structured examination of the NPL situation in India, drawing on the parallels and contrasts with the Vietnamese experience as detailed in the study.

ARC's AND SSF's DIFFERENCE

Asset Reconstruction Companies (ARCs) and SSFs may appear to operate within the same sphere of distressed assets, but they embody different structures, regulatory frameworks, and operational strategies. One of the biggest perks of being involved in a SSF is that you get to directly influence how a troubled asset gets turned around. This is different from the traditional approach where an ARC trustee company oversees the resolution process.[10]

ARCs in India are regulated primarily by the RBI under the SARFAESI Act, with the specific mandate to acquire and resolve NPAs. These companies purchase NPAs from banks and financial institutions, which enables these lenders to clean their balance sheets by offloading defaulted loans. The ARCs aim to recover the debts through various mechanisms such as restructuring the loan, changing the management of the borrower company, or liquidating assets. This process helps banks to focus on their core business activities instead of expending resources on recovery processes. ARCs profit from the resolution process either by recovering amounts greater than what they paid for the NPA or through management fees and surplus sharing with the original lenders. ARCs hold and manage these distressed assets, generally

[9] P Boumparis, C Milas and T Panagiotidis, *Non-performing loans and sovereign credit ratings*. International Review of Financial Analysis. 64: 301-314, 2019.

[10] Founding Partners, *Special situation funds (India chapter in international insolvency & restructuring report 2022-23)*, AZB, https://www.azbpartners.com/bank/special-situation-funds-india-chapter-in-international- insolvency-restructuring-report-2022-23/ (April 13, 2024).

through trusts set up as Security Receipts (SRs) to investors, which serve as a recovery mechanism and value extraction from the distressed loans.

On the other hand, SSFs are categorized under Category-I AIFs, which are governed by the SEBI. They represent a specialized segment of investment vehicles created to invest in distressed assets but with a broader investment mandate than ARCs. Unlike ARCs, which are limited to acquiring NPAs, SSFs can also invest in securities of companies under stress, offering a unique proposition in the distressed asset market. Their investor base is diversified, including institutional investors like pension funds and high-net-worth individuals who seek to capitalize on the potential upside of investing in companies facing financial difficulties.[11]

SSFs' operational strategy involves not only the revival of the distressed asset but also potentially taking an active role in the management and turnaround of the companies they invest in. They can engage in the entire life cycle of a distressed asset, from pre-resolution to post- acquisition, which includes influencing the resolution plans under the IBC. The flexibility and investment acumen of SSFs allow them to strategize for longer-term value creation by working closely with the management of the distressed entities, providing capital infusion, and ensuring sustainable restructuring.

The regulatory framework for SSFs is comparatively nuanced, where SEBI, as the market regulator, provides the operational guidelines. These guidelines ensure that SSFs contribute effectively to the distressed assets market by imposing certain restrictions and investment conditions that ARCs do not face. For example, SSFs are subject to the minimum holding period for stressed loans acquired under the RBI Master Directions, which dictates the time frame within which they can hold and resolve these assets.

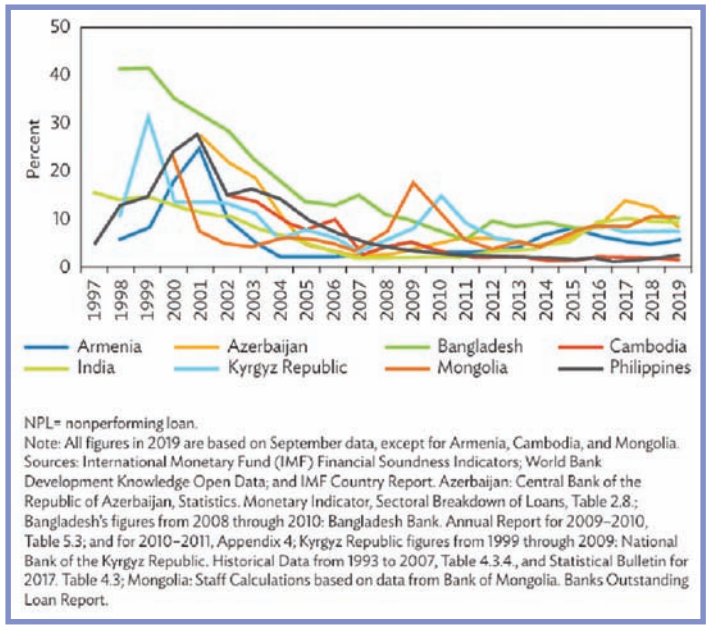
Moreover, SSFs have a different impact on the financial market. While ARCs directly affect the banking sector's NPL ratios by purchasing the bad loans, SSFs can provide a more market-driven solution by bringing in additional capital and investment expertise, often leading to a more competitive and efficient resolution process. They play a crucial role in deepening the distressed assets market by offering additional avenues for banks to manage their distressed assets. In terms of resolution, ARCs have historically been the primary players in the Indian context, but SSFs are expected to bring in more sophisticated and diverse strategies given their wider investor base and flexible investment mandates. The harmonization of regulations by the RBI and SEBI is poised to further streamline the operations of both ARCs and SSFs, fostering an ecosystem where both can coexist and provide complementary solutions in the distressed assets market.

NPL RESOLUTION MECHANISMS GLOBALLY

In the graph given below, Armenia generally maintains a lower percentage of NPLs, indicating a relatively stable financial environment. In contrast, Azerbaijan experiences significant fluctuations in NPLs, with peaks observed around 2009 and 2016, suggesting periods of financial stress. The Kyrgyz Republic shows a gradual decline in NPLs, indicating improving loan performance over time. Similarly, Mongolia's NPLs peak around 2009 and 2016, mirroring

[11] Outbreak Has, R., *Sebi details regulation norms for SSF*, Elplaw.in, https://elplaw.in/wp- content/uploads/2022/01/ELP-Update-SEBI-details-regulatory-norms-for-Special-Situation-Assets.pdf (April 13, 2024).

Azerbaijan's pattern of fluctuation. Bangladesh, on the other hand, remains relatively stable with minor variations in NPLs, indicating a resilient banking sector. Finally, the Philippines demonstrates a steady decline in NPLs over time, reflecting sustained improvements in loan quality and financial stability.



NPL= nonperforming loan.
Note: All figures in 2019 are based on September data, except for Armenia, Cambodia, and Mongolia.
Sources: International Monetary Fund (IMF) Financial Soundness Indicators; World Bank Development Knowledge Open Data; and IMF Country Report. Azerbaijan: Central Bank of the Republic of Azerbaijan, Statistics. Monetary Indicator, Sectoral Breakdown of Loans, Table 2.8.; Bangladesh's figures from 2008 through 2010: Bangladesh Bank. Annual Report for 2009–2010, Table 5.3; and for 2010–2011, Appendix 4; Kyrgyz Republic figures from 1999 through 2009: National Bank of the Kyrgyz Republic. Historical Data from 1993 to 2007, Table 4.3.4., and Statistical Bulletin for 2017. Table 4.3; Mongolia: Staff Calculations based on data from Bank of Mongolia. Banks Outstanding Loan Report.

According to Preqin, as of November 2020, distressed debt and special circumstances funds, which make money by purchasing assets or debt at steep discounts, had $131.8 billion in capital, or dry powder, to deploy globally. This is around 40% more than five years ago and 150% more than 10 years ago.

Japan

Japan amended its Corporate Reorganisation Law to enhance efficiency. Before 2002, restructuring a loan required summoning an "Assembly of Related Persons" three times, even without any party's request. Since 2002, only courts or selected parties like creditors' committees can summon this assembly, expediting the bankruptcy process. Additionally, a rehabilitation plan now requires a simple majority rather than two-thirds of voters. In 2001, the "Private Rearrangement Guidelines" established principles for out-of-court debt workouts, simplifying restructuring processes.

United States

In 2005, the United States introduced simplified procedures within insolvency laws for Small and Medium-sized Enterprises (SMEs). A new Chapter 11[12] was created for SMEs, featuring standardized forms, simplified procedures, and no creditor committee requirement. Subsequently, there was an initiative to amend Chapter 12, a simplified procedure for family farmers or fishermen.

Spain

An up to three-month stay on execution was established by a new statute that was passed in 2013. A corporation and its creditors may agree on a pre-insolvency agreement thanks to changes made to the insolvency law between 2013 and 2015. After debtors' assets are handled for creditors' benefit, this insolvency law provides a debt exemption process. Further changes in 2014–15 lessened the limitations on debt reductions for unsecured debt and settlement rescheduling. Write-downs are no longer limited, and there is a ten-year window for rescheduling. Additionally, a new class voting mechanism was implemented, which requires the approval of a restructuring plan by a simple majority of either 50% or 65% of ordinary creditors.

[12] Chapter 11- bankruptcy basics , United States Courts, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics.

Greece

2014 saw the introduction of a new rule that permitted[13] short-term out-of-court workouts, including prepacks for big businesses and methods for SMEs. By limiting the automatic stay of creditors, a 2015 modification to the insolvency law improves and streamlines the rehabilitation procedures.[14] The bankruptcy process was revised in 2016 to shorten the time required to complete it by doing away with supplementary actions. In 2010, the personal insolvency rule[15] came into effect. In 2015, it underwent restructuring to expedite procedures.

THEORETICAL FRAMEWORKS FOR UNDERSTANDING SSF INVOLVEMENT IN NPL RESOLUTION

Policy options for NPL resolution

A critical framework in understanding NPL resolution is the exploration of policy options. This framework considers various instruments and approaches aimed at addressing NPLs within a country's financial system. It encompasses both debtor-focused and bank-focused resolution instruments. Debtor-focused instruments aim to assist distressed borrowers, while bank-focused instruments focus on strengthening the financial institutions themselves.[16]

Macro-financial implications of NPLs:

A key theoretical framework for understanding the macro financial consequences of NPLs is the adverse feedback loop. Empirical research supports that NPLs negatively impact macroeconomic stability and financial systems. The extent of these impacts can differ based on the specific context.[17]

RESEARCH QUESTIONS

Given the complexity of non-performing, the researchers will make an effort to keep the subject within an acceptable bound. The goal of the paper is to provide a certain amount of insight into certain problems.

1. What role do SSFs play in mitigating NPLs in the Indian financial system?
2. How do SSFs contribute to NPL resolution processes, particularly within the framework of the IBC?
3. What are the regulatory frameworks governing SSFs' operations in India, and how do they impact NPL resolution?

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[13] B C M Karatzas, V Salaka, and A S Tsatsi, *Insolvency proceedings in Greece after recent reforms*, Clearygottlieb.com, https://www.clearygottlieb.com/-/media/organize-archive/cgsh/files/2017/publications/emrj-spring-2017/insolvency-proceedings-in-greece-after-recent-reforms.pdf (April 13, 2024).

[14] *Update on new framework on corporate insolvency*, Pwc, https://www.pwc.com/gr/en/publications/New_Insolvency_Framework_GR.pdf, (April 13, 2024).

[15] Global Legal Group, *International comparative legal guides*, https://iclg.com/practice-areas/restructuring-and-insolvency-laws-and-regulations/usa.

[16] P. Baudino, and H. Yun, *Resolution of non- performing loans – policy options*, Bis.org, https://www.bis.org/fsi/publ/insights3.pdf.

[17] N.d. Adb.org. April 13, 2024i. https://aric.adb.org/pubs/nplresolutionstrategies/npls-in-asia-and-europe- causes-impacts-resolution-strategies_CH8.pdf

4. What are the opportunities and challenges associated with SSF involvement in NPL resolution, including potential benefits and drawbacks?

5. How can SSFs address ethical considerations such as predatory practices, market concentration, and conflicts of interest, while safeguarding minority shareholder rights?

The study will be categorized under investigation and analysis, utilizing qualitative research methodologies to ensure coherence, distribution levels, and reliability. This research will be underpinned by extensive literature reviews, which offer valuable insights into the subject matter. The researcher will heavily rely on reports and frameworks issued by renowned international organizations in the field, such as the Asian Development Bank (ADB), International Accounting Standards (IAS), among others.

RESEARCH OBJECTIVES

1. The study seeks to understand the role of SSFs in addressing NPLs within the Indian financial system, particularly through their capacity to inject fresh capital, manage distressed debts, and enhance market discipline.

2. It examines how SSFs contribute to the resolution of NPLs, especially within the framework of the IBC, and the effectiveness of these strategies in expediting debt recovery and maximizing stakeholder value.

3. The research analyzes the regulatory frameworks that govern SSFs' operations in India, assessing how these regulations facilitate or hinder the involvement of SSFs in NPL resolution, and suggesting improvements for a more balanced approach.

4. This objective focuses on identifying both the potential benefits and drawbacks associated with SSF involvement in NPL resolution. It includes exploring ethical considerations like preventing predatory practices, managing market concentration, and safeguarding the rights of minority shareholders

OVERVIEW OF REGULATORY GUIDELINES FOR SSFs OPERATING IN INDIA

In an effort to breathe life back into struggling businesses and safeguard investor interests, the SEBI introduced a new regulation for AIFs. This amendment carves out a new niche within AIFs specifically for SSFs. These SSFs function as a financial rescue team, targeting "special situation assets" - assets that hold potential for a turnaround but require intervention due to financial stress.

What qualifies as a special situation asset? Imagine stressed loans that banks are willing to sell at a discount or securities of companies facing temporary difficulties. The purview of SSFs extends even further, encompassing assets designated by SEBI that present opportunities for revival. SSFs aren't just passive investors; they can actively participate in the resolution process for companies undergoing bankruptcy under the IBC.

So, how does an SSF function? First, they need to register with SEBI and comply with specific investment regulations. These regulations ensure SSFs focus on their core objective – reviving troubled assets. To prevent conflicts of interest, SSFs are prohibited from investing in companies

affiliated with themselves or in other AIFs (with the exception of other special situation funds). There are also minimum investment amounts set for individuals who want to participate in SSFs.

The AIF Amendment goes a step further by outlining specific regulations for SSFs acquiring stressed loans. These loans typically come with a mandatory holding period to prevent quick flips. Additionally, SSFs must conduct thorough due diligence before acquiring these loans, ensuring they fully understand the associated risks and potential rewards.

The introduction of SSFs is seen as a positive development for the financial landscape in India. It offers a much-needed mechanism for intervening in stressed businesses before they reach the point of no return. By providing a pathway to revival, SSFs can not only protect investor interests but also contribute to the overall health of the Indian economy.

In India, SSFs operate under the watchful eyes of two main regulators: the SEBI and the RBI. SEBI actually created a special place for SSFs within the world of AIFs, classifying them as a subcategory under Category I AIFs. This means SSFs need to follow the rules laid out in the SEBI (AIF) Regulations from 2012, along with any specific instructions issued by SEBI in a circular dated January 27, 2022.[18] These regulations outline eligibility, investment, transfer, monitoring, and supervision norms for SSFs. While SEBI focuses on the overall structure and operations of SSFs, the RBI plays a different role. Through its master directions, the RBI lays out specific rules for how stressed assets (troubled loans) can be transferred from banks and other financial institutions to SSFs. These master directions cover important aspects like who can participate, how loans are valued, what information needs to be disclosed, and how much risk financial institutions can take on when selling these assets.

SEBI's consultation paper, released on 28 November 2023, outlines crucial amendments to the regulatory framework for SSFs, including the definition and scope of SSA, eligibility criteria for SSFs and their investors, adhering to S. 29A of the IBC for investor eligibility, and investment concentration limits.

Regulatory disparities between ARCs and AIFs, such as differential regulatory frameworks and limitations on investment scope, can create an uneven playing field, potentially disadvantaging ARCs.[19] To foster a fair environment, SEBI should consider harmonizing the regulatory requirements for both entities, allowing them to operate on a level playing field.

The regulatory guidelines for SSFs operating in India involve stringent regulations outlined by both SEBI and the RBI. These guidelines cover eligibility, investment, transfer, monitoring, and supervision norms, as well as criteria, valuation, disclosure, and prudential norms for loan transfers from financial institutions to SSFs. SEBI's consultation paper proposes amendments to the regulatory framework, aiming to unlock capital tied up in stressed loans and revitalize crucial sectors like banks and NBFCs.

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[18] Centre for Business and Commercial Law, *Vision for SSF: Decoding the SEBI consultation paper, CBCL. Centre for Business and Commercial Laws*, https://cbcl.nliu.ac.in/capital-markets-and-securities-law/vision-for-SSF-decoding-the-sebi- consultation-paper/, (2023).

[19] Anshul, *SEBI proposes changes for special situation funds — what are SSFs and who should invest?*, CNBCTV18, https://www.cnbctv18.com/personal-finance/special-situation-mutual-funds-sebi-changes-returns- who-should-invest-18444961.htm, 2023,

HOW DOES THE IBC ACCOMMODATE SSF PARTICIPATION IN THE RESOLUTION PROCESS?

The IBC provides a framework for the resolution of stressed assets, including those held by SSFs. The IBC aims to protect the interests of creditors, debtors, employees, and investors alike through mechanisms like time-bound processes, the committee of creditors (CoC), and priority distribution.[20]

Section 29A of the IBC, which was inserted with retrospective effect from November 23, 2017, aims to prevent individuals who have contributed to the defaults of a corporate debtor (CD) from gaining or regaining control. This provision applies not only to the resolution process but also to the liquidation process, ensuring that ineligible persons cannot acquire the assets of the corporate debtor during liquidation.[21]

The liquidator, who exercises quasi-judicial functions during the liquidation process, cannot sell the immovable and movable property or actionable claims of the CD in liquidation to ineligible persons. This ineligibility cannot be disregarded by the NCLT, which acts as the Adjudicating Authority.

The Insolvency and Bankruptcy Board of India (IBBI) has issued the Liquidation Process Regulations, which were amended on July 25, 2019, to include Regulation 2B. This regulation outlines the process for the sale of assets during liquidation, ensuring that ineligible persons cannot acquire the assets of the CD.

The IBC offers a lifeline to companies on the brink of collapse (section 12). This process, called corporate insolvency resolution process (CIRP), can be triggered by creditors owed money by the company (financial creditors) or those owed goods or services (operational creditors) under section 10.

WHAT LEGAL PROTECTIONS AND OBLIGATIONS ARE IN PLACE FOR SSFS UNDER THE IBC?

SSFs operating in India are subject to legal protections and obligations under the IBC, which governs the resolution of stressed assets. SSFs are permitted to act as resolution applicants under the IBC, allowing them to bring in capital, expertise, and diverse strategies to facilitate improved price discovery, valuation, and reduce the burden on lenders.

Under the IBC, SSFs must comply with section 29A, which aims to prevent individuals who have contributed to the defaults of a CD from gaining or regaining control. This provision applies not only to the resolution process but also to the liquidation process, ensuring that ineligible persons cannot acquire the assets of the CD during liquidation.[22]

When a company is on the brink of collapse, the IBC offers a lifeline. It has two main tracks: reviving the company or liquidation.

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[20] Khaitan & Co., https://www.khaitanco.com/sites/default/files/2023- 10/Emerging%20Ideas%20on%20IBC.pdf.
[21] J Swaminathan, *Swaminathan J: Resolution of stressed assets and IBC – the future road map,* https://www.bis.org/review/r240117g.htm, 2024.
[22] Isda.org, https://www.isda.org/a/1ElEE/APAC-Regulatory-Profiles-January-2018.pdf .

- Revival Track (CIRP): This process can be started by creditors (those owed money by the company) and involves appointing a professional to assess the situation. A CoC is then formed to create a plan to save the company, which needs approval to proceed.
- Liquidation Track: If revival isn't possible, the IBC outlines a separate process for selling off the company's assets to repay creditors. However, even during liquidation, there might still be a chance for a comeback. Under the Companies Act, 2013 the court can allow the company to reach an agreement with its creditors or members, potentially saving it from complete closure. One mode of revival for a company facing corporate death under liquidation is through the provisions under section 230 of the Companies Act, 2013, which pertains to the power of the NCLT to allow for a compromise or arrangement between a company and its creditors or any subset of creditors or between a company and its members or subset of members.

OVERVIEW OF REGULATORY FRAMEWORK

SSFs are a sub-category of Category I AIFs in India that invest in stressed assets to address the challenges posed by stressed loans in the Indian financial ecosystem. The RBI has issued directions on the transfer of loan exposures, which SSFs can acquire by Clause 58 of the RBI Master Directions. To facilitate the acquisition of stressed loans by SSFs, the SEBI has proposed amendments to the regulatory framework for SSFs.

The proposed guidelines by SEBI aim to provide clarity and enhance the regulatory framework for SSFs in India. These guidelines cover various aspects, including the definition of 'special situation assets', eligibility criteria for investors, restrictions on investments in connected entities, guidelines for the minimum duration SSFs must hold stressed assets, and frameworks for ongoing monitoring and supervision.

Definition of Special Situation Assets

SEBI wants to clearly define what types of investments SSFs can make. This will keep them focused on their core mission of buying stressed loans – those where companies are struggling to repay their debts. By doing so, SSFs can play a crucial role in helping these companies get back on their feet.

Eligibility criteria for investors

SEBI proposes setting specific criteria for who can invest in SSFs. This ensures only qualified investors, with the knowledge and experience to navigate the complexities of stressed assets, are involved. They'll understand the potential rewards and risks associated with these investments.

Restrictions on investments in connected entities

SEBI suggests limiting how much SSFs can invest in companies they have connections with. This helps prevent situations where the SSF might favor certain companies for unfair reasons, ensuring transparency and fair practices across the board.

Minimum holding period for stressed assets

SEBI recommends a minimum holding period for stressed assets before SSFs can sell them. This discourages quick flips and encourages a long-term approach. By holding onto the assets for a while, SSFs are more likely to focus on genuinely resolving the debt issues of the companies they invest in, contributing positively to the financial sector's health.

Ongoing monitoring and supervision

SEBI aims to establish frameworks for ongoing monitoring and supervision of SSFs to ensure compliance with regulatory standards and investor protection. This guideline is crucial in ensuring that SSFs operate within a transparent and regulated environment, promoting accountability and investor confidence.

The proposed guidelines by SEBI reflect the regulator's efforts to enhance the regulatory framework for SSFs in India, aligning with the broader goal of promoting transparency, accountability, and efficiency in the acquisition and management of stressed assets by these funds. The guidelines also complement the RBI's directions on the transfer of loan exposures, providing a comprehensive regulatory framework for SSFs in India.

Entities seeking to operate as SSFs are required to register pursuant to the guidelines outlined in Chapter II of the AIF Regulations, 2012. Moreover, these funds must meet stringent eligibility criteria when they act as resolution applicants under the IBC, thereby ensuring that only competent entities engage in the complex process of financial restructuring. SSFs are subject to investment restrictions, including prohibitions against allocating funds to their associates, other AIFs—except fellow SSFs—or any schemes managed by their sponsors or managers' affiliates. The investment conditions for SSFs stipulate a minimum corpus requirement of ₹100 crore[23] for any scheme and set the minimum investment threshold at ₹10 crore, which is adjusted to ₹5 crore[24] for accredited investors, alongside a more accessible entry point of ₹25 lakhs for employees or directors associated with the SSF or its management. When acquiring stressed loans, SSFs must operate within the framework established by the RBI's Master Directions, including adhering to a minimum lock-in period of six months post-acquisition, unless a recovery from the borrower nullifies this condition. Furthermore, in aligning with RBI's standards for ARCs, SSFs are mandated to maintain a diligent investor due diligence process both at the onset and throughout their investment tenure. This comprehensive regulatory framework is designed to bolster the resilience of India's financial system, fortify investor confidence, and provide an efficacious avenue for the resolution and reclamation of stressed assets, solidifying the role of SSFs as a cornerstone in the country's economic stability and growth.

SSFs' ROLE IN THE NPL RESOLUTION PROCESS: OPPORTUNITIES AND CHALLENGES

Regulators are working to plug the gap that allowed insolvent debtors to seize back control of

[23] Reserve bank of India - Master Circular- Asset Reconstruction Companies, https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=12225, (April 14, 2024).
[24] SEBI, https://www.sebi.gov.in/legal/regulations/jan-2022/securities-and-exchange-board-of-india- alternative-investment-funds-regulations-2012-last-amended-on-january-25-2022-_55672.html.

their businesses. The goal of SEBI's most recent consultation paper on "special situation funds" regulation is to stop bad debtors from purchasing their businesses back from lenders at a significant discount. "SSFs shall not invest in or acquire a special situation asset if any of its investors is disqualified in terms of Section 29A of the IBC (Insolvency and Bankruptcy Code) with respect to such special situation asset," according to a statement made by SEBI.

SSFs face difficulties in obtaining and settling stressed loans due to operational and legal difficulties, such as those with due diligence, valuation, paperwork, and enforcement concerns. Complying with RBI and SEBI regulations may lead to discrepancies and overlaps, which further complicate matters. The intrinsic illiquidity of stressed assets can expose investors to higher risks and longer lock-in periods. The intricate structures and tactics of SSFs may make it difficult for investors to oversee and assess them. The modification places restrictions and expenses on investor eligibility under section 29A of the IBC, which may affect confidentiality.[25]

India's regulations for SSFs have a good goal: ensure transparency. However, there's a potential downside. The strict rules requiring SSFs to disclose a lot of information to regulators and those handling the turnaround process might clash with something else investors value highly - confidentiality.

Here's the concern: Investors might worry that all this detailed reporting could make sensitive information about their investments public. This could potentially hurt their returns or even disqualify them from future opportunities if certain details are revealed.

This creates a balancing act for SSFs. They need to follow the rules set by regulators while still making sure their investors feel comfortable with the amount of information that needs to be disclosed.

Additionally, the strict eligibility criteria under section 29A of the IBC may limit the investment opportunities and flexibility for SSFs. This could lead to legal consequences if investors are deemed ineligible, further complicating the investment process. The regulatory amendments may also restrict the overall scope of investment for SSFs, necessitating extensive due diligence on related parties and accommodating changes during the investment period. This can undermine the confidentiality and competitiveness that are crucial for these funds.

By purchasing stressed loans from businesses that already have equity or debt exposure, SSFs may be more vulnerable to concentration hazards. SSFs face difficulties in obtaining and settling stressed loans due to operational and legal difficulties, such as those with due diligence, valuation, paperwork, and enforcement concerns. Complying with RBI and SEBI regulations may lead to discrepancies and overlaps, which further complicate matters. The intrinsic illiquidity of stressed assets can expose investors to higher risks and longer lock-in periods. In essence, the multifaceted regulatory environment surrounding SSFs can impose significant burdens, constraints, and costs, ranging from compliance challenges to market uncertainties. This can impact investment decisions and expectations, potentially undermining the effectiveness and attractiveness of SSFs in the Indian financial landscape.

[25] *SEBI's consultation paper on SSF regulatory changes*, Taxguru Consultancy & Online Publication LLP, https://taxguru.in/sebi/sebis-consultation-paper-SSF-regulatory-changes.html., 2023.

CASE STUDY: DEVELOPMENT OF THE NPL MARKET IN THE REPUBLIC OF KOREA

In response to the Asian financial crisis, the Government of the Republic of Korea undertook significant measures to restructure its struggling banking sector. Central to this effort was the transformation of the Korea Asset Management Corporation (KAMCO)[26] into a public asset management company (AMC). With limited public funding available, the government aimed to expedite the resolution of nonperforming loans (NPLs) acquired from financial institutions.

Early challenges and strategies

Initially, Korea lacked a domestic market for disposing of NPLs and had limited domestic investor interest in such assets. In this context, KAMCO employed various strategies for NPL resolution, including international auctions to attract foreign investors, NPL securitization, and corporate restructuring initiatives.

Government reforms and institutional support

Recognizing the need for a conducive legal and institutional environment, the government implemented reforms to facilitate the rapid disposal of NPLs. These reforms aimed to streamline the acquisition and disposal processes, thereby enhancing the efficiency of KAMCO's operations.

Emergence of private AMCs and market development

The measures undertaken to improve NPL resolution not only benefited KAMCO but also stimulated the development of the NPL market. Private asset management companies, such as UAMCO and Daishin F&I, emerged to specialize in NPL acquisition and disposal. Additionally, commercial banks began using asset-backed securities issuance as a means of NPL disposal.

Figure 3: Restructuring and reforms in the Korean banking industry

NPLs Resolution Tools Used by Republic of Korea Banks, 2007–2019
(%)

Tool	2007	2009	2011	2013	2015	2017	2019
Write-offs	24.6	32.0	30.9	35.2	33.6	27.1	26.7
Sales[a]	7.4	13.8	24.8	25.4	23.3	20.3	22.8
Asset-backed securities	14.8	12.8	...	...	...	...	...
Sale of collateral	31.1	19.5	23.8	22.5	22.9	34.3	22.8
Credit normalization	18.9	16.8	18.5	12.7	15.7	11.6	22.2
Others	3.3	4.7	2.0	4.1	3.6	6.8	5.6

AMC = asset management company, F&I = finance and insurance, NPL = nonperforming loan, UAMCO = United Asset Management Corporation.
Note: [a] From 2011, the resolution through issuing asset-backed securities is included in the sales category.
Source: Authors' calculations based on the press release of the Financial Supervisory Service.

[26] S-M Kim, J-Y Kim, and H-T Ryoo, *Restructuring and reforms in the Korean banking industry*, bis.org, https://www.bis.org/publ/bppdf/bispap28q.pdf.

The resolution of a considerable amount of NPLs or stressed assets within their banking sectors has proven to be a serious difficulty for both Korea and India. At first, neither nation had a strong domestic market for selling distressed assets.

Comparative analysis and possible resolutions

Under the IBC, SSFs in India can be crucial in helping acquire stressed assets from banks, much as Korea's KAMCO. SSFs in India can follow Korea's lead in order to increase the pool of potential investors for stressed assets. The Korean experience highlights the significance of luring in overseas investors.

One effective strategy that SSFs in India can use to increase the appeal of stressed assets to investors is the securitization of NPLs, as it has been done in Korea. This approach is in line with the objective of effectively resolving stressed assets by spreading risk and providing a variety of investment options.

The Indian government can make a substantial contribution to the growth of the SSF market, much like the Korean government did in enabling KAMCO's operations. Simplifying the legal procedures related to SSFs' acquisition and disposal of assets under the IBC is one of the most important stages. Resolution efforts can be accelerated by streamlining rules. Furthermore, these organisations' ability to resolve stressed assets can be strengthened by offering institutional support for SSF operations through a legislative environment that is favourable to their operations.

Hence, India can maximise the contribution of SSFs to stressed asset resolution under the IBC framework by learning from Korea's experience. In the end, this strategy can support financial stability, investor confidence, and the effective resolution of stressed assets, all of which can lead to a stronger banking industry.

REGULATORY AND ETHICAL CONSIDERATIONS

Policy instruments to resolve systemic NPLs **Table 1**

Debtors (non-financial companies)	
Policy instruments	**How it works**
Debt restructuring, including out-of-court workouts	Either corporate or loan restructuring, involving the banks that are creditors to the same customer
Banks	
Policy instruments	**How it works**
Write-off	Loans are written off from banks' balance sheets
Direct sale	Banks or AMCs sell NPLs in dedicated markets
Securitisation	Banks, special purpose vehicles or AMCs pool and tranche loans and sell the securitised products in dedicated markets
Asset protection schemes	State-backed entities offer insurance on loss on NPLs in order to restart banks' credit provision
Centralised asset management company (AMC)	Dedicated companies buy bad assets from the problem bank(s)

To address instances of predatory behavior or ethical lapses in SSF operations, it's crucial to review laws and regulations in other jurisdictions for best practices. Implementing stringent ethical guidelines and oversight mechanisms can ensure SSFs operate with integrity and prioritize fair treatment of debtors. Additionally, integrating ethical considerations into the design and implementation of NPL resolution strategies can mitigate potential risks and promote responsible financial practices.

The image that is attached shows the different approaches used to address NPLs and moral issues in the specialised funds (SSFs) industry.

Debt restructuring

Debt restructuring involves modifying loan terms to make them more manageable for debtors, potentially reducing the likelihood of default. However, ethical concerns may arise if SSFs exploit debtor vulnerability or fail to provide transparent and fair restructuring terms.

Direct sale

Direct sale of NPLs to AMCs or investors can improve bank liquidity and financial health. However, there's a risk of predatory behavior if SSFs acquire NPLs at unfairly low prices, exploiting the distress of the debtor.

Securitization

Securitization pools NPLs into different risk categories for sale to investors, increasing liquidity. Ethical lapses may occur if SSFs misrepresent the risk associated with securitized assets or engage in deceptive practices to attract investors.

Asset protection schemes

Government-backed insurance on NPL losses can incentivize lending but may lead to moral hazard if banks become lax in risk assessment, relying excessively on government protection.

Centralized AMC

Centralized AMCs like KAMCO in South Korea specialize in purchasing, managing, and selling NPLs. While beneficial for resolving NPLs, ethical concerns may arise if SSFs prioritize profit over fair treatment of debtors or engage in aggressive debt collection practices.

TECHNOLOGICAL INTEGRATION AND FUTURE OF SSF INVOLVEMENT

SSFs and the IBC are harnessing technological advancements to transform investment opportunities in distressed assets. For example, inspired by Blackstone's "Horizon" platform, an SSF could develop a similar AI-driven system to analyze vast amounts of data from past IBC cases in India, which includes company details, industry data, turnaround success rates, and legal precedents, to identify potential investment targets. Similarly, following Thailand's implementation of a blockchain pilot project[27] to track asset movements during bankruptcy proceedings, an SSF in India could advocate for a blockchain-based system within the IBC

[27] T Rai, *Thailand to be the first to use Blockchain technology for voting*, Appinventiv, 14 November, https://appinventiv.com/blog/blockchain-technology-for-voting-system/, 2018.

framework to enhance transparency and reduce fraud risks by creating a verifiable ledger of every transaction. Additionally, mirroring Oaktree Capital's use of cloud technology, an SSF could employ a cloud-based platform to manage its IBC case portfolio,[28] centralizing documents, analytics, and communications to improve collaboration and enable real-time decision-making, thus streamlining workflows and enhancing efficiency in handling distressed assets.

The future involvement of SSFs in the IBC landscape is poised to be significantly shaped by technological innovations, enhancing their capacity to identify and capitalize on investment opportunities. Envision an SSF utilizing a platform akin to Kensho,[29] a financial data analytics tool acquired by JPMorgan Chase, tailored to analyze the complexities of the Indian market. This AI-driven tool could sift through data pertaining to hundreds of companies facing potential insolvency, pinpointing undervalued assets and forecasting their turnaround potential based on historical data and current market trends. Such advanced analytics would enable SSFs to spot promising investments, potentially increasing their market participation.

Moreover, SSFs might adopt specialized strategies using AI, akin to Sculptor Capital[30] Management's focus on the retail sector's distressed debt. An SSF in India could develop a niche in sectors like retail or manufacturing, employing AI to dissect past IBC cases within these sectors to unearth successful turnaround strategies. This specialization not only fosters targeted investment approaches but could also enhance returns from these ventures.

Additionally, the efficiency of SSFs in handling IBC cases could be augmented through the automation of routine tasks such as document analysis and data entry, leveraging technology similar to Kira Systems,[31] which uses AI for legal document review and due diligence. By automating these labor-intensive processes, SSFs could allocate more resources to strategic activities like deal negotiations and portfolio management, thereby not only improving their operational efficiency but also speeding up the resolution process and reducing costs. These technological integrations signify a transformative phase for SSFs, equipping them with the tools necessary to thrive in a competitive and evolving financial landscape.

CONCLUSION

The investigation into SSFs within India's IBC framework reveals their significant role in managing NPLs. By providing capital, managing distressed assets, and reinforcing market discipline, SSFs enhance the efficiency of NPL resolutions, ensuring that the recovery processes are not only expedited but also yield maximum value for all stakeholders. However, the research underscores a crucial need for tighter regulatory oversight to curb potential predatory practices and avoid market concentration, which could otherwise harm the rights and interests of minority shareholders and other creditors.

In order to optimize the interplay between SSFs and the IBC framework, several targeted

[28] G Shok, *Cloud mirroring: Data resilience in a chaotic world*, *Spiceworks*, https://www.spiceworks.com/tech/cloud/guest-article/cloud-mirroring-data-resilience-in-a-chaotic-world/, 2022.
[29] *Home*, *Kensho Technologies*, https://kensho.com/ (April 14, 2024).
[30] *Sculptor Capital Management on the benefits of casting a wide net* (2024) *Private Debt Investor*, https://www.privatedebtinvestor.com/sculptor-capital-management-on-the-benefits-of-casting-a-wide-net/.
[31] M Bretzfield, *Leveraging AI-powered tools for streamlined contract analysis in Intellectual Property law*, Linkedin, https://www.linkedin.com/pulse/leveraging-ai-powered-tools-streamlined-contract-law- bretzfield, 2023.

strategies are proposed. First, it is essential to clearly delineate the roles and responsibilities of SSFs in the NPL resolution framework, setting forth explicit participation conditions and obligations. Ensuring that SSFs adhere to strict licensing and accreditation criteria will help maintain high ethical and financial standards across operations. Implementing robust legal protections against predatory asset acquisitions and stringent conflict of interest regulations will further safeguard the process. Additionally, integrating advanced technologies such as blockchain could significantly enhance transparency and traceability in SSF transactions, contributing to greater accountability. Regular engagement with stakeholders through consultations, coupled with mandatory ethical training for personnel involved in NPL resolution, will align the diverse interests towards cooperative resolution efforts. These recommendations aim to fortify the regulatory framework, thereby enabling SSFs to contribute effectively to the stability and resilience of the financial system, enhancing the overall health of India's banking sector.

SUGGESTIONS OR PROPOSITION OF STRATEGIC MODEL

The roles and responsibilities of SSFs within the IBC and NPL resolution frameworks must be clearly defined, including conditions for participation, rights, and obligations. Strict licensing and accreditation should be enforced to ensure that only SSFs meeting high ethical and financial standards are allowed to participate. Legal safeguards are necessary to protect against predatory acquisition of distressed assets, including stipulations like minimum bid prices. Regulations to manage conflicts of interest should be strictly enforced to prevent related entities from participating in the resolution of the same NPL. The activities of SSFs should be monitored by independent third-party entities reporting directly to regulatory bodies. SSFs must be required to provide regular reports detailing all transactions related to NPL acquisitions and resolutions. A comprehensive code of ethics should be developed for SSFs and related stakeholders, delineating acceptable and unacceptable behaviors. Mandatory training programs on ethical practices, transparency requirements, and legal implications should be required for all personnel involved in NPL resolution. Blockchain technology could be employed to create an immutable ledger for all NPL-related transactions, ensuring transparency and traceability. Regular stakeholder consultations are essential to gather feedback on SSF activities and the NPL resolution process.

12

STRATEGIC ABUSE OF CORPORATE INSOLVENCY RESOLUTION PROCESS UNDER THE INSOLVENCY & BANKRUPTCY CODE, 2016

Debaranjan Goswami

ABSTRACT

This paper examines the possibility of strategic abuse of voluntary corporate insolvency provisions under the Insolvency and Bankruptcy Code, 2016 (IBC/Code). The paper analyses the current law on the voluntary corporate insolvency process and identifies certain loopholes in the law. Thereafter, the paper conceptualizes how the existing law might be reformed and reinterpreted in response to the possibility of its strategic abuse. These reforms and suggested approaches, it is argued, will provide more certainty in the law and further the objectives and purposes behind the Code.

INTRODUCTION

The broad aim of corporate insolvency law is to provide an easy exit to unviable businesses and redeploy the resources to more productive sectors of the economy.[1] Corporate debtors (CDs) can, however, abuse corporate reorganization and resolution provisions in the Code for purely strategic purposes. One of the common approaches to strategic abuse has been to utilize bankruptcy provisions to shift current financial liabilities to other constituents.[2] Therefore, as Gupta et al. have noted, policymakers must be cognizant that not all insolvency applications may be due to 'misery'; some may be due to 'strategy'.[3]

It is assumed by some that the stigma attached to bankruptcy makes it an option of last resort.[4] Therefore, it is expected that a CD would utilize all available means at its disposal before invoking the insolvency process. Scholarship has, however, challenged this assumption and understanding. Delaney has shown how the United States bankruptcy provisions can be abused as a strategic weapon for corporations to use their power to avoid current financial burdens and shift future financial risk toward more vulnerable groups.[5]

** Many thanks to the organizers of the 3rd International Research Conference on Insolvency and Bankruptcy where I presented a draft of this paper. I am particularly grateful to Professor Andrew Godwin for his valuable suggestions and comments on this paper. All errors are mine.*

[1] Rizwaan Jameel Mokal, Corporate Insolvency Law: Theory and Application (Oxford University Press 2005).

[2] J Gupta, M Barzotto and AAF De Moura,*Bankruptcy Resolution: Misery or Strategy*, Abacus (2024).

[3] *Id.*

[4] RISuttonandAL Callahan, *The Stigma of Bankruptcy: Spoiled Organizational Image and its Management*, 30 Academy of Management Journal405 (1987). The author wants to highlight that he does not endorse bankruptcy stigma as not all bankruptcies arise out of corporate malpractices.

[5] KJ Delaney, Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 To Their Advantage (University of California Press 1999).

It can perhaps be argued that the literature describing strategic insolvency abuse in the United States context does not apply to the Indian insolvency landscape. This is because of the sharp distinction between the insolvency resolution process followed by each jurisdiction. The United States employs a 'debtor-in-possession' model for bankruptcy reorganization, allowing the debtor's management 120 days—extendable up to 180 days—to propose a reorganization plan.[6] Contrast this with the position in India, which follows a 'creditor in control' insolvency resolution procedure. Here the management and control vests with the resolution professional on insolvency admission. However, this paper will highlight that the Code remains prone to strategic insolvency abuse and must develop internal safeguards against such abuse.

In this paper, the author examines instances where the voluntary insolvency resolution framework may be strategically invoked for purposes other than insolvency resolution. In doing so, the author's broader endeavour is to initiate a conversation around strategic abuse under the Code.

THE REGIMES FOR VOLUNTARY CORPORATE INSOLVENCY RESOLUTION AND LIQUIDATION PROCESSES UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

The success of an insolvency regime depends, in part, on its ability to detect financial distress early and incentivize private informal workouts.[7] When negotiations for private workouts fail, insolvency proceedings become a practical necessity. The success of a corporate insolvency regime also depends on the stage at which CDs are referred to insolvency proceedings. Early initiation of corporate insolvency proceedings increases the chances of resolution and reduces the chances of destruction of enterprise value. Sometimes creditors may be slow in filing applications for insolvency commencement leading to value erosion and destruction of CD's assets. Therefore, the Code facilitates voluntary initiation of insolvency proceedings by CDs to achieve better resolution outcomes.

The possibility of the Code being strategically abused is, however, more pronounced when a CD voluntarily initiates insolvency proceedings. The requirements for initiating voluntary corporate insolvency proceedings are laid down in section 10 of the Code. The Code also permits voluntary liquidation proceedings under section 59. However, textual analysis of the two sections reveals that the procedures for initiating a voluntary corporate insolvency resolution proceeding and a voluntary liquidation proceeding are starkly different. While there is a considerably relaxed framework for initiating a voluntary corporate resolution proceeding there are significant procedural hurdles for initiating a voluntary liquidation proceeding. Their difference, however, appears reasonable. Liquidation leads to the corporate death of the debtor while insolvency resolution is an exercise in resolving the CD as a going concern.

The Code has been amended numerous times since its enactment.[8] Regulatory interventions to enhance market outcomes are commendable, but they can also be criticized for increasing

[6] S. Jones, *Corporate Bankruptcy Prediction: A High Dimensional Analysis*, 22 Review ofAccounting Studies1366 (2017).
[7] Mobilox Innovations Private Limited v.Kirusa Software Private Limited,2017 INSC 975.
[8] The Code has been amended about 8 times as of the date of writing this paper.

uncertainty in insolvency results. Occasionally, these amendments appear to have been rushed and not to have fully considered their effects on other aspects of the Code.

LEGAL POSITION ON VOLUNTARY CORPORATE INSOLVENCY RESOLUTION PROCESS IN INDIA

The Code prescribes that Adjudicating Authorities (AAs) at the stage of admission of voluntary corporate insolvency proceedings must be satisfied of the existence of debt and default.[9] It must also be satisfied that the CD is not otherwise ineligible under the Code.[10] Furthermore, the application must be complete in all respects. So long as these considerations are satisfied, an application must be admitted.[11]In *Unigreen Global Private Limited*, the AA had dismissed an application for voluntary initiation of the corporate insolvency resolution process on grounds outside those prescribed under the Code. The AA held that under the garb of initiating voluntary insolvency, the CD and its directors were trying to avoid making lawful payments of the dues owed to the financial creditors (FCs) and from realizing their security interests by initiating several legal proceedings in different courts and forums. According to the AA, these proceedings were initiated with the sole motive of removing their personal property from the 'clutches of the law'.[12] This reasoning was rejected by the Appellate Tribunal with the finding that an application for voluntary insolvency initiation must be determined based on the information required under the Code and the accompanying rules and regulations.[13] Therefore, non-statutory grounds cannot be considered while dismissing an application, and ulterior motives behind the initiation of corporate insolvency resolution are irrelevant to this assessment.[14]

The requirement for establishing the existence of default before initiating a voluntary corporate insolvency proceeding can be viewed as a filter against initiating the voluntary corporate insolvency proceeding for purely strategic reasons. In other words, a CD must demonstrate the existence of default when triggering a voluntary corporate insolvency proceeding, thereby minimising its abuse. This, it is suggested, appears to be an insignificant hurdle. A CD can default intentionally to meet the requirements of the section when it has the ability to repay.[15] While the statutory provision mandates that the books of accounts of the CD be placed before the AA at the time of filing the insolvency application, it is silent on the contours of the scrutiny that the AA must exercise before admitting an application. Therefore, this procedural requirement does not automatically replace the existing test that is based on default with a balance sheet insolvency test. There is, however, case law suggesting that a company must not be profit-making at the time of triggering voluntary insolvency proceedings.[16] A company's assets and liabilities can provide an important indication of its profitability. Therefore, the examination of the balance sheet of a company can be a relevant factor at the time of admitting an application for a voluntary corporate insolvency proceeding.

[9] Insolvency and Bankruptcy Code, 2016, § 10.
[10] *Id.*, § 11.
[11] Unigreen Global Private Limited v.Punjab National Bank and Ors, 2017 SCC Online NCLAT 566.
[12] In Re: Unigreen Global Private Limited (NCLT - Principal Bench), MANU/NC/0338/2017.
[13] Unigreen Global Private Limited, *supra* note 11.
[14] BCL Homes Ltd v.Canara Banks & Ors, 2018 SCC Online NCLAT 134; Antrix Diamond Exports Pvt Ltd v. Bank of India and Ors, 2018 SCC Online NCLAT 33.
[15] The corporate debtor can trigger a technical default to take the benefit of voluntary corporate insolvency proceedings.
[16] Vyomit Shares Stock & Investments Pvt Ltd v. Securities and Exchange Board of India, 2019 SCC Online NCLAT 287.

A company may be profit-making but still face insolvency due to a contingent liability.[17] The Code does not provide for prohibitions against insolvent trading.[18] However, responsible director' duties mandate that when the threat of insolvency is imminent, insolvency proceedings must be voluntarily initiated to avoid the destruction of enterprise value.[19] Therefore, the profitability of a business cannot be the sole ground for rejecting the initiation of voluntary corporate insolvency.

Like any other insolvency process, the voluntary initiation of an insolvency process leads to a moratorium on pending legal suits against the CD. It also prohibits the filing of new suits and legal proceedings. These have important consequences, especially for judgment creditors who are unable to execute their claims against the CD. This issue received some attention in the GoFirst insolvency case but like previous judgments, this case was decided without engaging in relevant conceptual and policy debates.[20]

The lack of consistent jurisprudence on how to deal with fraudulent and malicious initiation of a voluntary corporate insolvency proceeding highlights the need for more conceptual clarity on the issue. Section 65 of the Code penalizes insolvency initiation undertaken with malicious and fraudulent intent. A detailed analysis of the section is relevant at this juncture.

> 65 Section:
>
> Fraudulent or malicious initiation of proceedings. –
>
> (1) If, any person initiates the insolvency resolution process or liquidation proceedings fraudulently or with malicious intent for any purpose other than for the resolution of insolvency, or liquidation, as the case may be, the Adjudicating Authority may impose upon such person a penalty which shall not be less than one lakh rupees, but may extend to one crore rupees. (2) If any person initiates voluntary liquidation proceedings with the intent to defraud any person, the Adjudicating Authority may impose upon such person a penalty which shall not be less than one lakh rupees but may extend to one crore rupees. (3) If any person initiates the pre-packaged insolvency resolution process— (a) fraudulently or with malicious intent for any purpose other than for the resolution of insolvency; or (b) with the intent to defraud any person, the Adjudicating Authority may impose upon such person a penalty which shall not be less than one lakh rupees, but may extend to one crore rupees.

The section is designed to penalize insolvency applications initiated for purposes other than insolvency resolution and places a further requirement to satisfy the absence of fraudulent or malicious intent. The peculiar feature of the section is that it seeks to only penalize such acts but does not classify them as grounds for dismissal of the application for insolvency admission. In a way, the section presumes that the AA will not admit such applications and, instead, impose a penalty if the requirements of the section are otherwise met. Therefore, it

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[17] BTI 2014 LLC v. Sequana SA and Ors.,[2022] UKSC 25.

[18] Aurelio Gurrea-Martinez, *Towards an Optimal Model of Directors' Duties in the Zone of Insolvency: An Economic and Comparative Approach*, 21 Journal of Corporate Law Studies 365, 389-90 (2021).

[19] Rizwaan J. Mokal, *An Agency Cost Analysis of the Wrongful TradingProvisions: Redistribution, Perverse Incentives and the Creditors' Bargain*59TheCambridge Law Journal335 (2000); Anthony John Wright and Geoffrey Paul Rowley & Ors v. Dominic Joseph Andrew Chappell & Ors (Re BHS Group Ltd & Ors (in liquidation)), [2024] EWHC 1417 (Ch).

[20] In Re: Go Airlines (India) Limited, Company Petition No (IB)-264(PB)/2023.

is incumbent on the AA to decide on the issue of fraudulent and malicious initiation of the corporate insolvency resolution process at the stage of admission. In this respect, admitting the application and leaving it to the parties to ventilate any claims of fraud and malice thereafter goes against the spirit of the section and the Code in general.[21]

There may be various practical reasons for initiating a voluntary corporate insolvency proceeding,[22] including the desire of the existing management of the CD to be absolved from all liabilities and ensure a dignified exit from the business. However, it is essential to properly analyse the extent to which some of these practices are in accordance with bankruptcy objectives and purposes.

In addition to the creditors' bargain theory, the design of the Code is also influenced by the value-based theory postulated by Korobkin, whereunder insolvency law considers the distributional impact of winding-up on those who may not have formal legal rights to the assets of the business.[23] The aim of bankruptcy law under this theory is to take into account the multidimensional but conflicting interests of various claimants, and provide for a solution whereunder each claimant derives optimal value.[24]Consequently, safeguarding against the misuse of the Code to defeat or impair the claims of certain creditors is a part of India's bankruptcy objectives.

In contrast to traditionalists, the proceduralist school contends that the purpose of insolvency law is to facilitate the swift and cost-effective distribution of a debtor's assets to creditors to maximize their returns. It emphasizes the preservation of pre-insolvency entitlements and does not concern itself with issues of distributional fairness.[25]

Judicial opinion suggests that India tends to favour a traditionalist approach, such as that advocated by Korobkin, as it seeks to balance the interests of all stakeholders.[26] The bias against liquidation often exhibited by the judiciary also points towards a communitarian outlook of protecting employment.[27] However, there are also contrary judicial opinions endorsing the proceduralist position that prioritizes the interests of the FCs.[28] This suggests that certain references to the communitarian framework do not necessarily point toward the Code's deeper commitment to upholding stakeholder values. Under the Indian insolvency framework, both traditionalist and proceduralist positions are important considerations with each theoretical position illuminating different stages of the insolvency process.

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[21] Wave Megacity Centre Private Limited v. Rakesh Taneja & Ors,Company Appeal (AT) (Insolvency) No 918 of 2022. In this case, an IA preferred under Section 65 of IBC, 2016 was heard before the admission of the Section 10 Application, which led to the dismissal of the §10 Application by the NCLT Principal Bench, and that was upheld by the Hon'ble NCLAT.

[22] Kushagra Gahlot, *Taking Control: Voluntary Initiation of Corporate Insolvency*, Mondaq (15 September 2023),https://www.mondaq.com/india/insolvencybankruptcy/1366450/taking-control-voluntary-initiation-of-corporate-insolvency.

[23] Phoenix Arc Private Limited v. Spade Financial Services Limited and Ors,2021/INSC/51.

[24] D.R. Korobkin, *Rehabilitating values: A jurisprudence of bankruptcy*, 91 Columbia Law Review717 (1991).

[25] T H Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91Yale Law Journal 857 (1982).

[26] Phoenix Arc Private Limited, *supra* note 23.

[27] Hero Fincorp Limited v. M/S Hema Automotive Private Limited, Company Appeal (AT) (Insolvency)No.1540 of 2022.

[28] Pratap Technocrats (P) Ltd and Ors v.Monitoring Committee of Reliance Infratel Limited and Ors, 2021 INSC 395.

This judicial trend suggests that the Code's communitarian outlook is limited to the manner of distribution of insolvency proceeds and does not permeate all aspects of the Code. In this paper, the author does not argue for a normative position on this issue, instead argues in favour of a position where the different theoretical and conceptual positions are analysed and harmonised coherently and thereafter decided on careful judicial reasoning.

Judgment creditors under the Indian insolvency regime are generally considered unsecured creditors.[29] In some cases, it has been alleged that the insolvency resolution process has been invoked as a strategic device to defeat the interests of judgment creditors. This ground was argued when the AA initiated insolvency proceedings against RHC Holding Private Limited in an application filed by Religare Comtrade Limited, a FC to the CD. The insolvency admission was appealed before the Appellate Tribunal by way of an intervention application by Daiichi Sankyo Limited.Daiichi Sankyo Limited was a judgment creditor in proceedings against the CD and several other entities. The Appellate Tribunal stayed the insolvency proceedings without any reasoning by only citing an earlier Supreme Court order involving the same parties.[30] However, when Amazon NV intervened in insolvency proceedings initiated by the Bank of India against Future Retail Limited on the ground that the insolvency proceedings were sought to be initiated to defeat its interest as a judgment creditor, the Appellate Tribunal refused its prayer and admitted the application.[31]The AA determined that it could not deny admission to the corporate insolvency resolution process based on the intervenor's submissions, since the criteria under section 7 of the Code for initiating the process against the CD had been met. This inconsistent judicial reasoning underscores the need for the present analysis. While these cases arose in the context of involuntary insolvency proceedings, the issues raised in these cases have important consequences for the voluntary insolvency framework.

While the initiation of the voluntary corporate insolvency resolution process must be encouraged so that financial distress can be resolved early, it must be discouraged when triggered for purposes other than resolving financial distress. Often judges and commentators have regard only to the core situations in which a doctrine applies, without appreciating the limits of a doctrine or its underlying rationales. Such a limited understanding of the law is detrimental to its rational development.[32] The judgments in Future Retail and Daiichi demonstrate an apparent lack of coherency. The outcomes may have been justified but lack requisite judicial reasoning. The judgments vacillate between traditionalist and proceduralist positions. While judicial opinions can be a compromise between the two positions, they need to be clearly articulated in their decision-making. Such ad-hocism portrays the Indian insolvency regime as immature.[33]

Before embarking on a fully-fledged judicial analysis, the AA must first address the question

[29] Under the Indian insolvency regime, the nature of the underlying debt decides whether a creditor is secured or unsecured. As a result, a judgement creditor is generally considered unsecured creditors.

[30] Daiichi Sankyo Ltd v. Religare Comtrade Ltd and Ors, Company Appeal (AT) (Ins) No645 of 2022.

[31] Bank of India v. Future Retail Limited Intervention Petition/1/2022 In C.P.(IB)/527(MB)2022.

[32] Ying Khai Liew, Rationalising Constructive Trusts, Hart Studies in Private Law (Hart Publishing 2017).

[33] This relates to a project the author is currently working on, which focuses on the treatment of contingent or disputed claims in a resolution plan. We are increasingly observing arbitral tribunals asserting jurisdiction over claims that have been extinguished by the resolution plan. As a result, the new management of the corporate debtor must defend itself against these undecided claims.

of how it views its role in the insolvency ecosystem. Ideally, the AA must have the discretion to decide on the best course of action depending on the facts and circumstances in each case. However, the Indian insolvency regime does not allow for any equity-based jurisdiction, and therefore obligations must be statutorily imposed.[34] As a result, the powers of the AA are circumscribed by the provisions of the statute which confers jurisdiction upon it.It can exercise only such powers within the contours of jurisdiction as prescribed by the statute, the law in respect of which, it is called upon to administer.[35]

Another issue is about balancing the interests of all stakeholders while maintaining the efficiency of the process. Economic efficiency dictates that directors of a company must be incentivized to file insolvency applications and that such applications should be adjudicated in a time-bound manner so that there can be minimum erosion of enterprise value. The opportunity for giving a hearing to other creditors and stakeholders before admitting an application for voluntary insolvency is at cross-purposes with such an understanding.[36] The more fundamental question is whether a hearing must be a mere formality without any substantive protections. In the event, the management of the CD wants to commence insolvency proceedings voluntarily, can the law prevent it from doing so, if the statutory conditions are otherwise met?

The Code places prohibitions on wrongful trading.[37] It casts a duty on the directors to minimize the losses to the creditors when they ought to have known about the CD's insolvency. Initiation of voluntary corporate insolvency process is often the only means of avoiding losses to creditors in a company. Placing burdensome restrictions on the right to initate voluntary corporate insolvency resolution process is inimical to the principle of ease of entry and exit of businesses which forms one of the cornerstone of a successful insolvency regime.

In this context, we must also consider a situation where a judgment creditor has initiated an execution petition against a company, in case, the petition succeeds, the CD will be 'cash flow' insolvent. The CD therefore triggers voluntary insolvency proceedings at the behest of its lenders to defeat the interests of the judgment creditor(s). Similar strategic abuse of the Code could be replicated when faced with a mass tort claim.[38] In such instances, the AA must be sensitive to such situations and manoeuvres by different interest groups. The AA must therefore exercise caution while admitting such applications. It must minutely scrutinize the existence of default by the CD and appreciate the circumstances that led the CD to trigger such insolvency proceedings. Efficient enforcement of director duties and prohibitions against wrongful trading would perhaps come to the rescue of the judgment creditors and victims of mass tort but the regime remains relatively underdeveloped and as a result underenforced in India.[39] Consequently, a director of a corporation may continue incurring

[34] Pratap Technocrats, *supra* note 26.
[35] Embassy Property Developments Pvt. Ltd. v. State of Karnataka and Ors.,(2020) 13 SCC 308.
[36] In Re: Go Airlines (India) Limited, Company Petition No (IB)-264(PB)/2023.
[37] Insolvency and Bankruptcy Code, 2016, § 66.
[38] Insolvency literature classifies victims of mass torts as involuntary creditors. When a person becomes a creditor to a company without its consent, the person is classified as an involuntary creditor.
[39] M. P. Ram Mohan and Urmil Shah, *Director Liability Framework during Borderline Insolvency and Corporate Failure in India*, 18University of Pennsylvania Asian Law Review 32 (2022). The paper argues that the failure of the Code to define the standards necessary for wrongful trading contributes to the underenforcement problem.

high volumes of debt and distribute dividends even when there is an imminent threat of insolvency as a result of a contingent liability maturing.[40]

When the Code was enacted, it was silent on the eligibility of CDs to bid for their assets. Later the Government placed prohibitions on existing management of CDs from bidding for assets in its own corporate insolvency resolution process.[41] As presently drafted, however, the Code allows Micro, Small, and Medium Enterprises (MSME) to bid for their assets.[42] The author contends that this created a loophole in the Code, making it vulnerable to strategic abuse by unscrupulous promoters of insolvent corporate debtors.

THE INTERPLAY BETWEEN SECTIONS 10 AND 240A OF THE CODE

Insolvency scholars have often advocated for simplified insolvency procedures for MSMEs.[43] Recognizing the role of MSMEs in the economic development of a country the Code grants MSMEs certain exemptions from the rigours of section 29A of the Code. Section 29A of the Code prescribes the eligibility criteria for resolution applicants under the Code. The exemptions to section 29A allow MSMEs to bid for their assets at a haircut during the corporate insolvency resolution process, which is otherwise impermissible under section 29A of the Code. These measures, while laudable, expose the MSME industry to industry malpractices and strategic insolvency abuse.

The exemptions granted to MSMEs allow them the opportunity to trigger voluntary insolvency under the Code and thereafter bid for their assets at a haircut during the corporate insolvency resolution process (CIRP).[44] Therefore, MSMEs with mounting debt obligations may find the insolvency resolution process an easy option to deleverage or even extinguish their debt obligations.

In other circumstances, a CD could intentionally default on a debt by an operational debtor, and thereafter the operational creditor may in connivance with the CD apply to initiate corporate insolvency proceedings.

The United States experience has demonstrated that debtor-in-possession as a mode of insolvency resolution exposes the regime to strategic defaults and other accompanying abuses. At the time of making legislative changes to allow MSME promoters or CDs to bid for the insolvent company, adequate consideration should have been given to the possibility of strategic abuse of insolvency provisions.

Therefore, necessary amendments must bemade to section 240A of the Code to disallow MSMEs that have initiated voluntary insolvency resolution process from bidding for their assets. In the alternative, more procedural safeguards including providing a fair hearing to its creditors must be enshrined under the Code before an MSME entity can initiate voluntary insolvency proceedings.

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[40] Sound corporate governance practices dictate that when there is a contingent liability that is highly probable and makes the insolvency of a corporate debtor imminent, the company must ensure it has enough retained earnings to satisfy the claim.

[41] Insolvency and Bankruptcy Code, 2016, § 29A.

[42] *Id.*, § 240A.

[43] AurelioGurrea Martinez, *Insolvency Law in Emerging Markets*, Working Paper 3/2020, Ibero-American Institute for Law and Finance22.

[44] Under § 240A of the Code, MSME corporate debtors can bid for their assets in a corporate insolvency resolution process.

The suggested second approach may be difficult to implement as it is difficult to ascertain the MSME status of a CD at the time of initiation of the CIRP. This issue has been further complicated because a textual reading of the Code suggests that an MSME certification may be granted after the commencement of the CIRP and therefore entitle the existing management to attain eligibility under section 240A of the Code after the initiation of the CIRP.[45]

Indeed,the initiation of the CIRP with the hope of regaining control is a risky endeavour. There could always be bidders in the market presenting higher competing offers. However, the existing management of a CD is often able to offer the most profitable valuation of the CD because of insider information.

Another, possible disincentive from the abuse of voluntary insolvency resolution is that it exposes the CD to the scrutiny of preferential, undervalued, fraudulent, and extortionate transactions.[46] Financial distress is often a result of preferential, undervalued, fraudulent, and extortionate transactions and an MSME must be careful to not expose itself to such actions as a result of voluntary insolvency resolution.

Under the current law, avoidance applications do not abate with the successful resolution of the CD.[47]The regulations mandate that a resolution plan provides for the manner in which proceedings in respect of avoidance transactionsor fraudulent or wrongful trading will be pursued after the approval of the resolution plan and howthe proceeds, if any, from such proceedings should be distributed.[48] An MSME which is a resolution applicant in its own corporate insolvency resolution process would naturally want all avoidance actions to stop after it takes over the corporate debtor. Therefore, the Code must be suitably amended to restrict outcomes that put an end to avoidance actions. The regulations must clarify that the liberty to deal with the manner in which avoidance transactions are to be pursued does not confer the right to put an end to such proceedings. It is important to note that the law does not allow management found guilty of avoidance transactions to propose a resolution plan. Therefore, the spirit of the law mandates that an MSME should not be allowed to compromise avoidance actions under its resolution plan. Interestingly, there have been instances where an MSME has taken over the management of a CD with the understanding that the FCs will be at liberty to continue pursuing the avoidance actions.[49] However, the fate of such applications for avoidance transactions after a CD's existing management wrests back control is doubtful.

RETHINKING THE LAW ON VOLUNTARY INSOLVENCY COMMENCEMENT IN INDIA

The abuse of the Code for ulterior motives derives its incentives primarily from the 'clean slate doctrine'. The corporate insolvency process extinguishes all the debts of the CD and allows it to emerge with a clean slate.[50] It is therefore important to question whether the benefit of the 'clean slate doctrine' must be extended to CDs who have initiated the CIRP with ulterior motives.It is also important to develop a framework on which such a challenge may be sustained.

[45] Hari Babu Thota v. Ors.,Civil Appeal No 4422/2023.
[46] Kushagra Gahlot, *supra* note 22.
[47] Tata Steel Bsl Limited v. Venus Recruiter Private Limited, 2023/DHC/000257.
[48] CIRP Regulations, Reg 38(2)(d).
[49] Bank of India and Ors v. Anand Tex India Pvt Ltd,CA No 1103/2019 (NCLT - Chandigarh).
[50] Ghanashyam Mishra and Sons Private Limited v.Edelweiss Asset Reconstruction Company Limited and Ors.,2021 INSC 28.

This paper has highlighted some instances of abusive conduct under the Code. It has also argued that it is not feasible to provide a hearing or notice to all stakeholders before voluntary insolvency admission. However, the analysis of the present law has demonstrated the need to safeguard the interests of unsecured creditors comprising judgment creditors and involuntary creditors[51] who are most impacted by the insolvency commencement of the CD. Therefore, when such parties approach the AA before insolvency commencement, they must be provided with an opportunity to be heard. This will provide an avenue for such affected parties who have an economic interest in the CD to ventilate their grievances. At the same time, limiting the hearing to parties that have an existing economic interest in the corporation and have approached the tribunal will provide more certainty to the law. This will exclude contingent claim holders from being provided a hearing. This provision for a prior hearing of vulnerable unsecured creditors most affected by the 'clean slate doctrine' will eliminate the need for radical exceptions to the clean slate doctrine.

The Code has consciously adopted the default test of insolvency. However, to prevent abusive conduct, the AA must consider whether a genuine situation of balance sheet insolvency exists before admitting applications for voluntary insolvency commencement. The alleged insolvency must not be a result of a temporary cash flow crisis which can be improved by proper financial management. At the same time, profitability cannot be a ground to deny insolvency admission if, otherwise, the CD is balance sheet insolvent.

As this paper has previously argued, applications under section 65 of the Code alleging malicious and improper initiation of the corporate insolvency resolution process must be adjudicated at the stage of insolvency admission rather than deferring it to a later stage. The purpose of the law is frustrated if a decision is not made at the stage of admission. Recourse against fraudulent and malicious initiation of the CIRP is an important remedy that must be decided before admitting any application.

The authors have also argued that permitting promoters of MSME corporate debtors to bid for their assets during the corporate insolvency process is susceptible to strategic abuse of the voluntary insolvency process. However, placing a complete prohibition on MSME CDs subject to voluntary insolvency proceedings from bidding for their assets in the resolution process may also be counterproductive. Therefore, the author suggests that when approving a resolution plan for an MSME CD undergoing voluntary insolvency with no change in management and control, the AA must apply a higher level of scrutiny to examine allegations of selective impairment of creditor rights. There needs to be further discussion on whether pending suits and arbitration proceedings should continue after the approval of resolution plans, particularly when it appears that the voluntary corporate insolvency process was initiated to stymie the interests of parties involved in those suits and arbitration proceedings.[52] The Indian insolvency regime defers to the commercial wisdom of the committee of creditors and does not confer 'fairness jurisdiction' on the AA, under which it can take issues of fairness into account. The

[51] When a person becomes a creditor to a company without its consent, the person is classified as an involuntary creditor. Victims of mass tort claims become creditors to a company involuntarily.

[52] In Fourth Dimension Solutions Limited vs. Ricoh India Limited and others (Civil Appeal No. 5908 of 2021, decided on 21.01.2022), the Supreme Court of India allowed the pending arbitration proceeding to continue post resolution plan's approval.

author argues that such a judicial position is unsuitable at the time of approval of a resolution plan of an MSME CD that is a resolution applicant in its own voluntary corporate insolvency process. When an MSME CD is a resolution applicant in its own voluntary corporate insolvency process there should be stricter scrutiny by the AA at the time of plan approval about selective impairment of rights and the fate of transaction avoidance proceedings after plan approval.

To tackle perverse insolvency objectives,it's essential to approach transaction avoidance applications in CIRPs with greater responsibility and diligence, particularly in cases where there is no change in management. Specifically, when the existing management of an MSME CD regains control following the resolution process, these applications must be handled with more care and diligence. Such a framework, while upholding the spirit of the law to provide ease of entry and exit of businesses, will establish guardrails against abusive conduct. A CD must be allowed the freedom to exit businesses that it considers unviable but the law must ensure that it faces the consequences of corporate malpractices. Otherwise, it will lead to the establishment of a corporate culture where CDs are incentivized to siphon off their assets to a different company, deplete all their assets, and thereafter trigger a voluntary insolvency proceeding culminating in an asset-less liquidation. Thereafter, it can take over the management and control of the same corporate debtor in the case of an MSME unit or carry on the same business through the entity where it has siphoned off its assets after extinguishing all its liabilities.[53] It is perhaps appropriate for the insolvency regulator to intervene in such a situation to empower resolution professionals.[54] The regulator can establish a fund to provide funding to the resolution professionals to investigate transaction avoidance and corporate misconduct.[55]

CONCLUSION

In this paper, the author highlights some instances where the Code is susceptible to strategic insolvency abuse. It has been observed that section 29A of the Code serves as a deterrent against CDs abusing the Code for purely strategic purposes. The loss of management and control serves a useful purpose in preventing provisions of the Code from being abused. However, the disincentives become weaker in the case of an MSME CD on account of exemptions granted to it that allow it to bid for its assets during corporate insolvency resolution. Therefore, the paper proposes that in circumstances where an MSME CD is a resolution applicant in its own voluntary corporate insolvency process, there should be stricter scrutiny by the AA at the time of plan approval about selective impairment of rights and the fate of transaction avoidance proceedings after plan approval.

[53] Such an activity can be viewed as a variation of what is commonly referred to as phoenixing.

[54] Jason Harris, The competing goals theory and insolvency law'in Emilie Ghio, Joh M Wood& Jennifier LL Gant et.Al. (eds.) Re-examining Insolvency Law and Theory(Cheltenham, UK: Edward Elgar Publishing2023) 149.

[55] Australia has the Assetless Administration Fund, managed by its insolvency regulator, ASIC. This fund provides limited financial support to insolvency practitioners when a company lacks sufficient assets to cover basic investigations and examinations.

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