IBC
Idea, Impressions and Implementation
2022
The Insolvency and Bankruptcy Code, 2016 (Code) is the umbrella legislation for insolvency resolution of corporate persons, partnership firms and individuals. The Code hailed as a paradigm shift from the erstwhile insolvency regime in India in terms of its design and architecture as it strives to maximise the value of the corporate debtor’s assets while balancing the interests of all stakeholders during the process. The Code aims at developing a robust stressed assets market and providing a graceful exit to the genuine business failures. The outcomes of the Code in the initial years of its enactment have been truly inspiring and note-worthy.

Marked by six amendments till date, the Code has achieved institutional milestones and built a sense of hope and optimism among the stakeholders. The evolution of the Code with the constantly changing market dynamics and emerging realities makes it a rightful example of a ‘living law’. The exciting journey of the Code is hence worth to be penned down for the benefit of the readers as well as the stakeholders. As a part of its Annual Publication series, the Insolvency and Bankruptcy Board of India is set to release its fourth annual publication on the momentous occasion of six years of its establishment on October 1, 2022. The publication presents stimulating thoughts and viewpoints of various stakeholders and contributors on the ever emerging insolvency landscape in our country.

The theme of this year’s publication is ‘Idea, Impressions and Implementation’. It details the path the law has taken in terms of its evolution and emerging jurisprudence; the continual improvements during the past six years; contribution of the key pillars and stakeholders in its effective implementation; the impact that the law has created; and lastly peeps into what lies ahead. Practitioners, policymakers, lawyers, subject experts, and academicians have graciously shared their thoughts in the publication around this theme.
The Insolvency and Bankruptcy Code, 2016 (IBC/Code) enacted in the year 2016 has proved to be a comprehensive ‘one stop shop solution’ for resolving insolvency of corporate businesses. This greatest market reform legislation of the recent past, has had profound impact, which is felt across the business environment. The Code has made the exit of firms equally easy as its entry and sustenance in the market, thus completing the cycle of freedom of entry, competition and exit of businesses. The reallocation of idle resources by putting it to more viable uses, has been made possible with the implementation of the Code, as it enables the firms to restart in the hands of new management, if feasible, or to liquidate its assets and put it to new uses.

The IBC presented itself as a ray of hope to the situation of rising non-performing loans in India. It facilitated a collective mechanism for resolution of distressed assets while maintaining a delicate balance for all stakeholders to preserve the economic value of the process in a time bound manner. The Code has repeatedly withstood judicial scrutiny and in over six years of its enactment, has strengthened the rights of creditors and reinforced the confidence of investors. The Code has continued to evolve with the changing dynamics of the market and emerging challenges. A few watershed moments in the exciting and eventful journey of the Code, so far, include recognising homebuyers as financial creditors, introduction of section 29A making defaulting promoters ineligible to re-enter as resolution applicants, introduction of insolvency resolution process for financial service providers and pre-packaged insolvency resolution process etc. The constant endeavour of the Government and the Insolvency and Bankruptcy Board of India (IBBI) to urgently address the upcoming challenges, has transformed IBC into a future ready and relevant in time, legislation.

This annual publication of the IBBI, fourth in the series, gives a glimpse of the journey of the Code and provides a thoughtful perspective on the potential reforms. It assembles the experiences and insights of experts, stakeholders, researchers, and IBBI officials who have been an integral part of this exciting journey of the implementation of the Code and have plenty to share to induce enriching discussions. We are thankful to all the contributors for their insightful contributions, generosity, and expertise utilised for this publication, adding to the current understanding of the law and building a new perspective on the forthcoming reforms.

We thank the team at IBBI comprising of Mr. Sudhaker Shukla, Mr. Jayanti Prasad, Mr. Ritesh Kavdia, Mr. Shiv Anant Shanker, Mr. Deepak Rao, Mr. Sushanta Kumar Das, Ms. Pooja Singla and Ms. Medha Shekar for their commitment, enthusiasm, and exacting diligence in putting this publication together.

We are hopeful that this publication will provide the readers a new outlook of what has happened, how did it happen and what is set to happen next. It is our hope that the visionary thoughts expressed in the publication will drive the future policy discourse.

Ravi Mital
Chairperson
Insolvency and Bankruptcy Board of India
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A cting as the third pillar of economic freedom, the Insolvency and Bankruptcy Code, 2016 (Code) has been a game changing endeavor to provide a market driven and time bound mechanism for resolution of insolvency cases in the country. It has facilitated a collective effort not only to keep a distressed entity alive but also to maximise the value of its assets while exploring the best possible avenues for tackling such state of distresses. Initiated as one of the greatest economic legislations in the recent past, the Code has had a profound impact on the creditor-debtor relationships and their behavior in India. It has marked a radical departure from the prevalent approaches as it embraced the ‘creditor-in-control’ model as against the ‘debtor-in-possession’ model that had failed to produce significant improvements in the credit discipline in the country.

2. Since its implementation in the year 2016, like any other law, the Code too has experienced its own learning curve. It, however, has managed to adapt to the ever-changing needs of the market. Marked by six amendments till date, the Code has achieved institutional milestones and has built hope and optimism among the stakeholders. It has improved the business climate in the country by making it easier for enterprises to exit in case of difficulties, thereby boosting the startup culture in the country. The Code responded in time to the market disruptions caused by COVID-19, by suspending the recourse to the Code under Sections 7, 9 and 10, with the objective to prevent operationally and economically viable firms from being pushed into insolvency.

3. The IBC has been a landmark legislation which has borne fruits of economic transformation in its initial years itself. It has established institutions to address the issue of rising NPAs effectively and efficiently in the economy. Through time-bound and effective insolvency resolution procedures, the Code has encouraged promoters of Corporate Debtors (CD)/entities facing genuine business failures to come forward and make an honest attempt to restart. It has reduced the stigma associated with the terms ‘insolvency’ and ‘bankruptcy’, thus making it a ‘new normal’. The number of resolutions approved under the Code has proved that the entity/CD facing business failures are given an opportunity to revive and stand on its feet. The Code has given a new dimension to creditor’s rights and has resulted in increased flow of credit into the economy. Entering its sixth year of operation, the Code, once nascent, has now evolved into a future ready legislation.

4. With a view to enhance the efficacy of insolvency resolution process under the Code, the Government and the Insolvency and Bankruptcy Board of India (IBBI) have been continually making concerted efforts to overcome barriers in terms of delays in the resolution process and resultant value erosion of assets of the corporate debtor. The IBBI is committed to make the processes simpler and quicker with an aim to preserve the value of the business while it undergoes resolution. The proactive regulatory interventions by the IBBI shows its keenness to ease the compliance burden on the service providers and to cut short the timelines, wherever feasible.
5. While continuous efforts are being made to further finetune the resolution process, the contribution of the judiciary has proved to be equally important in the success of the Code. Evolution of jurisprudence in form of judgements and orders has indeed been significant as various contentious issues were addressed by such judicial pronouncements. Some of the important issues so addressed include, inter-alia, constitutional validity of the Code, the primacy of commercial wisdom of the committee of creditors, protection of inter-se priorities of secured creditors, effect of moratorium on the guarantors, treatment of the homebuyers in Corporate Insolvency Resolution Process (CIRP), applicability of the Limitation Act, 1963 to the proceedings under the code etc. While the Code has had a remarkable journey so far, going forward, evolving with changing scenarios and responding to new challenges in future will be critical.

6. As the code evolves further, it needs a careful evaluation, analysis, through comparison of its actual achievements with the desired outcomes as laid down in the Code. With a view to streamline the processes under the Code and to facilitate faster exit of firms, the IBBI has been engaging with stakeholders to build discourse around critical aspects and best practices webbed around the insolvency space in the country. Academic knowledge, empirical evidence based on rigorous analysis and domain expertise etc. can collectively lead to further refinement in the formation and implementation of the policies of the Government. Towards this objective, this publication titled ‘IBC: Idea, Impressions and Implementation’, the fourth in the series, contains thought provoking knowledge articles by academicians, policy experts, researchers and subject experts, which have been organised under five parts in the Publication. I am confident that this year’s publication will not only add to the current understanding of processes, outcomes, and impact but will also provide an insight into the future version of the Code.

Tarun Bajaj
Secretary to Government of India
Ministry of Corporate Affairs
Businesses fuel the economy with production of goods and services, generating employment and economic activity and resultant increased revenues to the Government. It is an accepted principle that economic freedom and economic performance have significant correlation. Optimal business environment and related regulations yield better performing businesses, which results in higher economic wellbeing of the country. It is, therefore, the endeavour of different economies to ease its business regulations. A firm needs freedom broadly at three stages of a business - to start a business (free entry), to continue the business (free competition) and to discontinue the business (free exit). The first stage ensures allocation of resources to the potentially most efficient use, the second stage ensures efficient use of resources allocated, and the third stage ensures release of resources from inefficient uses for fresh allocation to competing uses - and consequently the highest possible growth.

After a multitude of insolvency legislation which were sub-optimal, the Insolvency and Bankruptcy Code, 2016 (IBC/Code) was enacted by the Government in the year 2016, as the third pillar of economic freedom, i.e., freedom to exit. The Code proved to be a landmark legislation which provides for institutionalised mechanism for insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner with the objective of maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit, while balancing the interests of all the stakeholders. This legislation, as one of the most important economic legislations of the recent times, contributed significantly to the remarkable improvement in easing India’s business environment. As per the latest World Bank’s ‘Doing Business’ Report, India’s overall ranking in the ease of doing business had jumped to 63 from its earlier rank of 142 pertaining to the year 2015. Post initiation of the IBC, India’s rank relating specifically to the ‘Insolvency Resolution’ indicator, had improved to 52 from the earlier 137, during the same period.

The IBC, in no time, has established itself as the most effective remedy for resolution of stressed assets. It has brought a remarkable transformation in the creditor-debtor relationships and overall credit culture in the economy. Like any other economic law, the Code too has undergone several revisions as and when market dynamics so warranted. With evolving market conditions, the legislative interventions and evolving jurisprudence have imparted further depth and maturity to the once nascent legislation.

The Code facilitates a collective effort to revive the firm and to keep it going, wherever viable and promotes ease of exit, wherever required. It enables optimum utilisation of resources, either through resolution or liquidation. All processes envisaged under the Code are largely market driven and primacy is accorded to the commercial wisdom of the committee of creditors. Liquidation is, however, to be considered as a last resort. The outcomes of IBC can be gauged from the fact that out of a total of 5,636 cases, which had commenced till June 2022, closure has been achieved in 3,637 cases. Of the cases closed,
while 1,934 companies (53% of total closed cases) got rescued, 1,703 cases have ended in liquidation. Out of the rescued cases, 774 cases have been closed on appeal or review or settlement; 643 cases have been withdrawn; and 517 cases have yielded approved resolution plans. Of the resolved cases, 34% of cases were earlier with Board for Industrial and Financial Reconstruction and/or were defunct. The data shows that the Code has made it possible for even defunct companies to get another chance of survival, which otherwise would have been liquidated. Under the resolution plans, the creditors have realised ₹ 2.35 lakh crore, whereas the liquidation value of the assets of the corporate debtor (CD) was only ₹ 1.31 lakh crore, though they owed ₹ 7.67 lakh crore. This translates into the fact that the creditors have achieved more than 178% of the liquidation value and 30% of the total admitted claim. Over more than 22,400 applications having an underlying default of ₹ 7.10 lakh crore were settled even before admission. This is testimony of behavioural change in debtor-creditor relationship that the Code has triggered.

The IBC was enacted as a critical building block of India’s progression to a mature market economy. It addressed the growing need for a comprehensive law that would be effective in resolving insolvency of debtors, maximising the value of assets available for creditors and easing the closure of unviable businesses. The objective was to ease the exit of firms to reallocate the freed resources to more efficient uses. The Code read with rules and regulations made thereunder prescribes timelines at various stages of the process starting from admission till completion of the resolution/liquidation process. The adherence to these timelines requires a collective effort by all the stakeholders.

In the words of Robert T. Kiyosaki, ‘Today, wealth is in information. And the person who has the most timely information owns the wealth’. Information is a crucial asset for any organisation and more so if the company is in a distressed state.

Information asymmetry tilts the balance of power in favour of the party having the information at the expense of other who goes for financial contract without gauging the market pulse. In case of a distressed company, its shareholders and promoters are better informed of the asset value than the creditors. Incomplete or missing information delays decision making, exacerbates value erosion and increases the costs associated with re-organisation of the firm. Considering the paramount significance of information availability in case of a distressed CD, the Insolvency and Bankruptcy Board of India (IBBI) amended various regulations to facilitate the submission of information at the time of filing/admission as well as during the process by personnel, promoters, management, and creditors of the CD.

Any economic law must keep responding to emerging market conditions and challenges, to continue to remain relevant. The IBC is no different and as a key economic reform, has evolved itself, in short span of time, as a credible instrument which has brought about perceptible transformation in the prevailing credit culture in the country.

This is the fourth annual publication of the IBBI, being released on completion of six years of its establishment. It presents thought provoking experiences and insights which apart
from capturing the progress of the Code and its institutions, provides a multi-disciplinary perspective on the outcomes, jurisprudential developments, and impact of the Code and the potential reforms that may be required in future.

The publication has been divided into five Parts. Articles in Part I, titled ‘Initiation and inflections’ present the journey of IBC over past six years. Authors pen down their thoughts on the evolution of the market for distressed assets in India and emerging jurisprudence, providing an overall view of the accomplishments of the insolvency reforms so far and a glimpse of the road ahead.

While the Code has laid down robust mechanisms and processes for resolution of stressed assets, continuous improvements are part and parcel of any economic reform. In Part II, ‘Improvement in Processes’, the authors suggest ways to further strengthen the existing processes in the interests of all stakeholders and time bound resolution of the distressed assets.

Part III, ‘Institutions and Interdependencies’, presents the view of the authors on the indispensable institutions created by IBC and suggests ways to further strengthen these.

Part IV, ‘Imprint, Impact and Insight’, traces the achievements of the Code and discusses its far-reaching impact on the credit markets and overall economic growth.

The Part V titled ‘Ideas, Ideals, and Inspiration’, discusses unchartered territories such as treatment of intellectual property licenses, resolution of group insolvency and cross border insolvency, use of mediation in insolvency resolution, insolvency framework for a digital economy and implementing the remaining provisions of the Code viz. individual insolvency.

We are extremely grateful to all the authors for sharing their experience and expertise through their insightful contributions to this publication.

We are hopeful that this publication would trigger further knowledge discourses amongst the practitioners of the Code and all stakeholders towards improving the efficacy of the IBC, even further.

Jayanti Prasad
Whole Time Member
Insolvency and Bankruptcy Board of India
Part I
Initiation and Inflections
The economic arguments for the ease of doing business are plenty - including attracting higher investments, development of competitive environment and innovations. However, it is important to note that ease of doing business is not only about this, but also about ‘Ease of Exit’. While entry barriers determine the ability of competition to make inroads in business, exit barriers determine the competitive structure that persists among the incumbents within the industry. It is an equally essential aspect of the ease of doing business, as much as entry into business.

Over the years, the Government has passed laws and set up various mechanisms to resolve the systemic problems stemming from borrowers unable to service loans received from financial institutions. The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) was passed more than three decades ago to resolve bankruptcies and the Bureau of Industrial and Financial Reconstruction (BIFR) was set up under SICA. However, the resolution process was found to be very slow. Later on, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) was approved by Parliament. These regimes did not turn out to be sufficient for providing quick resolution. Not only was the process very time-consuming, but the recovery rates were also very low.¹ The Economic Survey 2015-16 also noted this and called this a ‘Chakravyuha challenge’. The survey argued that India had made great strides in removing the barriers to the entry of firms, talent, and technology into the Indian economy. However, much less progress had been made on exit processes.

Recognising that ease of exit is an important part of doing business and there was a need for developing a robust mechanism for the same, the Insolvency and Bankruptcy Code, 2016 (IBC/Code) was enacted. The Code has been successful in bringing about an overhaul in the resolution process. The Table below shows that the amount recovered has been much higher than under any other method in 2019-20 and even for the period 2020-21 where there were restrictions on initiation of proceedings under IBC², it accounted for almost 43% of the amount recovered, showing its success. The amount recovered as a percentage of amount involved was 46.3% under IBC, higher by a very large margin as compared to other methods in 2019-20. In comparison, it was 17.4% under the SARFAESI Act, which had the second highest recovery rate. The same trend was true for the previous two years as well (2017-18 and 2018-19), although this was not so in 2020-21 largely due to suspension of proceedings on account of pandemic. This is a noteworthy achievement considering it has been less than six years since inception of the Code.
Adding IBC to the existing arsenal of creditors has provided more than just a recovery route. It has triggered a systemic response to the underlying attitudinal problems in the creditor-debtor relationship by bringing about a positive behavioural change. The credible threat of a resolution process that may shift the control and management of the firm away from existing promoters and managers, deters the management and promoters of the firm from operating below the optimum level of efficiency and motivates them to make the best efforts to avoid default. Further, it encourages the debtor to settle default with the creditor(s) at the earliest. There have been instances where debtors have settled their debts voluntarily or settled immediately on filing of an application for corporate insolvency resolution process (CIRP) with the Adjudicating Authority (AA) before the application is admitted. As on December 2021, 19,803 applications for initiation of CIRPs of corporate debtors (CDs) were resolved even before their admission.

**JOURNEY SO FAR**

Since the provisions of CIRP came into force in 2016, a total of 4946 CIRPs have commenced by the end of December 2021. 2527 CIRPs were initiated by operational creditors (OCs), 2111 by financial creditors (FCs) and 304 by CDs.

Out of the total cases that have been closed, around 47% (1514 cases) have been ordered for liquidation. In more than 60% of such cases, the committee of creditors (CoC) decided to liquidate the CD, in another 35%, the AA did not receive any resolution plan. In the rest three percent of cases, the AA rejected the resolution plan.

It is often argued that the outcome of the IBC process has been more titled towards liquidation than resolution. However, approximately 77% of the 1514 CIRPs which were

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**Table: Non-Performing Assets of Scheduled Commercial Banks recovered through various channels**

<table>
<thead>
<tr>
<th>Channel</th>
<th>2019-20</th>
<th>2020-21</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of cases</td>
<td>Amount</td>
</tr>
<tr>
<td></td>
<td>referred</td>
<td>involved</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lok Adalats</td>
<td>59,86,790</td>
<td>67,801</td>
</tr>
<tr>
<td>DRTs</td>
<td>33,139</td>
<td>2,05,032</td>
</tr>
<tr>
<td>SARFAESI Act</td>
<td>1,05,523</td>
<td>1,96,582</td>
</tr>
<tr>
<td>IBC*</td>
<td>1,986</td>
<td>2,24,935</td>
</tr>
<tr>
<td>Total</td>
<td>61,27,438</td>
<td>6,94,350</td>
</tr>
</tbody>
</table>

Source: Off-site returns, Reserve Bank of India (RBI) and Insolvency and Bankruptcy Board of India (IBBI)

Notes: * Refers to the amount recovered during the given year, which could be with reference to the cases referred during the given year as well as during the earlier years; DRTs: Debt Recovery Tribunals; @: Cases admitted by National Company Law Tribunals under IBC; The resolution plan of Essar Steel India Ltd. was approved in 2018-19. However, as apportionment among creditors was settled in 2019-20, the recovery is reflected in the latter year data.
ordered for resolution were earlier with BIFR or were defunct/non-functional. So, the value in these cases had already been eroded and these CDs had assets which on average were valued at less than eight percent of the outstanding debt amount.\textsuperscript{3} Going forward, the situation may improve as these legacy cases are resolved.

It is sometimes argued that the value recovered by creditors has been low. It is mentioned various times that in various cases, the haircuts on borrowings were at times upwards of 90%. However, coming to this conclusion misses a crucial point, which is how much is the remaining value of assets when the resolution process starts. For instance, as of December, 2021, in the 457 CIRPs which were resolved, ₹ 8.34 lakh crore was owed to creditors whereas resolution plans realised ₹ 2.59 lakh crore. However, the correct comparison should be with the value of assets of debtors, which was ₹ 1.51 lakh crore. Therefore, realisation by FCs under resolution was 165.8% as compared to liquidation value and 33.1% as compared to their claims (until December 31, 2021). Similarly, the 292 CDs which have been completely liquidated had outstanding claims of ₹ 49,500 crore, but the assets were valued at ₹ 2293.42 crore and out of this, ₹ 2177.6 crore was realised during the liquidation of these companies.

Usually, the assets under cases that come to resolution have low value or are in distress. Each asset has its life cycle and if the distress in the assets is not resolved, the value of the assets diminishes. The extent of haircut taken by creditors is not the apt measure to judge the success of IBC as in many cases the value of assets when companies go into resolution has already become low.

Six years since its commencement, the IBC has seen a paradigm shift \textit{vis-à-vis} its nascent stage – on-field challenges, as and when faced, have been attempted to be tackled by way of amendments.

Keeping in line with the dynamic nature of the Code which led to making changes along the way when needed, the Code was amended again in 2021 to include a pre-packaged insolvency resolution process (PPIRP) for micro, small, medium enterprises (MSMEs) to an alternative insolvency resolution process to ensure quicker outcomes. This is a combination of a debtor-in-possession and a creditor-in control approach. As nomenclature suggests, pre-pack is a restructuring plan which is agreed to by the debtor and its creditors prior to the insolvency filing and then sanctioned by the court on an expedited basis. PPIRP is introduced which will help MSMEs to negotiate with the FCs and revive the enterprise by the management/promoters/partners while continuing to remain in the management. In the case of PPIRP, it’s only the CD\textsuperscript{4} and not the creditors who can file application and submit the base resolution plan.\textsuperscript{5} The entire process of PPIRP is to be completed in a maximum of 120 days. Simply put, PPIRP is nothing but consensual restructuring where there is mutual agreement between CD and creditors (informal) and then judicial approval of AA (formal).

**INTERNATIONAL COMPARISON OF IBC WITH US AND UK**

Chapter 11 of the Bankruptcy Code in the US can be said to be the origin of the corporate resolution and reorganisation process. It is considered an extremely company-friendly
system and, in fact, are said to help companies continue to the furthest extent possible during the process.

In the US, in most cases, the debtor company files a petition in bankruptcy court with a list of creditors and a summary of assets & liabilities. Moreover, the management of the company continues, and the debtor remains in possession during insolvency proceedings. The debtor has a period of four months (extendable upto 18 months) to propose and seek approval from impaired creditors & shareholders within two months. The plan should be approved by a majority of each class of creditors whose rights have been impaired and two-third in amount. In the US, the debtor is allowed to sell substantially all its assets free of lien, to avoid further erosion of value due to losses. Once the resolution plan is confirmed, it discharges debtor’s pre obligation other than what is proposed in the plan. If the plan is not confirmed, then it is converted to bankruptcy proceedings.

The UK’s insolvency law ‘Insolvency Act, 1986’, on the other hand, is for the most part considered to be more creditor friendly. In UK, the creditors or CDs can start the insolvency process. Management control passes to an Insolvency Practitioner or Administrator during insolvency proceedings. The assets of the debtor may be sold by the Administrator. The resolution plan must be submitted within eight weeks of the appointment of an Administrator (or extended period as allowed by the court) and the approval requires a simple majority in value of those creditors present and voting. After one year (or whatever extended time was provided), the Administrator applies if no purpose has been achieved for resolution, then a liquidation proceeding can be initiated.

One of the major differences of IBC as compared to the US insolvency regime is that a ‘debtor-in-possession’ approach (management remains in control of running the company) is followed in the US, whereas IBC (as well as UK insolvency law) is more of a ‘creditor-in-control’ regime. Both approaches have their own merits. For example, the debtor in possession approach believes that the management of the company is best suited for running the company for a quick reorganisation plan rather than a new person who will have own learning curve as well cost. The argument in favour of the debtor in possession approach is that the removal of the debtor’s incumbent management in all cases could undermine the possibility of rehabilitation, since management will, in some cases, have the best understanding of the business’s operation. However, there are various arguments against this approach as well.

The first consideration relates to the type of incentives such an approach may create. First, if a debtor perceives that it has everything to gain (the stay on creditors) but nothing to lose (no loss of control in the business), it may be tempted to utilise the rehabilitation procedures when rehabilitation is clearly not possible. Specifically, a debtor that is no longer viable may attempt to use rehabilitation proceedings solely to delay the inevitable, with the consequence that the assets of the debtor continue to be dissipated. Accordingly, instead of promoting rehabilitation, such a system may merely encourage debtors to delay liquidation to the prejudice of creditors. Another issue is that even when the enterprise can be rehabilitated, there is the possibility that the debtor’s management may act irresponsibly and, in some cases, even fraudulently during this period.
On the other hand, the alternative approach, i.e., ‘creditor-in-control’ has certain merits as well as disadvantages. This approach envisages that the company can best be run by an Insolvency Professional over the previous management. Given that creditors are a key player in the insolvency process, this approach allows them to take key decisions, like approving the resolution plans. Giving creditors control over the initiation of insolvency proceedings binds them to take effective action to recover their dues. This helps in a more efficient and timely process (as compared to the lengthy court proceedings under the previous regimes in India). The appointment of a Resolution Professional (RP) who has expertise in the insolvency process is likely to lead to better outcomes for both the debtor company and the creditors, with reduced scope for appeals. Though there are certain arguments against the creditor-in-control regime as well.

The success of the creditor-in-control method relies heavily on the attitude of the creditors in question. Creditors may focus solely on their own interests, in terms of debt repayment, and therefore take decisions which are not in the best interests of the debtor company as a going concern or its shareholders/employees. This removes any potential for growth or renewal and may lead to poor resolution outcomes. Moreover, the process of creditors taking decisions regarding the debtor company and ultimately agreeing on a resolution plan may be a cumbersome process when creditors are not in agreement. This may lead to delays in the process. Though in both approaches, the laws look for a resolution plan on a going concern basis over liquidation.

India’s previous insolvency regime saw the promoters and management of the debtor company retaining some control of the company during the insolvency process. This resulted in long-drawn court battles, with lenders either waiting for years or even failing to recover their dues. The increasing number of bad assets and debts put significant pressure on the economy. Further, to protect any malfeasance, IBC prohibits the initial owners from offering resolution plans for their own firms (section 29A). In fact, this was added later on within a year after the Code was passed, once it was realised that the debtor companies were using this mechanism to take over the company back after restructuring with a significant haircut to creditors. For instance, the first resolution under the Code, Synergies Dooray Automotive Limited (August 2017) was an eye-opener. A related party of the defaulter’s company walked away with the company with a 94% haircut to the creditors. The Supreme Court in Chitra Sharma v. Union of India, held that the purpose behind the bar against certain individuals is to ensure that persons responsible for the insolvency of the CD do not participate in the CIRP by means of a backdoor entry. Similarly, in Phoenix ARC v. Spade Financial Services, it was observed that the IBC provides that any related party of a CD does not have the right to be part of the CoC. The object of such a provision is to prevent the decisions of the CoC from being sabotaged by related parties of the CD. Though a drawback of the Code is that some people argue that this has led to more focus on liquidation under IBC than resolution and restructuring.

Both in the UK and US, the Bankruptcy Code allows any stakeholders of the debtor to initiate the pre-pack process and the debtor is responsible for negotiating the plan of reorganisation with all the creditor classes. The US Bankruptcy Code facilitates three
forms of pre-packs, namely, pre-plan sales under section 363, pre-packaged bankruptcy proceedings and pre-arranged bankruptcy proceedings under Chapter 11. Even Indian IBC has now included the provisions for PPIRP, though it is available for MSMEs only. Though the design of the pre-pack is not exactly same as in US and UK.\(^8\)

The origins of the two different approaches to insolvency and resolution may be cultural. Nathalie Martin of Boston College wrote comprehensively on the cultural origins of bankruptcy law in 2005.\(^9\) In the US, business failures are considered rather normal and hence there is no stigma attached to it. There is no presumption either that the debtor has deliberately failed to repay creditors. Hence, the bankruptcy process does not seek to dispossess the debtor.

Professor William J. Woodward Jr., of the Temple University Beasley School of Law, in an article\(^{10}\) written in 2008, outlines the rationale for the way that bankruptcy law evolved in the US, particularly after 1978 when ‘debtor-in-possession’ was firmly enshrined. He contrasts the situation with China’s bankruptcy law, which more closely resembles that of India.

Whereas India’s bankruptcy laws modelled after the UK assume that debtors have failed to repay creditors deliberately and hence must be stripped of possession and control. In other words, the former can evolve in a society based on high levels of trust. The latter reflects low levels of trust. It might be understandable, due to the history of debtor frauds and defaults, caused not by ‘hard-to-control’ business failures but due to diversion of funds for purposes other than for which the loans were drawn. Indeed, the reasons why the implementation of IBC in India was hailed was that it handed creditors back control against borrowers.

In a way, a partial explanation for the inordinate delay in the settlement of bankruptcy proceedings in India well above the norm of 270 days is the ‘low trust’ culture in the country. That even RPs have, sometimes, attempted to game the process in favour of debtors is proof of that ‘low trust’ reality that will fade away only over time.

As an aside, it is worth pointing out that low-trust reality manifests itself in many situations. Therefore, there is a cat-and-mouse game between fraudsters and lawmakers. The outcome is an elaborate, complex and hard-to-comprehend set of laws, rules, regulations and enforcements. These extract an economic cost in terms of lost growth and productivity that is hard to measure.

Corporate governance improvement, not in law, but in practice, will be a key requirement for countries to move towards ‘debtor-in-possession’.

Writing in September 2020, Sumant Batra makes the case for India’s IBC process to provide for ‘debtor in possession’ provisions, alongside the existing ‘credit in control’ provisions.\(^{11}\) Apparently, Singapore adopted this approach in recent reforms and some other countries are also examining it. The author suggests that India should consider providing for both approaches if it were to attract investments from American firms who are used to a ‘debtor-in-possession’ approach.
In an affirmation of our earlier argument that low-trust societies opt for a ‘creditor-in-control’ approach, he suggests that in situations where there was no trust deficit between creditors and debtors, creditors should be free to opt for a ‘debtor-in-possession’ regime.

**CONCERNS IN INSOLVENCY PROCESS**

**Delays in admission of insolvency applications**

The Code prescribes a period of 14 days for admission of insolvency applications. However, in reality, the admission usually takes a much longer time than that. A consultation paper released by the IBBI on April 13, 2022, notes that the average time taken for admission of an insolvency application by an OC has increased from 468 days in 2020-21 to 650 days in 2021-22. This is longer than even the stipulated deadline for completion of a CIRP under the Code. A lot of petitions filed with the National Company Law Tribunal (NCLT) have been stalled at the admission stage for up to two years. The primary cause for this delay is insufficient human resources, as the NCLT often functions at less than 50% of its sanctioned strength. These kinds of delays affect the efficiency of the process.

**Delays in resolution process**

One important concern that remains is that the timelines set by the law for various actions have not been met. For instance, it took on an average 391 days for the CIRPs to end up for orders for liquidation. Further, for 20% of cases for which final reports have been submitted, it is a further 431 days on average. And the rest 80% cases for which order for liquidation has been passed, 46% of cases are still ongoing for more than two years, 23% for more than one and less than two years, 13% for more than 270 days and less than one year.

The delays are prevalent even in the case of voluntary liquidations. Out of the total ongoing cases for voluntary liquidation under IBC, 34% of cases are ongoing for more than two years, 18% each for more than one and less than two years, and more than 270 days and less than one year as of December 2021.

One reason for the delays is that there are few NCLT benches and there is not adequate manpower to handle the cases. The IBC cases are not the only mandate of NCLT, they also consider various cases under the Companies Act, 2013 such as mergers etc. For instance, of the sanctioned strength of 64 judges for NCLTs, only 45 positions were occupied as of November, 2021. This leads to delays in the commencement of the resolution process.

The Standing Committee on Finance 2020-21 also noted that there are huge pendencies with NCLT. As per the Report of the Committee, as on May 31, 2021, more than 70% of cases are pending with NCLT for more than 180 days. The Standing Committee’s Report has commented that the NCLT takes a long time to admit cases. The Committee noted that as of August 2021, about 13,740 bankruptcy cases were pending with NCLTs. Further, 71% of such cases have been under process for more than 180 days.
Further, there are several minor procedural and uncontested matters requiring NCLT approval, such as - (a) replacement of Interim Resolution Professional (IRP) with RP; (b) extension of CIRP from 180 days to 270 days; (c) exclusion of time period; (d) admission of CD into liquidation and appointment of a Liquidator etc. Given the issues with sanctioned strength of the NCLT, these approvals often take very long, causing unnecessary delays in the process of admission and/or liquidation.

**Need to put more focus on restructuring**

Under the Code, over time, the process has become overly focused on the overall price of resolution bids as compared to the actual plans for restructuring those firms’ business models and capital structure or the distribution of proceeds among creditors. There is a general understanding among bank creditors that they should accept the highest bid rather than assess operational or management plans for firms. FCs, for example, bank employees, face perceived legal risks in the judgments they make about restructuring loans and hence, in such a situation, it is easier to mechanically choose among the bids rather than going through complex negotiations. Further, in the resolution process there are always chances that the promoters of the CD will hesitate to co-operate with the RP in running the affairs of the debtor, due to which the RP will not be able to take complete control of the CD.

It was recognised that the Code has been more successful in liquidation than restructuring. Hence, the Code was amended in 2018\textsuperscript{13} with a view to encouraging resolution as opposed to liquidation. The voting threshold was brought down to 66% from 75% for all major decisions such as approval of the resolution plan, extension of CIRP period, etc. Further, to facilitate the CD to continue as a going concern during the CIRP, the voting threshold for routine decisions was reduced to 51%. Further, the Code also amended the criteria to be able to bid as a resolution applicant to be able to allow more entities to become eligible.

As of December 2021, out of the 3247 CIRPs that have been closed, 1514 have ended in orders for liquidation. However, approximately 77% of the 1514 CIRPs which were ordered for resolution were earlier with BIFR or were defunct/non-functional. For resolution to happen, the resolution value should be higher than the liquidation value and in cases where the value of assets has depleted, this may not happen. So, this needs to be kept in mind while assessing whether the Code favours liquidation more than resolution. Though, more efforts need to be made to bring more focus on restructuring.

Even the Standing Committee on Finance (2020-21) noted that there is a need to allow for more flexible resolution plans. The committee noted that:

Section 5(26) of the IBC defines a resolution plan as a plan proposed by a resolution applicant for insolvency resolution of corporate defaulters as a going concern. Resolution Professionals, CoC and certain judgements by NCLT indicate that the term ‘going concern’ must imply that the resolution plan must result in disposal of the entire business and operations of the Corporate Debtor under one plan. Though the actual experience shows that bidders may be interested in selected business units or assets rather than the entire business.\textsuperscript{14}
The committee recommended amendment in the Code to clarify that the resolution plan can be achieved through any means prescribed under regulation 37 (which allows RP much more flexibility in developing a resolution plan across multiple bidders each taking different pieces of corporate defaulters) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

**Insufficient provisions on cross-border bankruptcy and insolvency**

The IBC at present has no standard instrument to restructure firms involving cross-border jurisdictions. Cross-border insolvency is regulated by sections 234 and 235 of IBC. Section 234 empowers the Central Government to enter into bilateral agreements with other countries to resolve situations about cross-border insolvency. Further, the AA can issue a letter of request to a Court or an Authority (under section 235) competent to deal with a request for evidence or action in connection with insolvency proceedings under the Code in countries with the agreement (under section 234).

The problem of not having a cross-border framework problem was also expressed by the NCLT, Mumbai in a cross-border insolvency case involving an Indian entity. NCLT stated that while insolvency proceedings against the CD have already been initiated before a District Court in the Netherlands, ‘there is no provision and mechanism in the IBC, at this moment, to recognize the judgment of an insolvency court of any foreign nation. Thus, even if the judgment of the Foreign Court is verified and found to be true, still, sans the relevant provision in the IBC, we cannot take this order on record’.

Growing international trade is increasing the integration of businesses. As the world has become more financially interconnected, the need for a comprehensive provision for cross-border matters has become imperative.

The current provisions for IBC are ad-hoc and are susceptible to delays. The need for a cross-border insolvency framework under the Code was highlighted by the Insolvency Law Committee report (October 2018) as well. The committee recommended the adoption of the United Nations Commission on International Trade Law (UNCITRAL) with certain modifications to make it suitable to the Indian context. In fact, UNCITRAL Model Law on Cross-Border Insolvency, 1997 has emerged as the most widely accepted legal framework to deal with cross-border insolvency issues. This law helps address the main four issues in a cross-border case: (a) Access to foreign courts (b) Recognition of foreign proceedings; (c) Cooperation between courts; (d) Coordination of more than one insolvency proceedings. Further, it provides for flexibility to tweak it to suit the requirements of domestic jurisdictions.

**Group resolutions**

Another important dimension that needs to be incorporated into the Code is the concept of group resolution – one in which the resolution of borrowers belonging to the same corporate group is undertaken together. An example of this was seen during the resolution process of the Videocon Group; however, the same was put in place through discretionary powers available to the AA rather than through a feature of the Code. Such a process is
especially vital in an economy like India where traditionally credit contracts have been embedded with cross obligations and credit mitigating cover provided by parent and group companies of the borrower. In such a system, default by a borrower is likely to spur cross defaults by group companies, thereby increasing the overall credit risk to the financial system. A comprehensive process for collective resolution of such interlinked corporate groups is thus necessary to further improve the efficacy of the Code.

**CONCLUSION AND WAY FORWARD**

The Code marked a radical departure from the prevalent approaches in that it embraced the ‘creditor-in-control’ model as against the ‘debtor-in-possession’ model that had failed to produce any tangible improvements in the credit discipline in the country. Thus, the Code fundamentally reset the power balance between debtors and creditors in the face of a default by the debtors. The Code has been successful in bringing about marked changes in resolving contracts and the way insolvency is handled in the country. In a single stroke, the Code removed ‘the divine right of promoters to continue in the saddle’, as had been observed by the Hon’ble Supreme Court, restoring the interests of other stakeholders, especially the creditors. The insertion of section 29A provided further fillip to the notion that an insolvent debtor has to be protected from its own management, if required, for the maximisation of value from the debtor to society as a whole. Thus, for the first time, the promoters are faced with the possibility of losing control of their respective companies if financial stress is not addressed in a timely and comprehensive manner. The Code also enhanced the negotiating power of OCs by allowing them also to make applications for initiating CIRP in respect of the debtors who are in default. Of the total CIRP cases as on December 31, 2021, over 51% of the cases had been filed by OCs. Such cases had a higher proportion of withdrawals as well – at over 50%, constituting 71% of the total withdrawal cases – indicating that filing of insolvency proceedings as a negotiating tactic appears to be working for OCs. It helped to increase the recovery rates and binging about behaviour changes in debtors as well.

As pointed out by Shri M. Rajeswar Rao, the Deputy Governor of the Reserve Bank of India, in a recent speech, another often ignored aspect relating to the impact of the Code is the credible ‘threat of insolvency’. A key metric for assessing this impact is the number of CIRP applications that are withdrawn before admission. Till December 2021, 19,803 applications for initiation of CIRPs having total underlying default of ₹ 6.1 lakh crore were resolved before admission.

Of course, some challenges remain. For instance, the actual time being taken for the resolution is much longer than what is prescribed in the Code. To speed up resolution of bankruptcies, the number of NCLT benches and sanctioned strength of judges should be increased. There is also a case for reserving some benches for cases with very large amounts. Setting aside a specified number of NCLTs to hear cases of large defaults would be consistent with the recommendations of the Parliamentary Standing Committee as well. There is also a case for removing some decisions to require an NCLT mandate, such as replacement of IRP with RP,
extension of CIRP time etc. Another issue is to put in place features so that the process puts more emphasis on resolution rather than liquidation. Moreover, there are not yet enough provisions for cross-border insolvency and group insolvencies in the Code which should be introduced. Furthermore, there is a need to radically simplify the voluntary liquidation process under IBC, though the effort has already begun with the announcement of Centre for Processing Accelerated Corporate Exit (C-PACE) in the Union Budget 2022-23.

The IBC is still a new law and newer issues keep appearing. Though the Government has been very proactive in bringing about changes in the Code whenever required. For instance, in the first year of the Code, it was found that the promoters were trying to hold on to their companies through their related parties bidding for resolution plans along with significant haircuts to the creditors. For instance, in the first resolution under the Code, *Synergies Dooray Automotive Limited* (August, 2017), a related party of the defaulter company walked away with the company with a 94% haircut to the creditors. Post this, the Code was amended to include section 29A to prohibit related party transactions. The next issue that has come to light recently is in respect of the treatment of secured vs unsecured creditors. In India, all the FCs (both secured and unsecured) of a debtor form a part of the CoC, which goes on to take significant decisions regarding the future of the debtor company, including the appointment of a RP and the final resolution plan. In recent times, the case of *KG Corp* came to light where some unsecured creditors came together, took control of CoC and came up with a resolution plan with a very small resolution value.

These kinds of examples are attempts of gaming the system by insolvent debtors. Banks have brought this to the attention of NCLT, which has ordered the RP to provide inspection and copies of the documents sought by the banks.

To sum up, the IBC has been a very crucial reform which has brought very important changes in the insolvency landscape in India. It is evolving in the right direction and, surely, over time, it will result in substantial improvement in economic efficiency and higher economic growth by enhancing the willingness and ability of creditors to lend.
As per data available from RBI databases.

2 Insolvency and Bankruptcy Code (Second Amendment) Act, 2020 providing insertion of section 10A in the Code to temporarily suspend initiation of CIRP under sections 7, 9 and 10 of the Code for a period of six months or such further period, not exceeding one year, w.e.f. March 25, 2020.

3 IBBI Quarterly newsletter, October – December, 2021.

4 The CD has to be eligible under section 29A to submit a resolution plan.

5 A base resolution plan is the resolution plan prepared by the CD in conformity with section 30 of the Code and presented in the first instance to its CoC for consideration after the PPIRP application is admitted.


7 Civil Appeal No. 2842 of 2020 with Civil Appeal No. 3063 of 2020.


14 Supra Note 12.


17 Address delivered by Shri M. Rajeshwar Rao, Deputy Governor, Reserve Bank of India, in the International Research Conference on Insolvency and Bankruptcy held at IIM Ahmedabad (2022), “Resolution of Stressed Assets and IBC”, 30 April.

18 2022, “How a web of ‘related parties’ gamed the IBC process of a Tayal group firm to con PNB, BoI, UCO Bank”, Economic Times, 4 April.
The path to economic growth has many drivers. One of the lesser discussed elements being the role of insolvency and bankruptcy systems in economic growth. Insolvency and bankruptcy are not synonyms but concepts that complement each other. Insolvency is the state when debtors are unable to pay their debts as and when it becomes due. In contrast, bankruptcy is the state when the legal process to manage the financial affairs of the insolvent is invoked often under the supervision of courts.

With the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/ Code), India moved to the 3rd generation insolvency & bankruptcy system (IB System). The progress made in the last five years is quite impressive. Between the enactment of the Code and September 2021, as many as 421 cases involving claims of ₹ 7.19 lakh crore resolved with a realisable value of ₹ 2.55 lakh crore and 1,149 cases liquidated having a liquidation value of ₹ 52,036 crore. This article explores the evolution of IB systems across the world through its four generations and looks at the potential for the IB System in India to move to the 4th generation system, using the start-up sector as the lab to experiment, for adoption by the more conventional sectors of the economy later.

IB Systems vary based on the motive for the legislation and the system followed for implementing it. Motives for regulating IB Systems initially stemmed from ethical and moral principles that sought to eliminate insolvencies in society, as it was primarily seen as an undesirable element of personal life of individuals. In this view, the locus for insolvency and bankruptcy was an individual, and the reason for insolvency was attributed to speculative behaviour and/or excess and conspicuous consumption. This was viewed as born out of a sense of vanity and pride, which was deemed morally undesirable for a healthy society. The objective of this IB System is to be a deterrent for others by leaving the insolvent individual badly scarred in the process.
Evolution of Insolvency and Bankruptcy Laws: Building a Case for India to Experiment with the 4th Generation IB System For The Start-Up World?

In the 19th century, when economics lens became increasingly used to evaluate many social, moral, and ethical issues, the motive for regulating the IB system too turned to economics. The result was a major shift in how insolvencies were viewed. Insolvencies were redefined from being seen as ‘an individual’s sin to business breakdowns’, and from ‘moral lapses to economic failures’.

Using this redefined view, insolvencies were not seen as something undesirable to be eliminated in an economy, but processes that needed to be judiciously regulated using cost-benefit analysis. By weeding out inefficient businesses, well-regulated IB systems promoted faster economic growth. This lens views insolvencies as primarily found in businesses and centred in firms. Insolvencies are attributed to failed risk management, often caused by external factors like changes in the economic cycle, technology and / or a result of business failures due to rapid expansion or mismanagement. The benefits of a well-regulated IB system are seen in a growing economy driven by risk taking entrepreneurs who innovate and adopt technology changes that benefits everyone.

Like in the motives attributed to insolvencies, the system adopted to regulate bankruptcies too evolved from a morally driven system in the initial days, before it was succeeded by an economic system.

Table 1 - Reasons attributed to insolvency: Moral Vs. Economic lens

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Bankruptcy</th>
<th>Moral Lens</th>
<th>Economic Lens</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Primary forces</td>
<td>Individual - personal forces</td>
<td>Firm/Company - impersonal forces</td>
</tr>
<tr>
<td>2</td>
<td>Source</td>
<td>Moral failure</td>
<td>Economic failure</td>
</tr>
<tr>
<td>3</td>
<td>Reason</td>
<td>Personal excesses /vanity</td>
<td>Unmitigated risk</td>
</tr>
<tr>
<td>4</td>
<td>Locus</td>
<td>Transactional or micro view</td>
<td>Systemic shifts or macro view</td>
</tr>
<tr>
<td>5</td>
<td>Desired goal</td>
<td>Justice and deterrent</td>
<td>Fresh start and economic vibrancy</td>
</tr>
<tr>
<td>6</td>
<td>Likely outcome</td>
<td>Scarred for life</td>
<td>Entrepreneurship</td>
</tr>
</tbody>
</table>

Table 2: Systems for bankruptcy laws: Moral Vs. Economic lens

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>System features</th>
<th>Moral Lens</th>
<th>Economic Lens</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Based on</td>
<td>Judicial system driven</td>
<td>Judicial system supervision</td>
</tr>
<tr>
<td>2</td>
<td>Driven by</td>
<td>Creditors</td>
<td>Debtors</td>
</tr>
<tr>
<td>3</td>
<td>Initiated by</td>
<td>Creditors</td>
<td>Either debtor or creditor</td>
</tr>
<tr>
<td>4</td>
<td>Debtors role</td>
<td>Secondary</td>
<td>Primary</td>
</tr>
<tr>
<td>5</td>
<td>Creditors role</td>
<td>Primary</td>
<td>Secondary</td>
</tr>
<tr>
<td>6</td>
<td>Desired goal</td>
<td>Maximise recovery</td>
<td>Minimise costs for restart</td>
</tr>
<tr>
<td>7</td>
<td>Likely outcome</td>
<td>Liquidation</td>
<td>Reorganisation and discharge from debts</td>
</tr>
</tbody>
</table>
Morally driven bankruptcy systems were primarily judicial systems, with the creditors playing the lead role. The objective is to maximise recovery for the creditors with liquidation being the most likely outcome. This result was a logical end to a process where the insolvent was an individual in the initial stages and recoveries were to be made from physical assets like land, building and other moveable assets that had a ready market. The role of insolvent debtors was secondary to the entire process which only required them to cooperate with the creditors in maximising asset recovery.

In contrast to the morally driven bankruptcy systems, the economics based bankruptcy systems had to confront businesses going insolvent. Business assets are not as amenable to quick recovery as personal assets held by an individual. Further, the ability of judicial authorities or creditors to manage the business and realise their debts is a major handicap. This resulted in the debtor or a person with debtors’ business competence taking a dominant role in the IB System with two equally important primary objectives:

(a) For the creditor - to maximise recoveries, and
(b) For the debtor - to ensure the least cost and time for the restart.

**TRIGGERS FOR EVOLUTION OF IB SYSTEMS**

The result of interplay between motives for insolvency and the system used to handle bankruptcies creates four generations of IB systems. History shows that a borrower had to repay his loans, no matter what, irrespective of the geography in which they resided. The norm was repayment- whether voluntarily or otherwise. About 4000 years ago, the Code of Hammurabi required the borrower to repay their loans failing which they had to ‘sell’ themselves, their spouse and children as slaves or give them in forced labour.\(^1\) Similar practices existed in India too. Manu Smriti provided for the recovery of debt ‘by law, legal action, trick, the prevailing customs or by force’. If a creditor recovers his money from a debtor for himself, the King could not prosecute him for recovering his own property.\(^2\) The Roman law too was not very different. It considered an insolvent on par with a thief or swindler. The Latin phrase *fallitus ergo fraudator* (insolvent thus a swindler) captures the essence of this belief. These beliefs were the basis for the first generation IB system which sought to deter insolvencies and scar the insolvent to hold them up as price to pay for insolvencies.
Table 3: Interplay of motives for regulating insolvencies and managing bankruptcies

<table>
<thead>
<tr>
<th>Economic motive for regulating insolvencies</th>
<th>3rd Generation (Economic motive &amp; moral system)</th>
<th>4th Generation (Economic motive &amp; economic system)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognised business failures but scarred the insolvent</td>
<td>Recognised business failures and prioritise fresh restart</td>
<td></td>
</tr>
<tr>
<td>Moral motive for regulating insolvencies</td>
<td>1st Generation (Moral motive &amp; system)</td>
<td>2nd Generation (Moral motive &amp; economic system)</td>
</tr>
<tr>
<td>Deter insolvencies &amp; scar the individual - bonded labour</td>
<td>Deter insolvencies and maximise debt recover - Debtors prison</td>
<td></td>
</tr>
<tr>
<td>Moral system for handling bankruptcies</td>
<td>Economic system for handling bankruptcies</td>
<td></td>
</tr>
</tbody>
</table>

From bondage and corporal punishments, the debtors prison evolved with the belief that forcing a debtor into a prison and putting them to hardship would force the swindlers to reveal their hidden wealth by which the creditors could maximise their recoveries. While the belief that insolvencies were undesirable continued due to the moral taint associated with its origin, the recovery process shifted its focus from scarcing the insolvent to maximising the recovery for creditors by separating the individual from his assets. While a charitable view could link this shift to respect for human rights, the less charitable view associates it with the cost of maintaining ‘slaves’ in an increasingly urban environment. This shift led to the second generation IB Systems that continued with the moral motive to deter insolvencies but also introduced an economics based recovery system that aimed at maximising recoveries.

The emergence of large sized businesses combined with the advent of corporations with limited liability in the 18th century Europe highlighted the risks arising from business cycles and vagaries of nature that sank ships, which was the primary source of transport for international trade. Gradually the belief that insolvencies and bankruptcies could be a result of economic factors, or ‘Act of God’ and not purely ethical or moral failures of individuals gained ground. This is best captured in the words of Blackstone, whose writing in 1765 noted:

The Bankrupt.... was formerly considered merely in the light of criminal... But at present the laws of bankruptcy are considered as laws calculated for the benefit of trade, founded on the principle of humanity as well as justice: and to that extent they confer some privileges, not only on the creditors, but also on the debtor or the bankrupt himself.¹

Further the value created by merchants and businessmen who took risk was also recognised, leading to the need to enable failed merchants to get back to their ventures and create value for the society. This needed the concept of discharge from unpaid debts, which for the first time was recognised in the enacted of 1705 CE, in England, popularly known as ‘the Statue of Anne’.¹
The Statue of Anne of 1705 CE introduced the concept of discharge for unpaid debts for the cooperating debtor and it also provided for a monetary allowance for their sustenance from the bankruptcy estate, with its quantum decided by the percentage dividend paid to the creditors. The need for debtors’ cooperation becomes more vital in dealing with business assets as opposed to personal assets that have higher marketability. The recognition of business failures was the tilting point in the shift from moral based view of insolvency to an economics based view laying the foundation for the 3rd generation IB Systems. This system not only recognised the systemic or impersonal nature of insolvency triggers but also continued the moral bankruptcy practice of curbing the debtors’ rights over their business by handing it over to the creditors or their judicial representatives.

The hallmark of the 4th generation IB System is the provision for debtors to file for voluntary bankruptcy and provide discharge to debtors without the consent of the creditors. The US Federal Act of 1841 is the pioneer in this regard. Triggered by a devastating economic collapse in 1837 CE, the 1841 Act for the first time permitted -

(a) individuals to file for voluntary bankruptcies,

(b) provided discharge to debtors for their unpaid debt without requiring the consent of creditors, and

(c) extended it to individuals for their debts, which till then was limited only to merchants.

Such extensive change led to a large number of debtors who took advantage of this act and filed for voluntary bankruptcies in a short period of time, causing an outrage that led to the Act being repealed in 1843 CE.

Despite its short lived status, this was a landmark act that set the stage for 4th generation IB System. The precedents set by this Act was followed in England when in 1842 CE, the requirement for creditors consent was dispensed with, soon followed by voluntary bankruptcy permitted in 1844 CE, and in 1861 CE non-merchants were permitted to file for voluntary bankruptcy. From there it was not a smooth sailing for this system, as its enactment was followed by misuse which led to its repeal, but soon it was reintroduced for the economic benefits it provided, a cycle that played itself over a couple of times before a more viable system evolved.

### DOES INDIA NEED A 4TH GENERATION IB SYSTEM?

The predominant use of economic lens for decision making is the hallmark of our 21st century society. India too is not an exception to this trend as evidenced by the celebrity status accorded to the billionaires and millionaires in India. The rise of start-ups leading to India being ranked among the top three counties with the largest number of start-ups, combined with the rise of unicorns in 2021 puts the spotlight on the bright side of risk-taking by entrepreneurs. It is a known and acknowledged fact that the failure rate among start-ups is much higher and some estimates put it at around 90% by numbers. While celebrating entrepreneurs who succeed, there is a pressing need to provide options for the
yet-to-succeed entrepreneurs by giving them the opportunity for a fresh start. This requires the ability to make a quick and efficient exit from their current ventures. This can ensure that a larger number of talented individuals enter the start-up world and create more new ventures and provide employment opportunities in our society.

Can India experiment by providing the start-up sector the 4th generation IB systems for efficient and timely exit? This experience can later be the basis for expanding this system to the other more conventional sectors of the economy. To recap, the five key ingredients of the 4th generation IB systems are:

1. **Economic view of insolvencies** - of viewing insolvencies as an integral part of failed risk-mitigation i.e., failure to manage economic, technological or market shifts rather than viewing them as moral lapses caused by vanity resulting in conspicuous consumption or speculative behaviour.

2. **Economic system for bankruptcies** - by providing the debtors control over the company during the bankruptcy process for closing the venture. This system would need adequate safeguards for protecting the creditors interest provided by the regulatory framework.

3. **Voluntary adoption of bankruptcy process** - option for the debtor, in this case the start-up, to initiate the bankruptcy process on their own without support or consent from the creditors or other stakeholders.

4. **Reorganisation** - provision for the debtor to renegotiate binding contracts on more favourable terms of either reduced payments or elongated payment terms that enable the organisation to survive and revive.

5. **Discharge for the insolvent for unpaid debt without the consent of creditors** – an essential requirement that is vital for efficient operations of the insolvency system is not to taint the entrepreneur who has used this system to create fresh starts for themselves.

Like every other system, the fourth generation IB systems too are not without drawbacks or opportunities for misuse. These drawbacks can be traced to mis-governance and manifest themselves through ill-intent of the decision makers, or insider trading, or misuse of information. Ill-intent takes the form of strategic or convenience bankruptcies. This is seen in strategic or convenient choices made by the promoters to avoid commercially non-profitable but binding agreements with labour unions, customers, or suppliers and / or to avoid penalties imposed by the regulators for non-compliances. Insider trading in bankruptcies takes the form of circular trades where the promoter in the guise of another legal entity buys valuable assets of the insolvent company without the corresponding liabilities often at the cost of employees or other service providers or the revenue authorities. Misuse of information for personal benefits is a generic challenge in business that also manifests itself in bankruptcies. While each of these cases are to be dealt with on a case-to-case, basis, the presence of these drawback itself should not be the reason for not initiating this system.
Like all other economic choices, the decision to adopt 4\textsuperscript{th} generation IB system too needs to be based on cost-benefit analysis. The benefits of adopting it on a trial basis initially only for the recognised start-ups, would result in accelerated growth in number of enterprises, overall economic growth and employment generation. A further benefit of this limited adoption could be that the lessons learnt from this experience could be extended to the wider commercial system after a period of three to five years, thereby enhancing the robustness, effectiveness and efficiency of the IB Systems in India.

1 Clause 17, The Code of Hammurabi.
3 Blackstone W. (1765), Article 1, Section 8, Clause 4 (Bankruptcy), Commentaries 2: 471-73.
4 Prisoners in debtors prison whose possession was not worth more than five pounds, besides their cloth and tools were to take an oath to that effect before the justices, and after due notice was served on the creditors, the prisoners were to be discharged.
5 IB Act was enacted in 1867 and repealed in 1878 CE. This was preceded by the IB Act of 1841 that was repealed in 1843 CE.
The last two and a half years have been a challenging time for people around the world, for some even more than others. We witnessed an unprecedented global health crisis, lockdowns and social isolation, disruption of global supply chains, a change in power in Afghanistan, the outbreak of war, and more recently, an economic crisis in our neighbouring country. Thankfully there were silver linings. We saw people coming together in solidarity, supporting friends, family and more importantly strangers during the pandemic. We were excited to witness the first civilian expedition into space (whether it qualified as a space mission is another matter) and attend weddings virtually. We experienced joy and pride as a nation when we won our first individual Olympic gold in athletics. All in all, there’s no denying that a lot has happened in the last two and a half years.

Today, we stand at a stage where most of us have emerged out of our homes, have begun travelling for work and pleasure, and are attempting to resume the lives we had to some extent put on hold in 2020. Our economic story is somewhat similar. Having weathered the tough times, it is raring to go on the one hand and beset by rising inflation on the other. The Government is clearly focused on spending to drive the growth agenda, whether through ambitious public spending on infrastructure building or policy initiatives such as production-linked incentives to boost private sector capital expenditure. While these big-ticket items are important, there are other areas that can unlock significant growth potential. One such area is the stressed assets sector which has immense latent potential. We have of course come a long way in the evolution of the stressed assets market, but today we stand on the cusp of a new journey.

THE ROUTE TAKEN BY THE STRESSED ASSETS SEGMENT

Over the last nearly four decades, we have seen the regulatory environment surrounding stressed assets change in response to the evolving non-performing asset (NPA) situation. Each of these new regulations attempted to offer a solution that was meant to correct the issues of the previous regime. While some of these were more successful than others, each regime had certain characteristics which have brought us to where we are today. It is important to reflect on each of these and learn from them before we forge the path ahead.
SICA: Misusing moratorium in the debtor-in-control model

The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) was introduced with the aim of identifying sick or potentially sick companies in a timely fashion, and for taking necessary action to correct or prevent the same. SICA faced many challenges and is believed to have failed in becoming a successful method of debt resolution. It became associated with lengthy proceedings (typically five to seven years), and moratoriums with debtors in control made it a ‘haven for misbehaving debtors’, while creditors lacked a requisite say in the proceedings and conflicting viewpoints on rehabilitation vs. liquidation, considering the impact on other stakeholders.

Lok Adalats: Attempting amicable settlements with limited success

The Lok Adalats were constituted to provide amicable settlement of disputes (including those pertaining to financial matters such as recovery of NPAs) under the Legal Services Authorities Act, 1987. It is a free service and can be used to settle pre-litigation disputes and cases pending in a court of law. It can be used to settle loan amounts up to ₹ 20 lakh, which was increased in 2004 from the original limit of ₹ 5 lakh. Over the last 15 years, i.e., 2006–2021, Lok Adalats have handled over three crore cases amounting to loans of ₹ 3.2 lakh crore, of which around 6% has been recovered. While this means that Lok Adalats have handled the highest number of cases compared to any other mechanism of debt resolution, they clearly do not have the best recovery ratios.

DRTs: Setting up dedicated recovery forums to expedite claims

The Recovery of Debts and Bankruptcy Act, 1993 introduced the concept of Debt Recovery Tribunals (DRTs). This was intended to facilitate faster recovery of debts by banks and other financial institutions through the creation of a specialised and dedicated forum for resolution. This was a big step as it allowed recovery claims to step out of civil courts which were already dealing with numerous cases and that too with very diverse facts and needs. DRTs were initially empowered to adjudicate on claims exceeding ₹ 10 lakh. This limit was raised to ₹ 20 lakh in 2018. Over 2006–2021, DRTs have handled over 10 lakh cases amounting to loans of over ₹ 12 lakh crore and have been successful in recovering around 7% of the loan amount. DRTs experienced inordinate delays in debt recovery with studies showing that completion of cases could often take even more than seven years. One such study delved a layer deeper to understand the delays by analysing the outcomes of nearly 500 hearings. The study revealed that 58% of the hearings could be classified as failed hearings, implying that the hearing resulted in an adjournment without transacting judicial business and this was an avoidable adjournment. Moreover, each failed hearing delayed the case by an average of 40 calendar days, as shown by the study.
SARFAESI Act: Introducing the concept of creditor in possession

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), was introduced to improve debt recovery ratios without any court intervention. It aimed to do so by allowing creditors to take possession and adjudicate further action against secured borrowers (whose account has been declared an NPA and who have an outstanding loan of more than ₹ 1 lakh) who were unable to repay the amount demanded within a period of 60 days of the demand notice. This action can include selling or leasing collateralised assets or a part or whole of the business of the debtor. Over 2006–2021, the SARFAESI Act has impacted nearly 20 lakh cases amounting to loans of over ₹12.5 lakh crore and has been successful in recovering around 22% of the loan amount. While SARFAESI Act saw a rise in recovery amounts, it had its own challenges, including confusion due to the overlap with SICA.

ARCs: Taking initial steps to create a secondary market

The setting up of Asset Reconstruction Companies (ARCs) was proposed under Union Budget 2003, based on the recommendations of the Narasimham Committee II. They were set up under the SARFAESI Act as institutions for the sale of financial assets by banks and financial institutions. While on paper ARCs appeared to be a great solution to the worsening NPA solution, the ARC industry did not take off in a big way. While the number of ARCs grew, their assets under management declined when compared with the gross NPAs of banks and non-banking financial institutions. Moreover, for the large part, ARCs have remained dependent on borrowings from banks as a source of capital. It is only recently that they have turned to bonds and debentures as sources of funds. Other factors that limited the growth of the ARC industry were insistence of banks on cash deals, ARCs redeeming their own security receipts (SRs) on priority, banks being unable to offload the SRs and poor recovery by SRs.

THE NEED FOR DEVELOPING A SECONDARY MARKET

A market is defined as:

- a means by which the exchange of goods and services takes place as a result of buyers and sellers being in contact with one another, either directly or through mediating agents or institutions. Similarly, a secondary market is defined ‘as a platform where investors can easily buy or sell securities once issued by the original issuer, be it a bank, corporation, or government entity. Also referred to as an aftermarket, it allows investors to trade securities freely without interference from those who issue them.

When one talks of stressed assets, and as we saw in the journey described above, there has been limited success in developing a free market where trading of stressed assets can happen freely and with adequate liquidity. The Insolvency and Bankruptcy Code, 2016 (IBC/Code), has indeed been successful in delivering what the stressed assets market needed five years ago i.e., a mechanism to enable a one-time reduction in the large number of NPAs, an effective last-resort solution that can be availed by creditors and a permanent
change in the mindset of debtors by creating a regime of ‘pay-up or lose the business’. However, the need of the hour is different, and we must accordingly assess how to deliver the solution that is needed now.

**Initiate resolution earlier in the financial distress journey**

Just as the name suggests, the corporate insolvency resolution process (CIRP) under the Code is a process for companies that are in a state of insolvency. Under ordinary circumstances, a corporate debtor does not reach a state of insolvency overnight. It is a long-drawn process where the financial situation of a company gradually deteriorates. Similar to how the CIRP has been able to successfully replace the erstwhile mechanisms of debt recovery for companies that have experienced significant erosion in financial health, we require measures which can play a role well before a company reaches a state of insolvency. These alternatives must be capable of delivering results without the key tenets that make the CIRP successful—creditor-in-control, moratorium period to ensure that business isn’t interrupted, and a defined timeline for resolution with risk of liquidation if the resolution fails. If we can develop a robust secondary debt market for companies in financial stress, then the focus will clearly switch to revitalisation of the business as the new owner of the debt attempts to support a turnaround of the company eventually aimed at recovery of the loan amount.

**Extending participation beyond strategic investors**

The Code allows a new management to take control, often with a restructured loan (rather than one-time settlement), in a way transferring ownership of the loan from one borrower to another. This is clearly a market for stressed assets, albeit on the side of the borrower rather than the creditor. Moreover, the intent of the Code is not really to have the asset continue to change hands, the way a market intends for assets to get traded. This coupled with other factors such as the long-drawn process, lack of certainty of outcomes (although better than those of earlier regimes) and the limitation on ARCs becoming resolution applicants has resulted in limited participation from financial investors. If participation can be extended beyond strategic investors, we could potentially get fresh avenues of capital to help resolve the NPA situation.

**Focus on core competencies to drive effectiveness**

When the senior management of an organisation is developing a strategy for the business, one very often hears them talking about focusing on core competencies. Companies want to focus on what they are best at and outsource all other functions. Today, organisations outsource not just specific activities such as payroll processing, but often entire departments such as finance. With a thriving business process outsourcing and knowledge process outsourcing industry, it is evident that this philosophy is yielding good results for most organisations. If one were to extend this logic to banks and other financial institutions, then at the very core, isn’t the main role of a bank to borrow and lend money to facilitate
economic growth? While this may be an oversimplification, it does make a clear case for focusing the resources of banks on identifying the correct recipients of funds and lending to them. In turn, should an external agency which is specialised in not just recovery of debt but also resolution of debt, be focused on the rest of the lifecycle of a loan? In the current CIRP journey of stressed accounts, we see senior representatives of banks, as a part of the committee of creditors, continue to spend lengthy periods of time on resolution of accounts where they have already invested many years and by this stage know that they are set to take a significant haircut. Bringing in a specialist once an asset becomes bad could ease this burden that banks face.

**Strengthening the balance sheets of banks**

As of 2021, the total gross NPAs of scheduled commercial banks was ₹ 8.37 lakh crore.\(^{18}\) The gross NPAs as a percentage of gross advances were 7.3% and as per the estimates of the Reserve Bank of India (RBI), this ratio is likely to increase to 8.1%–9.5% by September 2022, indicating a significant increase in gross NPAs.\(^ {19}\) If the banking industry can recover these amounts or a portion of these amounts by handing over resolution of these debts to a specialist, these funds can potentially be deployed to fund further credit offtake. While a secondary market can make this possible, it would require access to fresh avenues of capital beyond the banking sector to truly release these funds for incremental lending. At a time when our economic growth forecast for 2022–23 has been cut by the International Monetary Fund (IMF) to 8.2%\(^ {20}\) from the earlier forecast of 9.0%\(^ {21}\), we need all that firepower to help drive economic growth.

**Enhancing the risk profile of banks**

Developing a market for the sale of stressed loans can not only provide a one-time release to the pressure built up on the balance sheet of a bank but can also lead to a more systemic change in how banks lend. Today, banks have developed a lending profile by leveraging many years of lending experience. This approach places a certain category of borrowers in a more disadvantageous position. If we are to achieve our ambitious plan of becoming a ₹ 5 trillion economy, some of these less established businesses would also need adequate access to capital to fund their growth journeys. If banks are able to find a clear avenue to deal with NPAs via a robust secondary market, then some of these borrowers who today are unable to meet the borrowing requirements of banks may perhaps be able to access this much-needed capital.

**THE PATH THAT LIES AHEAD**

The Code has been successful in bringing the required attention to the Indian market for stressed assets. RBI’s list of the ‘dirty dozen’ companies caught the public eye and a slew of successful resolutions under the Code managed to hold the public’s attention. The market for stressed assets is only set to deepen and the Government and various regulatory bodies are clearly already taking many measures to make this a reality.
**Bad bank: Introducing a specialist to provide a bulk solution to the NPA situation**

As announced in Union Budget 2021-22, a bad bank is set up as the National Asset Reconstruction Company Limited (NARCL). The NARCL is expected to acquire stressed assets of about ₹ 2 lakh crore in phases, and these soured loans would be transferred by paying 15% cash to lenders, while the remaining 85% would be paid through SRs. This concept of a bad bank is expected to be the next big step to boost the market for stressed assets.

It would be important for us to leverage the learnings of other countries as we venture down this path. An analysis of these experiences shows that there are certain factors which are key to ensure the success of a bank bad or AMC. These are (a) strong political will, (b) explicit government financial support, (c) supportive legal infrastructure, (d) efficient marketing environment, (e) clear AMC mandate, (f) well-defined AMC life, (g) adequate governance, (h) good transparency, (i) realistic asset pricing, and (j) speedy resolution. One of these elements pertains to having a clear mandate which could vary from specialising in asset sales to debt restructuring to corporate restructuring, or even some combinations of these three. We have seen different institutions adopt different measures to get the needed results – for example, the Korea Asset Management Corporation and Malaysian Danaharta were mandated to do both restructuring and rapid disposition, with the former more focused on corporate restructuring and the latter more focused on debt restructuring. At the same time, Japan’s Resolution and Collection Corporation was focused only on rapid asset disposition. The NARCL will have to carve its own path but will have the benefit of learning from all these other countries.

**Special Situation Funds**

In January this year, the Securities and Exchange Board of India (SEBI) introduced the concept of Special Situation Funds (SSFs), a sub-category under Category I Alternative Investment Funds. An SSF must have a minimum corpus of ₹ 100 crore and can only invest in stressed assets that lie in the areas defined by the SEBI. This includes, but is not limited to, participating in a CIRP as a resolution applicant, investing in SRs issued by an ARC and securities of investee companies which are under distress. The minimum amount that an investor must invest in an SSF is ₹ 10 crore, and in the case of an accredited investor, ₹ 5 crore. This can potentially bring new avenues of capital to the stressed asset market, which is exactly what we need at this moment. Additionally, with SSFs being allowed to directly purchase loans from banks, this is truly a significant measure in developing a market for stressed assets as it will not only create a connection between supply and demand but also allow pricing to be determined in a more independent market-driven fashion.

**CONCLUSION**

The stressed assets market has evolved over the years, learning from the shortcomings of each phase, constantly growing and attempting to better itself. The Code has been successful in creating a sizeable and active market for stressed assets. Not only does it...
lay out a clear process and timeline for sale of such assets, but it also encourages heathy competition amongst resolution applications. This competition is a key characteristic of a true market as it allows price to be determined in a fair and independent manner based on the rules of demand and supply. The Code has created the necessary framework to provide an exit to creditors from such NPAs while also ensuring that focus is on the resolution of the asset to aid broader economic recovery and protect the interests of stakeholders other than the creditors. With this framework now in place, the industry is ready to create a more active and liquid market which can operate earlier in the lifecycle of a stressed asset. The Code will become more of a last-resort mechanism to deal with assets that have seen significant erosion of value. Other vehicles such as SSFs, ARCs (potentially after a rehaul of regulations) and even the bad bank/NARCL will support the creation of a thriving secondary market for stressed assets. Each of these vehicles will increase the volume of such transactions, driving liquidity and inviting newer participants to join. We are clearly nearing the next phase of the journey of stressed assets and the ride ahead is going to be exciting.

8. Supra Note 2.
10. Ibid.
12. Supra Note 2.
20. IMF World Economic Outlook, April 2022.
24. Ibid.
Unlike traditional investment strategies, in a distressed debt strategy the investor purchases the firm’s distressed debt securities and then seeks to gain control by converting those securities into a controlling stake of equity of the post-restructured entity. The USA saw a surge in distressed debt investments after the enactment of the US Bankruptcy Code in 1978 and the rapid growth in the high-yield bond market in 1980s. The US distressed debt market provides a vital opportunity to turnaround financially distressed businesses through private initiative, avoiding the need for excessive state intervention to redress distressed debt. Indian distressed debt markets have lagged in comparison. State intervention has been haphazard, seemingly without any coherent conceptual approach. This state of affair appears to have started changing gradually since the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/Code). This article will give a brief overview of the position pre-2016 that had held up the growth of the distressed debt markets in India. It will then highlight the relevant reforms post-2016 to explain how the distressed debt market is slowly shaping up in India. It will also identify some areas for future reforms.

LOOKING BACK

The single biggest hurdle for the growth of a distressed debt market in India was the absence of an effective corporate insolvency law. The Companies Act, 1956 was the only law dealing with corporate insolvency till 1985. It provided for winding up as well as scheme of arrangement for debt restructuring. However, neither appear to have been particularly effective. In 2013, there were approximately 14 lakh registered companies in India of which only 9.5 lakh were active. In contrast, on an average, between 2008 and 2010 not more than 6,500 cases of winding up were registered with the High Courts. Only about 250-350 cases were added every year and about 300-600 completed every year. This highlights the low use of the Companies Act procedures for dealing with winding up. Similarly, the scheme of arrangement has been of limited utility for debt restructuring in the Indian context.

In 1980, the Tiwari Committee recommended legislative and administrative remedies to address the problem of industrial sickness. This resulted in the enactment of the Sick Industries Companies (Special Provisions) Act, 1985 (SICA). The said Act was supported by setting up two new institutions, the Board of Industrial and Financial Reconstruction and the Appellate Authority for Industrial and Financial Reconstruction. SICA was the first law...
to focus solely on corporate restructuring. The statute put the onus on the board of an industrial company to report sickness. Once sickness was reported, the statute provided for an automatic moratorium on all suits, claims and proceedings against the company. This moratorium soon became a haven for companies and their promoters to shelter from their creditors for years, delaying their repayment obligations. Judicial innovations, prompted by ‘pro-revival’ imperatives, further slowed the liquidation of ‘sick’ companies at precisely the point when economic reforms had for the first time made their closure much more likely.4

Corporate insolvency law began attracting policy attention in the early 1990s with the opening up of the Indian economy. The Indian government promised a review of the Indian corporate insolvency laws in 1991. Finally in 1993 an official committee was set up. However, its recommendations were not implemented possibly because closure of unviable companies was a politically sensitive issue.5

Faced with an ineffective corporate insolvency regime, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) were enacted to provide for a special foreclosure framework for banks and financial institutions to recover their dues.6 The SARFAESI Act also created the legal framework for establishing multiple private Asset Reconstruction Companies (ARCs). ARCs are a unique amalgamation of bad banks and stressed asset funds. Till recently, these ARCs alone were permitted to purchase non-performing assets (NPAs) from banks and financial institutions so as to transfer NPAs out of the banking system.7 This policy achieved only modest success. A Reserve Bank of India (RBI) study found that the preferred resolution method used by ARCs has been rescheduling of payment obligations over all other resolution methods. Change in or takeover of management or taking possession of assets has been sparingly used as a mode of resolution. Therefore, it may be reasonably concluded that ARCs have contributed little towards the development of a distressed debt market by engaging in genuine business turnarounds and sale.8

Since 2001, the RBI has also provided for various non-statutory restructuring mechanisms for use by its regulated banks. For instance, in 2001, the RBI emulated the London approach to set up the Corporate Debt Restructuring process as an out-of-court mechanism between a corporate debtor and its creditor banks to negotiate new terms on their existing loans. In 2014, the RBI introduced the Joint Lenders’ Forum mechanism. In 2015, it introduced the Strategic Debt Restructuring mechanism to facilitate debt to equity conversion to enable change in management of distressed firms.9 While these out-of-court mechanisms were used relatively more often by lenders, they could not substitute for the lack of a holistic statutory framework for restructuring and going concern sales.

Evidently, the Indian legal framework for handling corporate insolvencies was fragmented, lacking an overarching coherent policy rationale. This was one of the most critical barriers to the development of the Indian distressed debt markets. This problem has now been mitigated to a large extent with the enactment of IBC.
The second factor that held back the development of the distressed debt markets however continues unabated. The Indian corporate bond market continues to lack maturity in terms of depth and liquidity. The corporate credit market is primarily based on bank financing. Public Sector Banks (PSBs) play a crucial role in this market, although big private banks and Non-Bank Finance Companies (NBFCs) have gradually emerged over time. The relevance of PSBs in a bank-financed corporate credit market is a feature unique to India, based on deeper political economy dynamics. It is against this backdrop that recent reforms hold promise for the distressed debt markets.

**RECENT REFORMS**

**The Bad Bank**

The government, the RBI as well as the Securities and Exchange Board of India (SEBI) have unleashed a series of reforms in a well-coordinated strategy to address the NPA crisis. The policy mandarins of North Block deliberated on the management of stressed assets at the Financial Stability and Development Council in early September 2021. By mid-September, the Cabinet approved setting up of the National Asset Reconstruction Company Ltd. (NARCL) to take over nearly ₹ 2 lakh crore worth of NPAs from the banking sector. Earlier this year, the RBI approved the dual structure bad bank comprising NARCL and India Debt Resolution Company Ltd. (IDRCL). The NARCL will acquire and consolidate stressed assets worth ₹ 90000 crores in Phase I (out of total planned acquisition of ₹ 2 lakh crores), while the IDRCL will manage these assets by engaging market professionals and turnaround experts. NARCL is majority owned by PSBs, while IDRCL has majority private shareholding to encourage professional standards. The main advantage of NARCL is likely to be faster aggregation of bad loans and avoiding inter-lender litigation. The main disadvantage of NARCL is that being a centralised bad bank it is a relatively intrusive state intervention in the operations of financial markets. For instance, NARCL’s security receipts are backed by explicit sovereign guarantee to the tune of ₹ 30,600 crore and Central Government through PSBs would be able to exert de facto control over it. This creates a whole new set of incentives which may be at odds with market discipline, as has been observed in China.

**Transfer of loan exposure**

In parallel, the RBI liberalised its norms on transfer of stressed loans in September 2021. Banks, NBFCs, and All India Financial Institutions have now been allowed to use the resolution process under RBI Circular dated June 7, 2019 to sell their stressed loans on cash basis directly to a new set of players including corporates as well as financial sector entities permitted to take on such loan exposures by their respective regulators. The regulation however allows such transfer only if it results in exit for all RBI regulated lenders from the stressed loan exposure.
Special Situation Funds

In tandem with the RBI’s move, the SEBI introduced Special Situation Funds (SSFs) as a distinct sub-category of Category I Alternative Investment Funds (AIFs) earlier this year.\(^1\) SSFs have been allowed to take advantage of RBI’s new master direction and participate in the secondary market for loans extended to companies that have defaulted on their debt obligations. This is a major reform in the right direction.

India suffers from a chronic bad debt problem. Higher bad debt requires higher provisioning, locking up more capital in the banking system. This reduces credit supply and hurts economic growth. To overcome this problem, banks and financial institutions were initially allowed to sell their stressed loans only to ARCs. Now they can sell to SSFs too. Transfer of stressed loans to ARCs and SSFs would release capital locked-up in the banking system and help improve credit supply.\(^2\)

SSFs could potentially bring in risk capital from outside the banking sector into Indian distressed debt markets. Being AIFs, they would manage privately pooled funds raised from sophisticated investors with deep pockets. This opens-up a crucial channel for private risk capital, including foreign capital, to flow into the Indian distressed debt markets.\(^3\)

Challenges still remain. The current regulations allow SSFs to participate in the secondary market for corporate debt only after the underlying company defaults on its debt obligations. This merely delays the ability of private investors to invest in a company’s debt at the earliest signs of distress. Investors have to wait for the company to default, causing avoidable value destruction, before they can take over the distressed debt, acquire control of the company and change the management of the business in an effort to turn it around. This is clearly not the best option. The earlier the change in control and management happens, the better are the chances of value preservation and the higher is the probability of a turnaround. This remains an area for future reforms.

Transaction in defaulted debt security

An operational barrier in the development of the high-yield bond market in India was that stock exchanges and depositories did not allow transaction in defaulted debt securities, that is, debt securities on which redemption amount has not been paid on maturity or redemption date. Stock exchanges suspended trading/reporting of trades on debt securities before redemption date. Depositories imposed restriction on off-market transactions on redemption date that restricted transfers on and after the redemption date.

These restrictions were finally lifted by SEBI in June 2020. An operational framework was introduced by the regulator for transaction in defaulted debt securities. To reduce information asymmetry, various obligations have been imposed on issuers, debenture trustees and depositories to disclose the status of such securities (including payment status, restructuring, IBC proceedings etc) to investors through the stock exchange within prescribed timelines.\(^4\)
Going forward, the SEBI should enable SSFs to invest in debt securities, including defaulted debt securities. If SSFs could invest across the entire spectrum of corporate bond market, pre-default (in corporate bonds) as well as post-default (in defaulted debt securities), they would be better able to gain control of a distressed business by converting those bonds into a controlling stake of equity of the post-restructured entity and aid in the turnaround process.

**Asset Reconstruction Companies**

ARCs were introduced in India through the SARFAESI Act. The industry took off with the establishment of the Asset Reconstruction Company of India Ltd. in 2003. Although the number of ARCs increased over time, the market remains highly concentrated. According to an RBI study, the top three players hold 62% share of the assets under management.\(^{20}\) Moreover, the key shareholders of ARCs are banks and other financial institutions. Although 100% FDI is allowed in ARCs under the automatic route, there has been limited foreign participation in the sector. The RBI study has revealed that the sources of funds for ARCs has been largely bank-centric in nature.\(^ {21}\) This indicates that ARCs have not been able to channel as much foreign private risk capital into the distressed debt markets as may be desirable. This remains a major drawback for the current distressed debt market.

Although the SSF model could help ameliorate this particular concern, it would still be useful to reform the ARC model to make it more attractive for foreign capital. Any reform in this regard must begin with answering a simple conceptual question – should ARCs be regulated as bad banks or as stressed asset funds? The current policy on ARCs is unclear on this fundamental issue. In the aftermath of the Asian financial crisis, the Narasimham Committee (1998) had envisaged a single ARC in India as a centralised bad bank specifically for purchasing NPAs from banks and financial institutions. This model was possibly inspired by the state-funded centralised bad banks being set up at the time in some South East Asian economies. However, the SARFAESI Act ended up creating a legal framework to set up multiple private ARCs. As a result, regulations have treated ARCs as bad banks, although functionally they appear closer to privately funded stressed asset funds.\(^ {22}\) This dichotomy has been the source of problems facing the ARC industry. For instance, there were concerns about allowing ARCs to invest in the equity of a distressed company through the IBC as a resolution applicant.\(^ {23}\) This could have been problematic if ARCs were like traditional bad banks, owned or controlled by the Government. Government-owned or controlled bad banks may have political compulsions to invest in the equity of a distressed company for factors unrelated to economic objectives. On the other hand, if ARCs are like stressed asset funds that pool private capital to invest in distressed assets, allowing them to participate in the IBC as a resolution applicant does not raise any such problem. Going forward, the policy must treat ARCs as stressed asset funds and remove the regulatory arbitrage between ARCs and AIFs.\(^ {24}\) In this regard, the report of the Committee to Review the Working of ARCs has highlighted many areas of reforms which are worth serious consideration by the policymakers.\(^ {25}\)
CONCLUSION

The American experience suggests that for a distressed debt market to take off, an effective corporate insolvency law and a vibrant high-yield bond market are vital. In contrast, the Indian policy on distressed debt has been haphazard, seemingly without any coherent conceptual approach. This state of affair appears to have started changing gradually from 2016.

In 2016, India got a modern corporate insolvency law, the IBC. However, the second element of a vibrant high-yield bond market is still in the pipeline. In this regard, the SEBI’s operational framework for transactions in defaulted debt securities is a step in the right direction. Given the deeper political economic reality, bank financing is likely to retain its relevance in the Indian corporate credit market in the immediate future. Therefore, for distressed debt markets to work in India, there is an urgent need for developing the secondary market for corporate loans, investment as well as non-investment grade. In this regard, the RBI’s new master direction on transfer of loan exposure as well as SEBI’s introduction of SSFs are promising reforms. However, as highlighted above, there is scope for further improvement within each of these frameworks to facilitate trading of debt claims between lenders and SSFs.

Similarly, the recent review of the ARC framework is also a positive development. ARCs have stagnated primarily because the policy has treated ARCs as bad banks, although functionally they are closer to stressed asset funds. Going ahead, the policy must treat ARCs as stressed asset funds and remove the regulatory arbitrage between ARCs and AIFs. That would ultimately help make the ARC industry more relevant as well as help develop the distressed debt markets.

Finally, the creation of the dual structure bad bank, NARCL and IDRCL, is likely to facilitate debt aggregation. This would be a critical function for the growth of the distressed debt market, especially when court and tribunals suffering from low state capacity are likely to struggle to handle additional disputes arising out of claim trading and inter-lender litigation. However, being a relatively intrusive state intervention in the working of financial markets, policymakers should have ideally provided a sunset clause to limit the tenure of NARCL. In the long run, the policy should encourage development of a private market in distressed debt where the state’s role is strictly confined to that of a neutral umpire.
5 Ibid.
7 It may be important to clarify here that banks were allowed to purchase NPAs from other banks. This however did not help move NPAs out of banks’ balance sheets. In contrast, transfer of NPAs from banks to ARCs helped transfer NPAs outside of banks’ balance sheets. Consequently, ARCs alone provided the benefit of cleaning NPAs from the banking system.
9 Supra Note 2.
14 Reserve Bank of India, Master Direction – Reserve Bank of India (Transfer of Loan Exposure) Directions, 2021, Clause 58.
15 Ibid.
16 Securities and Exchange Board of India, SEBI (Alternative Investment Funds) Regulations, 2012, Chapter IIIB.
17 Datta P. (2022), “Why special situation funds are necessary”, Indian Express, 29 March.
18 Ibid.
20 Supra Note 8.
21 Supra Note 8.
22 Supra Note 12.
24 Ibid.
25 Reserve Bank of India, Report of the Committee to review the working of ARCs, September 2021.
26 Supra Notes 11 and 12.
imitation is a principle of general law that bars institution of any proceedings or preferring any appeal or making any application seeking to enforce any right, after a period prescribed in law. The legal principle of limitation is based on the two legal maxims ‘Interest Reipublicae Ut Sit Finis Litium’ which means that in the interest of the state as a whole, there should be a limit to litigation and ‘vigilantibus non dormientibus Jura subveniunt’ which means the law will assist only those who are vigilant with their rights and not those who sleep upon it. In India the general principles governing the law of limitation are enshrined in the Limitation Act, 1963 (the Limitation Act) which was enacted ‘to consolidate and amend the law for the limitation of suits and other proceedings and for purposes connected therewith’.

Section 3 of the Limitation Act stipulates as under:


(1) Subject to the provisions contained in sections 4 to 24 (inclusive), every suit instituted, appeal preferred, and application made after the prescribed period shall be dismissed, although limitation has not been set up as a defence.

(2) For the purposes of this Act,—

(a) a suit is instituted, — (i) in an ordinary case, when the plaint is presented to the proper officer; (ii) in the case of a pauper, when his application for leave to sue as a pauper is made; and (iii) in the case of a claim against a company which is being wound up by the court, when the claimant first sends in his claim to the official liquidator;

(b) any claim by way of a set off or a counter claim, shall be treated as a separate suit and shall be deemed to have been instituted— (i) in the case of a set off, on the same date as the suit in which the set off is pleaded; (ii) in the case of a counter claim, on the date on which the counter claim is made in court;

(c) an application by notice of motion in a High Court is made when the application is presented to the proper officer of that court.

Thus, any suit not instituted, appeal not preferred or application not made within the ‘prescribed period’ shall be barred by limitation and shall be dismissed by a Court or Tribunal or Adjudicating Authority (AA) even if the contesting party does not advance an argument against such suit, appeal or application based on the principle of limitation.
Section 2(j) of the Limitation Act defines ‘period of limitation’ as the period of limitation prescribed for any suit, appeal or application by the Schedule, and ‘prescribed period’ as the period of limitation computed in accordance with the provisions of this Act.

The Schedule to the Limitation Act contains as many as 137 Articles. While Articles 1 to 136 prescribe the period of limitation for various types of suits, appeals or application, Article 137 is the residuary Article, prescribing a period of 3 years as period of limitation in respect of applications not covered under the preceding Articles.

However as provided in section 3 of the Limitation Act itself, such period of limitation is not absolute and is subject to the provisions contained in sections 4 to 24 of the Limitation Act which, inter alia, provide for condonation of delay by the Court for sufficient reasons, exclusion of time spent in bona fide litigation before another Court and extension of the period of limitation under certain specified conditions including acknowledgement of debt in writing and payment on account of a debt or of interest on a legacy, even if the acknowledgement is made by an authorised agent of the debtor.

The Insolvency & Bankruptcy Code, 2016 (IBC/Code) has been enacted to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto. Since the IBC deals inter alia with the resolution of financial stress of the corporate persons by balancing the interest of all stakeholders in a time bound manner, it is important to examine the effect of limitation on the proceedings initiated under the IBC.

**LIMITATION IN THE CONTEXT OF IBC**

It is pertinent to note here that the IBC has been enacted as a self-contained Code, with overriding effect. Section 238 of the IBC stipulates that provisions of the IBC will have an overriding effect on any provisions contained in any other law or its instruments which are inconsistent with the IBC. However, when the Code was passed by Parliament and was notified in 2016, it did not contain any provisions relating to limitation, though many important provisions of the Code incorporated strict timelines to be adhered to. This led to confusion and debate as to whether the provisions of the Limitation Act will be applicable in respect of the proceedings initiated under the IBC. Consequently, the AA i.e. National Company Law Tribunal (NCLT) and the Appellate Authority i.e. National Company Law Appellate Tribunal (NCLAT) under the Code interpreted the provisions in their own way, which led to diverse and sometimes even contradictory orders coming out from various benches of NCLT and also from NCLAT. Ultimately the debate about whether or not the provisions of the Limitation Act are applicable to proceedings under IBC was settled with the
introduction of section 238A by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, w.e.f. June 06, 2018 which stipulated as under:

238A. The provisions of the Limitation Act, 1963 shall, as far as may be, apply to the proceedings or appeals before the Adjudicating Authority, the National Company Law Appellate Tribunal, the Debt Recovery Tribunal or the Debt Recovery Appellate Tribunal, as the case may be.

A bare reading of section 238A draws our attention to the stipulation that the provisions of Limitation Act are applicable ‘as far as may be’. Thus, the expression ‘as far as may be’ tones down the rigor of the provisions and is indicative of the fact that all or any of the provisions of the Limitation Act may not apply to the proceedings before the AA or the Appellate Authority if they are found to be inconsistent with some provisions of the IBC. In other words, the provisions of the Limitation Act would apply to the proceedings under IBC, keeping in mind the objectives of IBC, in a contextual and purposive manner.

Application of provisions of Limitation Act in proceedings under IBC

Though it was expected that the debate about the applicability of the provisions of the Limitation Act to the proceedings under the IBC would get settled with the introduction of section 238A in IBC, due to varied judgements of the AA and the Appellate Authority, the following questions still remain to be settled:

(a) Whether the provisions of the Limitation Act will apply retrospectively or prospectively or from the date on which the Code came into existence?

(b) Which Article of the Schedule to the Limitation Act shall be applicable to proceedings under the IBC?

(c) Whether the period of limitation may also be extended in terms of provisions of the Limitation Act for condonation of delay for sufficient reasons, exclusion of time taken in bona fide proceedings before another Court or extension of limitation on account of acknowledgement of debt in writing or part payment of debt or interest?

These issues have travelled to and settled by the Hon’ble Supreme Court in a series of judgements delivered in the last two years. The principles laid down by these judgements are summarised hereunder:

(a) Section 238A of IBC, being clarificatory and procedural in nature, must be given a retrospective effect. [K. Sashidhar v. Indian Overseas Bank & Ors.]¹

(b) The limitation period would not start from the date when IBC came into force i.e., December 1, 2016 but will start from the date when the loan account of the corporate debtor (CD) was declared as non-performing asset. [Gaurav Hargovindbhai Dave v. Asset Reconstruction Company (India) Ltd.]²
(c) No specific period of limitation is prescribed in the Limitation Act for an application under the IBC, therefore, these applications will be governed by limitation period of 3 years as provided in residuary Article 137 of the Schedule to the Limitation Act. [B. K. Educational Services Private Limited v. Parag Gupta & Associates]³

(d) The period of limitation for making an application under section 7 or 9 was 3 years from the date of accrual of the right to sue, that is the date of default. [Jignesh Shah & Anr. v. Union of India & Anr.]⁴

(e) After enactment of section 238 A of the Code on June 6, 2018, validity whereof has been upheld by this Court, it is not open to contend that the limitation for filing application under section 7 of the Code would be limited to Article 137 of the Limitation Act and extension of prescribed period in certain cases could be only under section 5 of the Limitation Act. There is no reason to exclude the effect of section 18 of the Limitation Act to the proceedings initiated under the Code. [Laxmi Pat Surana v. Union Bank of India & Anr.]⁵

(f) Thus, the period of limitation may be extended further as per the provisions of sections 18 to 20 of the Limitation Act, if there has been an ‘Acknowledgement of Debt’ before the expiry of the original period of limitation as provisions of sections 6 or 14 or 18 or any of the provision of the Limitation Act are not excluded by the Code. [Shesh Nath Singh & Anr. v. Baidyabati Sheoraphuli Co-operative Bank Ltd. & Anr.]⁶

(g) The question of applicability of section 18 of the Limitation Act to proceedings under the IBC was no longer res integra [Asset Reconstruction Company (India) Limited v. Bishal Jaiswal & Anr.]⁷

Effect of Acknowledgement in extension of Limitation

In the aforesaid background, we shall now examine the effect of ‘Acknowledgement of Debt’ in extension of limitation. ‘Acknowledgement’ is defined in Black’s Law Dictionary as ‘a recognition of something factual; an acceptance of responsibility; the act of making known that one has received something...’. What amounts to acknowledgement depends upon the relationship between the parties and certain sequence of events in which they communicate with each other regarding the subject matter of such communication. ‘Acknowledgement of Debt’ therefore, can be described as recognition of a debt by a debtor to the creditor in expressed or implied manner discernible from their conversation in lieu of such debt or from a document reflecting such recognition. ‘Acknowledgement of debt’, in the context of proceedings under the IBC, is to be considered while deciding applications filed under sections 7, 9, or 95 with regard to challenge, if any, brought about by the debtor invoking limitation.

Section 18 of the Limitation Act provides for extension of period of limitation in cases where debt is acknowledged in writing as hereinbelow:

(1) Where, before the expiration of the prescribed period for a suit of application in respect of any property or right, an acknowledgment of liability in respect of such property or
right has been made in writing signed by the party against whom such property or right is claimed, or by any person through whom he derives his title or liability, a fresh period of limitation shall be computed from the time when the acknowledgment was so signed.

(2) Where the writing containing the acknowledgment is undated, oral evidence may be given of the time when it was signed; but subject to the provisions of the Indian Evidence Act, 1872 (1 of 1872), oral evidence of its contents shall not be received.

Explanation- For the purposes of this section,-

(a) an acknowledgment may be sufficient though it omits to specify the exact nature of the property or right, or avers that the time for payment, delivery, performance or enjoyment has not yet come or is accompanied by a refusal to pay, deliver, perform or permit to enjoy, or is coupled with a claim to set-off, or is addressed to a person other than a person entitled to the property or right;

(b) the word “signed” means signed either personally or by an agent duly authorised in this behalf; and

(c) an application for the execution of a decree or order shall not be deemed to be an application in respect of any property or right.

**Conditions to be fulfilled for application of section 18 of the Limitation Act**

If we analyse the provisions of section 18 of the Limitation Act, it is observed that the following conditions are to be fulfilled for application of its provisions:

(a) The acknowledgement of liability must be in writing.

(b) The statement on which a plea of acknowledgement is based must relate to a present subsisting liability though the exact nature or the specific character of the said liability may not be indicated in words.

(c) Words used in the acknowledgement must, however, indicate the existence of jural relationship between the parties such as that of debtor and creditor, and it must appear that the statement is made with the intention to admit such jural relationship.

(d) The acknowledgement of liability must be made before expiry of limitation period for filing the suit or preferring an appeal or filing an application.

(e) If limitation has already expired, it would not revive under section 18 of the Limitation Act.

(f) The acknowledgement of liability must be unqualified and must be in unambiguous, clear terms.

(g) The acknowledgement must be signed either by the person or his duly authorised agent.

(h) An acknowledgement of liability may be unilateral or bilateral. A unilateral acknowledgement would be more reliable as it cannot be challenged like a bilateral
agreement on the ground that the acknowledgement was obtained by any kind of fraud, coercion, threat, inducement or promise.

**Documents constituting ‘Acknowledgement’ under section 18 of the Limitation Act**

Over the years, there has been substantial litigation as to what constitutes a valid ‘acknowledgement in writing’ so as to enable a creditor to claim extension of limitation under the provisions of section 18 of the Limitation Act and plethora of judgements are available. However, keeping in mind the context of IBC, and on the basis of judicial pronouncements made by various High Courts and the Hon’ble Supreme Court, the following documents, *inter alia*, would constitute ‘acknowledgement’ under section 18 of the Limitation Act:

(a) E-mails acknowledging the debt constitute a valid and legal acknowledgement of debt though not signed as required under section 18 of the Limitation Act, by virtue of the provisions of the Information Technology Act, 2000. [*Sudarshan Cargo Pvt. Ltd. v. Techvac Engineering Pvt. Ltd.*]  

(b) Debentures are documents which either create debt or acknowledge it. [*Commissioner of Income Tax v. Cochin Refineries Ltd.*]  

(c) Balance sheets are an admission of indebtedness and sufficient acknowledgment under the Limitation Act. The limitation period is calculated from the date it is signed. [*Bengal Silk Mills Co. v. Ismail Golam Hossain Ariff*] [*Mahabir Cold Storage v. Commissioner of Income Tax*] [*Dena Bank v. C Shivakumar Reddy & Anr.*]  

(d) An one-time settlement offer made within the limitation period is to be construed as an acknowledgement. [*Dena Bank v. C Shivakumar Reddy & Anr.*]  

(e) A judgment and/or decree for money in favour of the financial creditor (FC), passed by the Debt Recovery Tribunal, or any other Tribunal or Court, or the issuance of a certificate of recovery in favour of the FC, would give rise to a fresh cause of action for the financial creditor, to initiate proceedings under section 7 of the IBC and limitation will be counted from the date of such judgement, degree or recovery certificate. [*Dena Bank v. C Shivakumar Reddy & Anr.*]  

(f) Cheque given by a debtor to pay his dues is an acknowledgement, even though the cheque is dishonoured. [*Hindustan Apparel Industries v. Fair Deal Corporation*]  

(g) An acknowledgement of a payment made in the written statement in an earlier suit operates as an acknowledgement within the meaning of section 18 of the Limitation Act. [*C. K. Xavier v. S. Kasi*]  

(h) An insufficiently stamped document which contains an admission of liability can be relied upon only for the purpose of extending limitation period. [*Kempegowda v. Mahalingaiah*]  

(i) A letter of undertaking given ‘without prejudice’ is also a valid acknowledgement. The mere introduction of the words ‘without prejudice’ in the undertaking or acknowledgement have no legal significance. [*ITC Limited v. Blue Coasts Hotel*]
Documents not constituting ‘Acknowledgement’ under section 18 of the Limitation Act

Whereas the documents enlisted in the foregoing paragraph would constitute valid acknowledgement under section 18, the following documents would not constitute valid acknowledgement so as to extend limitation:

(a) Issuance of tax deducted at source (TDS) certificate does not amount to the acknowledgment of liability as TDS certificate is primarily to acknowledge the deduction of tax at source. [M/s. Actal v. M/s. India Infoline Limited]19

(b) Also, C forms are not due acknowledgement of debt as there is no acknowledgement of a present and subsisting liability. This is because no intention to acknowledge a liability can be inferred from the contents of the C form. Also, one cannot establish a jural relation of debtor and creditor from the contents of the C form. [Taipack Limited & Ors. v. Ram Kishore Nagar Mal]20

(c) Similarly, a letter in reply to a demand notice cannot be held as acknowledgement as long as it does not admit the liability.

Is acknowledgement also a promise to pay?

It may be kept in view that ‘acknowledgement’ under section 18 of the Limitation Act and ‘promise to pay’ under section 25(3) of the Contract Act, 1872 (the Contract Act) are different even though both have the effect of creating a fresh limitation period. Where section 18 grants a fresh period of limitation only in cases where acknowledgement is before expiry of limitation period; section 25(3) of the Contract Act can be invoked in cases where period of limitation has already expired. A promise to pay is a fresh contract, independent of the original debt, which may or may not have been acknowledged within the period of limitation. However, can an acknowledgement of liability also be construed as a promise to pay? In affirmatively answering this question, the Delhi High Court held that any written acknowledgment after the confirmation of the balance amount can safely be treated as a promise to pay and not mere acknowledgement. [State Bank of India v. Kanhaiya Lal & Anr.]21

Effect of acknowledgement in case of Guarantee

The IBC does not only provide for initiation of insolvency resolution process of the CD but also incorporates provisions for initiation of insolvency resolution process against the corporate guarantor or personal guarantor of the CD, if the CD being the principal borrower commits default in paying the acknowledged debt. The guarantee being co-extensive in terms of provisions of section 128 of the Contract Act, an acknowledgment by the principal-debtor also keeps the limitation saved against the surety [State Bank of India Branch Office v. 5 Dr. Anand R Ahuja].22 Where the surety has specifically empowered the principal debtor to give consent on behalf of the surety in respect of all matters concerning the debt, the acknowledgement of liability given by the principal debtor is binding on the surety, even
though he has not signed the acknowledgements [R. Lilavati v. Bank of Baroda & Ors.]. The fact that acknowledgement within the limitation period was only by the principal borrower and not the guarantor, would not absolve the guarantor of its liability flowing from the letter of guarantee and memorandum of mortgage. The liability of the guarantor being co-extensive with the principal borrower under section 128 of the Contract Act, it triggers the moment principal borrower commits default in paying the acknowledged debt. This is a legal fiction. Such liability of the guarantor would flow from the guarantee deed and memorandum of mortgage, unless it expressly provides to the contrary [Laxmi Pat Surana v. Union Bank of India & Anr.].

Section 19: Effect of payment on account of debt or of interest on a legacy

Whereas section 18 of the Limitation Act provides for extension of initial period of limitation on the basis of a valid acknowledgement in writing, section 19 of the said Act provides for extension of limitation in cases where either on account or partial payment has been made by the debtor or even interest on the debt due is paid either by the debtor or an agent duly authorised by the debtor as a consequence of which a fresh period of limitation shall be computed from the time such payment was so made. Section 19 stipulates as hereunder:

19. Effect of payment on account of debt or of interest on legacy.—Where payment on account of a debt or of interest on a legacy is made before the expiration of the prescribed period by the person liable to pay the debt or legacy or by his agent duly authorised in this behalf, a fresh period of limitation shall be computed from the time when the payment was made: Provided that, save in the case of payment of interest made before the 1st day of January, 1928, an acknowledgment of the payment appears in the handwriting of, or in a writing signed by, the person making the payment. Explanation. —For the purposes of this section,— (a) where mortgaged land is in the possession of the mortgagee, the receipt of the rent or produce of such land shall be deemed to be a payment; (b) "debt" does not include money payable under a decree or order of a court.

For successful application of the provisions of section 19, the following conditions must be fulfilled:

(a) The first condition to be fulfilled is that partial payment must be made on account of existing debt or interest thereon within the initial period of limitation; and

(b) The second condition to be fulfilled is that the payment must be acknowledged in writing by the person liable to pay or his duly authorised agent.

It is pertinent to note here that the underlying principle of section 19 is that a partial payment on account of an existing debt or interest is nothing but acknowledgement of the right of the creditor and the corresponding liability of the debtor. However, it is pertinent to note here that for applicability of section 19, a payment must flow from the debtor to the creditor either in cash or in kind if accepted by the creditor and the factum of such payment must also be recorded by the payer in handwriting or signing. That is why, a debit entry made by the creditor bank in the loan account of the debtor in its own books of accounts was not considered a payment under section 19 of the Limitation Act [Today Stationers & Gift Centres v. Allahabad Bank]. Further, where a cheque was issued in favour
of the creditor for part payment of debt and that cheque was honoured, it was held that both the conditions for application of section 19 were fulfilled, but if such a cheque got dishonoured, though it may be a valid acknowledgement under section 18, it shall not be considered valid for application under section 19 as no payment did materialise in such a case [Arjunlal Dhanji Rathod v. Dayaram Premji Padhiar]. If the partial payment was made within the period of limitation but the record in writing of such payment was not made simultaneously but at a later point in time, fresh period of limitation will be computed from the date of payment. However, the record of partial payment must be in existence on the date a suit is instituted, or an application is filed [Ramchandra v. P S Patil].

Section 20: Effect of acknowledgment or payment by another person

Section 20 of the Limitation Act stipulates as hereunder:

20. Effect of acknowledgment or payment by another person — (1) The expression “agent duly authorised in this behalf” in sections 18 and 19 shall, in the case of a person under disability, include his lawful guardian, committee or manager or an agent duly authorised by such guardian, committee or manager to sign the acknowledgment or make the payment. (2) Nothing in the said sections renders one of several joint contractors, partners, executors or mortgagees chargeable by reason only of a written acknowledgment signed by, or of a payment made by, or by the agent of, any other or others of them. (3) For the purposes of the said sections,— (a) an acknowledgment signed or a payment made in respect of any liability by, or by the duly authorised agent of, any limited owner of property who is governed by Hindu law, shall be a valid acknowledgment or payment, as the case may be, against a reversioner succeeding to such liability; and (b) where a liability has been incurred by, or on behalf of a Hindu undivided family as such, an acknowledgment or payment made by, or by the duly authorised agent of, the manager of the family for the time being shall be deemed to have been made on behalf of the whole family.

On a perusal of the section 20 of the Limitation Act, it can be immediately discerned that it is an explanatory section for sections 18 and 19. Both these sections provide for acknowledgement in writing or part payment of debt or interest, both by the debtor himself or by an agent duly authorised in this behalf. Section 20(1) clarifies that in case of a person with legal disability, the acknowledgement under section 18 or part payment under section 19 can be made by his lawful guardian, or committee or manager or an agent duly authorised by such guardian, committee or manager. It has been judicially held that an admission amounting to an acknowledgement under section 18 of the Limitation Act and the guardian of a minor appointed by the court is binding on the minor [Bageshwari v. Bindeshwari].

It is important to note here that the expression ‘lawful guardian’ in section 20(1) is not limited to a guardian appointed by the Court but also includes any person who is entitled to act as guardian under the personal law of the minor. Therefore, in the case of a Hindu minor, it was held that under the Hindu Law on the death of the father, the mother is not only the natural guardian but also the legal guardian and as such she can acknowledge a debt on behalf of the minor [Bechu v. Baldeo]. However, a de facto guardian was not considered a ‘lawful guardian’ within the meaning of section 20 and had no authority to
acknowledge a debt. Therefore, in the case where a Muslim minor boy was under the *de facto* guardianship of his mother, it was judicially held that a mother, not being a guardian of the property of her minor son under the *Mohammedan* Law, is not a lawful guardian, and cannot sign an acknowledgement on behalf of the minor.

Section 20(2) of the Limitation Act stipulates that an acknowledgement or part payment by one of the partners, contractors or mortgagees will save limitation in his own case but it does not necessarily of itself bind his co-partners, joint contractors or co-mortgagees; unless it is also shown that he had either an express or implied authority, to make the acknowledgement or part payment on behalf of himself and also his co-partners, joint contractors or co-mortgagees.\(^\text{30}\) 

Section 20(3) contains specific clarifications in respect of acknowledgement or part payment made by a Hindu widow being limited owner of family property and also by a *Karta* of a Hindu Undivided Family (HUF). Section 20(3)(a) categorically stipulates that an acknowledgement or part payment made by a Hindu widow being limited owner of family property or her duly authorised agent shall be a valid acknowledgement or payment as against a reversioner. Section 20(3)(b) is attracted if the acknowledgement or part-payment of the principal and interest of a family loan has been made and endorsed by the *Karta* or by his duly authorised agent. In such a case, the acknowledgement or part payment will be valid against all the members of the family. However, after disruption of an HUF, such acknowledgement shall not save the limitation against other members of the family.

**Date from which fresh limitation period is calculated**

It is clear from the analysis of sections 18 to 20 of the Limitation Act that if the conditions stipulated therein are fulfilled, the acknowledgement or part payment will result in extension of limitation and a fresh period of limitation shall be computed. In this regard the following points are to be kept in mind:

(a) Section 18(1) of the Limitation Act provides that the fresh period of limitation shall be computed from the time when the acknowledgment was so signed.

(b) Similarly, the fresh period of limitation is to be computed from the time when the partial payment is made, even if the payment was recorded by the payer later.

(c) In view of section 12(1) of the Limitation Act and section 9(1) of General Clauses Act, 1897 it was held that the day on which acknowledgment is made will have to be excluded in computing the period of limitation.

(d) In case of a minor, where an acknowledgement is made in favour of a minor, then the fresh period of limitation is to be computed from the date when the plaintiff/ minor attains majority.
CONCLUSION

In the context of the IBC, the law on limitation assumes great significance particularly for the financial or operational creditors, who seek to initiate insolvency resolution process against the CD, corporate guarantor or personal guarantor under sections 7, or 9 or 95 of the IBC. These creditors must keep in mind that once the cause of action arises, limitation period starts ticking without a break. As declared by the Hon’ble Supreme Court in their judgements referred to supra, the period of limitation for filing applications under the IBC is three years only as per Article 137 of the Schedule to the Limitation Act and an application under section 7 or 9 or 95 must be filed before the AA within such period, failing which no insolvency resolution process can be initiated. However, it is also settled by the judicial pronouncements of the Hon’ble Apex Court as mentioned above, that provisions of the Limitation Act relating to condonation of delay for sufficient cause or for exclusion of time spent in bona fide proceedings before another Court having no jurisdiction or extension of limitation on the basis of acknowledgement of debt or part payment of the debt or interest are also applicable to the provisions under the IBC and the creditors can avail these provisions subject to fulfilment of conditions stipulated therein. It is trite law that limitation only bars the remedy, it does not extinguish the rights of the creditor. Therefore, an acknowledgement of the debt or part payment of debt or interest either by the debtor or an agent duly authorised in this behalf as envisaged in provisions of sections 18 to 20 of the Limitation Act, may restore such rights with a fresh period of limitation to be computed from the date of such acknowledgement or part payment.

2 Civil Appeal No. 4952 of 2019.
5 Civil Appeal No. 2734 of 2020.
6 Civil Appeal No. 9198 of 2019.
7 Civil Appeal No.323 of 2021.
8 C.O.P. No. 11/2013.
9 1983 142 ITR 441 Ker.
10 AIR 1962 Cal 115.
11 AIR1991 SC 1357.
12 Civil Appeal No. 1650 of 2020 (SC).
13 Ibid.
14 Ibid.
15 AIR 2000 Guj 261.
16 AIR 1990 Ker 271.
17 AIR 1972 Mys 152.
18 Civil Appeal Nos. 2928-2930 of 2018.
19 Arbitration Petition No. 449 of 2012.
20 2007(3) ARBLR 402 Delhi.
21 RSA 248/2015.
22 FA 119 of 1993.
23 AIR1987 Kant 2.
24 Supra Note 5.
25 AIR 2004 P H 56.
26 AIR 1971 Pat 278.
27 AIR 1973 Bom 163.
28 AIR 1932 Pat 337.
29 AIR 1933 Oudh.132.
30 AIR 1936 All, 820 (FB).
Introduced as a measure to protect and preserve the value of assets of the corporate debtor (CD) during the insolvency resolution process, the moratorium period is famously known as 'calm period' across jurisdictions. The moratorium means a period wherein no judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets, or termination of essential contracts can be instituted or continued against the CD.

In India, the Bankruptcy Law Reforms Committee (BLRC), while conceptualising the Insolvency and Bankruptcy Code, 2016 (IBC/Code), stated that –

the motivation behind the moratorium is that it is value maximising for the entity to continue operations even as viability is being assessed during the IRP. There should be no additional stress on the business after the public announcement of the IRP. The order for the moratorium during the IRP imposes a stay not just on debt recovery actions, but also any claims or expected claims from old lawsuits, or on new lawsuits, for any manner of recovery from the entity.

Based on the recommendations of the BLRC, the Code provides for declaration of moratorium by the Adjudicating Authority (AA), which prohibits (a) the institution of suits or continuation of pending suits or proceedings against the CD; (b) transferring, encumbering, alienating or disposing off by the CD any of its assets or any legal right or beneficial interest therein; (c) any action to foreclose, recover or enforce any security interest created by the CD in respect of its property; and (d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the CD. The moratorium is applicable from the date of order by the AA till the completion of the corporate insolvency resolution process (CIRP).

The declaration of moratorium is intended to facilitate the continuation of CD as a going concern during the CIRP and to ensure that the individual enforcement actions of the creditors do not frustrate the process. It also bars the directors and suspended management of the company, to extract any funds out of the company after initiation of CIRP. The provisions contained in section 14 of the Code, however, imposes a duty on the Insolvency Professional (IP) to keep the assets of the CD intact, while facilitating the resolution so as to secure maximum value for the distressed company. This is further affirmed by the provisions of sections 20 and 25 of the Code which casts a duty on the Interim Resolution Professional (IRP) and Resolution Professional (RP) respectively, to preserve and protect the assets of the CD, and manage the operations of the CD as a going concern.
ESSENTIAL SUPPLIES

To ensure that the CD runs as a going concern, the Code provides for continuation of supply of essential goods or services to the CD during the moratorium period. These essential goods and services are specified as electricity, water, telecommunication services and information technology services, to the extent these are not a direct input to the output produced or supplied by the CD. For instance - water supplied to a CD will be essential supplies for drinking and sanitation purposes, and not for generation of hydro-electricity. This implies that the essential supplies, if needed to generate output product/service for the CD can be discontinued by the vendor, if it so desires.

The Code was amended in December, 2019 to include a clarification that a licence, permit, registration, quota, concession, clearance or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law for the time being in force, shall not be suspended or terminated on the grounds of insolvency, subject to the condition that there is no default in payment of current dues arising for the use or continuation of the license, permit, registration, quota, concession, clearances or a similar grant or right during the moratorium period. It further added the provision that where the IP considers the supply of goods or services critical to protect and preserve the value of the CD and manage the operations of such CD as a going concern, then the supply of such goods or services shall not be terminated, suspended or interrupted during the period of moratorium, except where such CD has not paid dues arising from such supply during the moratorium period.

The dues for the essential services availed during the CIRP are considered as part of the insolvency resolution process costs which are paid in priority to all other dues. These provisions have been explained in some of the judgments as elaborated below.

The National Company Law Tribunal (NCLT) Mumbai Bench in the matter of ICICI Bank v. Innoventive Industries, while deciding an application in reference to explanation to section 14(2) of the Code, clarified that electricity supplying to the debtor company for public distribution will not fall within essential supplies classified in regulation 32 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 and therefore, section 14(2) shall not be invoked to prohibit the supplier from terminating or suspending the services. It held as under -

...By reading this Regulation, it appears that electricity, water and telecommunication services and Information Technology service are to be considered as essential as long as these services are not a requirement to the output produced or supplied by the Corporate Debtor. Under this regulation, an illustration also been given saying that water is to be considered as essential service as long as it is used for drinking purpose and sanitization purpose but not for generating electricity. Whenever any illustration is given, it will be given to have an understanding about the provision of law. If supply of water for drinking and sanitization purpose is an essential service, the supply of electricity is also deemed to be limited for lighting purpose and other domestic purposes, which are in modern days considered as essential service. If the same electricity is used as input for manufacturing purpose making huge bill of lakhs of rupees to get output from that industry, then to our
understanding, supply of electricity is used as input for manufacturing purpose to get output from the factory and it obviously to make profits. Essential service is a service for survival of human kind, but not for making business and earn profits without making payment to the services used. When company is using it for making profit, then the company owes to make payment to the services/goods utilized in manufacturing purpose...

The NCLT Hyderabad Bench in the matter of Canara Bank v. Deccan Chronicle Holdings Limited \(^5\) held that –

Section 14(2) of the IBC Code, 2016 already exempted supply of essential goods and services to the Corporate Debtor and in addition the Learned Counsels for the Respondent submitted that goods/services viz. Water, Electricity, printing ink, Printing plates, Printing Blanket, Solvents etc. will also come under the purview of exemption and thus prayed to exempt above good/services from moratorium. We are convinced with the prayer of the Respondent that the above goods and services would come under exemption under this Section. Hence, we clarify that goods/services viz. Water, Electricity, Printing ink, Printing plates, Printing Blanket, Solvents etc. will come under this Section and these essential goods or services to Corporate Debtor shall not be terminated or suspended and interrupted during the moratorium period.

In the matter of M/s. Navbharat Castings LLP. v. M/s. Moser Baer India Ltd. & Anr.,\(^6\) the appellant (landlord) had challenged the order whereunder the application preferred by the appellant for direction to the CD through the RP to vacate the premises belonging to the decree holder has been rejected in view of the order of moratorium passed. The National Company Law Appellate Tribunal (NCLAT) held that in view of sub-clause (1) of clause (d) of section 14 of the Code, the recovery of property by the owner occupied by the CD is not permissible during the period of moratorium.

The NCLAT in the matter of Asset Reconstruction Company (India) Ltd. v. R. Venkatakrishnan & Anr.\(^7\) held as –

it is not open to the Electricity Board to disconnect the electric supply of the ‘Corporate Debtor’ during the ‘Corporate Insolvency Resolution Process’, the ‘Resolution Professional’ should not have paid any dues of the earlier period for restoration of electricity. The ‘Resolution Professional’ should have brought the fact to the notice of the Adjudicating Authority, who should have ordered for restoration of electricity with clear direction to pay the dues of the current charges of the ‘Corporate Insolvency Resolution Process’. Such being the position, the amount, if any, wrongly paid of the earlier period to the Electricity Board, the same should be adjusted from the current charges. On such adjustment, if it is found further amount is liable to be returned by the Electricity Board then the Electricity Board should be asked to return the amount.

The NCLAT in the matter of Dakshin Gujarat VIJ Company Ltd. v. M/s. ABG Shipyard Ltd. & Anr.,\(^8\) while deciding the issue of whether the order of moratorium will cover the current charges payable by the CD for supply of water, electricity etc. or not, held as -

If the ‘Corporate Debtor’ has no fund even to pay for supply of essential goods and services, in such case, the ‘Resolution Professional’ cannot keep the Company on-going just
to put additional cost towards supply of electricity, water etc. In case the ‘Corporate Debtor’ (Company) is non-functional due to paucity of fund and has become sick the question of keeping it on going does not arise.

Hence, the jurisprudence developed with respect to section 14 makes it clear that the IP needs to run the CD as a going concern, wherein essential supplies will be continued during CIRP subject to payment of dues arising during such period. The Code prohibits the payment of dues arising out of goods/services availed prior to CIRP initiation, even if it is related to essential supplies.

**INTERNATIONAL PRACTICE**

In Canada, similar provisions exist in section 69 of the Bankruptcy and Insolvency Act, 1985 (BIA) which prohibits the commencement or continuation of any action or proceedings against the debtor or debtor’s property, for the recovery of a provable claim in bankruptcy. Further, section 84.2 of the BIA prohibits the termination of the agreements or claiming the forfeiture of the terms of any agreement with a bankrupt individual by reason of only the individual’s bankruptcy or insolvency. It also protects the bankrupt individual from the discontinuation of public utilities solely by reason of the individual’s bankruptcy or insolvency or of the fact that the bankrupt individual has not paid for services rendered or material provided before the time of the bankruptcy.

Schedule B1 to the UK Insolvency Act, 1986 contains provisions for moratorium which prohibits the enforcement of security interest by the creditors or repossession of goods in company’s possession except with the permission of the Court or the Administrator. Section 233 of the said Act provides for the continuation of supply of gas, electricity, water and communication services etc. Suppliers are not permitted to require payment of outstanding debts in order to secure a new or continued supply to the company in administration. However, section 233 of the Act permits a supplier to stipulate that the Administrator must personally guarantee payment of charges in respect of the supply. In addition, under section 233A, a supplier of such services is generally unable to rely upon an ‘insolvency-related term’ in a contract of supply which would otherwise entitle the supplier to terminate the supply, alter the terms of the supply or compel higher payments for continued supply.

Thus, the international practice also assumes importance of continuation of essential suppliers to ensure going concern of the company and to attract viable resolution plans.

**INDIA’S EXPERIENCE**

The Indian insolvency regime is still at a nascent stage and is evolving. In its initial years of implementation, the Code has gone through several challenges and hence has brought amendments from time to time. The introduction of provisions pertaining to continuation of essential goods and services is a step in the right direction keeping in mind the objective
of the Code being rescue and not liquidation. However, it puts onus on the IP to identify the essential goods and services for a particular CD and ensure its continuation or non-termination during the resolution process.

The Insolvency Law Committee (ILC) in its Report dated March 26, 2018 observed that ‘...flexibility may be infused by adding a proviso to section 14(2), which states that for continuation of supply of essential goods or services other than as specified by IBBI, the IRP/RP shall make an application to the NCLT and the NCLT will make a decision in this respect based on the facts and circumstances of each case’. The Committee in its Report dated February 20, 2020 further noted that –

‘...Adjudicating Authorities under the Code were being approached on a case-by-case basis for the continuation of critical supplies other than those defined as essential goods and services under the CIRP Regulations...... the Committee recommended that a new sub-section be introduced in Section 14 to ensure that supplies that are critical to running the corporate debtor as a going concern, and would contribute to the preservation of the corporate debtor's value and success of the resolution plan should not be terminated, suspended or interrupted, except in certain specific circumstances. The supplies that would be considered critical should be identified by the resolution professional, who is entrusted with the responsibility of running the corporate debtor as a going concern....

The Committee, while entrusting the responsibility of identification of critical supplies to the IP, suggested that payment for such supplies during CIRP should be included in the resolution process cost, while past dues of such suppliers should continue to be regarded as operational debt as at the insolvency commencement date.

Though the Code has strived to provide protection against all foreseeable issues that can be faced by the IPs while taking charge of the CD or running the operations of the CD, the IPs are still facing challenges to enter the premises of the CD because of the unpaid rental dues or stalled electricity or water supply. There are cases where IPs are not able to take custody of the records of the CD stored in electronic form in computers as there is no electricity supply to the CD due to unpaid dues. No doubt, the Code has stated in clear terms that no essential supply shall be discontinued, the practical difficulties faced by IPs seem to have overshadowed the explicit provisions of the Code.

The scope of essential supplies as provided in the Code is restricted to a few goods/services and that too other than the direct inputs to the output generated by the CD. Even if IP identifies the goods or services that are critical to protect and preserve the value of the CD and manage its operations as a going concern, the decision of IP is not binding on vendors of the CD, who still have an option to not supply goods or services to the CD, unless prior dues are fully paid. This often leads to filing of interim applications before the AA, praying for passing directions to continue the critical supplies, which not only delays the process but also depletes the value of the CD and adds to the CIRP cost.
CONCLUSION

As suggested by the ILC, the list of critical supplies can be expanded. However, the same may not serve the purpose as the distressed companies belong to different sectors such as manufacturing, real estate, constructions, transport, hospitality, electricity, retail trade, service sector, etc., hence the nature of essential supplies will be different for every CD. It may not be convenient to list down each and every essential supply in the Code or the regulations.

A possible fix is to reconsider the provisions of sections 7, 9 and 10 of the Code in line with section 14(2A) of the Code which provides that where the IRP or the RP, as the case may be, considers the supply of goods or services critical to protect and preserve the value of the CD and manage the operations of such CD as a going concern, then the supply of such goods or services shall not be terminated, suspended or interrupted during the period of moratorium, except where such CD has not paid dues arising from such supply during the moratorium period. Since this provision, in practice, requires the IP to file an application before the AA for declaration of essential supplies, it results in a lengthy process and goes against the objective of the Code of time bound resolution of the CD.

To address this issue, the supply of essential goods and services needs to be ascertained at the time of admission of CIRP itself. The applicant who is filing the application for initiation of CIRP may provide the relevant information to the AA. In case the said information is not available with the applicant, the AA may direct the respondent i.e., suspended management to provide the information pertaining to the business prospects of the CD and its essential supplies. The AA then vide its admission order, will be able to include the list of critical supplies in the order itself, which will avoid the interim applications post initiation of CIRP and will ensure that CD runs as a going concern. The order of the AA will be binding on the vendors of the CD, which will ensure their cooperation during the entire process.

2 The word IRP in this para stands for ‘Insolvency Resolution Process’.
3 Section 14(2) and 14(2A), IBC.
4 MA 157 in CP 01/I&B/P/2016.
5 CP No. IB/41/7/HDB/2017.
6 Company Appeal (AT) (Insolvency) No. 323 of 2018.
Money lending has been an age-old business world over. The experience shows that the incidence of default in repayment of the debt in some cases has also been an avoidable characteristic of the money lending transactions. It gives rise to the question of recovery of the amount in default. Non-repayment of the sums borrowed from the lenders leads to dispute between the borrowing and lending entities. There could be various platforms available to the parties to seek resolution of such disputes through – negotiation, mediation, conciliation, arbitration and other judicial mechanisms to mention a few. There had always been attempts to make the process smoother and quicker. One of such attempts on the part of the Government of India had been an important and game-changing piece of a legislation for expeditious resolution of insolvency/ bankruptcy. The evolution and introduction of Insolvency and Bankruptcy Code, 2016 (IBC/Code) in India had a long-term vision of encouraging entrepreneurship and innovation with the underlying idea that it is natural for some business ventures to fail for various reasons predominant among them being -

(a) Poor management,
(b) Wrong decision making,
(c) Diversion of funds for unintended purposes,
(d) Obsolete technology,
(e) Adverse market development,
(f) Funds/liquidity crunch, etc.

But the remedial measures must focus on not to get bogged down with the mistakes of the past which resulted in the failure of the business but to handle the problem rapidly and swiftly. The purpose of the introduction of IBC in India has been as follows:

(a) To consolidate and amend the laws relating to re-organisation and insolvency resolution of corporate persons, partnership firms and individuals;
(b) In a time-bound manner;
(c) For maximisation of the value of the assets of such persons;
(d) To promote entrepreneurship;
Adherence to Timelines Is of Essence in Insolvency Resolution

(e) To ensure availability of credit;

(f) To balance the interests of all the stakeholders including alteration in the order of priorities of payment of government dues; and

(g) To establish an Insolvency and Bankruptcy Board of India (IBBI).

The Code is a complete and comprehensive law in itself and has come into force from December 1, 2016. The Code applies to the following in relation to their insolvency, liquidation, voluntary liquidation or bankruptcy as the case may be –

(a) Any company incorporated under the Companies Act, 2013 or under any previous company law;

(b) Any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act;

(c) Any Limited Liability Partnership incorporated under the Limited Liability Partnership Act, 2008;

(d) Such other body incorporated under any law for the time being in force, as the Central Government may, by notification specify in this behalf;

(e) Personal guarantors to the corporate debtors (CDs);

(f) Partnership firms and proprietorship firms; and

(g) Individuals, other than persons referred to in clause (e).

The Code has been not only complete and comprehensive but also dynamic and evolving law as is evident from the fact that in the first five years of its implementation, the Code has been amended six times. The IBBI and the Ministry of Corporate Affairs, Government of India have been quite sensitive and alive to the emerging situations in the implementation of the Code. The Hon’ble Supreme Court has also shown alacrity to settle the issues which were brought before it for consideration and adjudication from time to time.

ESSENCE OF THE CODE

Apart from being an economic reform, the Code has also got a social content while recognising the fact that the business be treated as a going concern and the law seeks to make all endeavours to ensure that the employees are not robbed of their livelihood by liquidating the business of the CD. All efforts should first be made to find out a resolution to the issue of insolvency and liquidation should be only the last resort. The simultaneous concern shown in the Code is to ensure the resolution or liquidation in a time bound manner so as to ensure that the erosion in the value of the underlying assets of the CD can be kept at minimum. Maximisation of the value of the assets shall benefit all the stakeholders. Section 12 of the Code therefore provides the following timelines for the disposal of the cases:
Subject to sub-section (2), the corporate insolvency resolution process shall be completed within a period of one hundred and eighty days from the date of admission of the application to initiate such process.

The resolution professional shall file an application to the Adjudicating Authority to extend the period of the corporate insolvency resolution process beyond one hundred and eighty days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of sixty-six percent of the voting shares.

On receipt of an application under sub-section (2), if the Adjudicating Authority is satisfied that the subject matter of the case is such that corporate insolvency resolution process cannot be completed within one hundred and eighty days, it may by order extend the duration of such process beyond one hundred and eighty days by such further period as it thinks fit, but not exceeding ninety days:

It is also provided that such extension of 90 days shall be allowed not more than once. The Code provides for an outer time limit of 330 days for the resolution of the insolvency process including the time taken in legal proceedings in relation to such resolution of insolvency. If, for whatever reason, the corporate insolvency resolution process (CIRP) is not completed within 180, 270 or 330 days, the Adjudicating Authority (AA) may initiate liquidation procedure as provided under section 33 of the Code.

Section 12A of the Code provides that the AA may allow the withdrawal of application admitted under section 7 or 9 or 10 on an application made by the applicant with the approval of 90% voting share of the committee of the creditors (CoC). Such application may be made in the following situations-

(a) Before the constitution of the CoC

(b) After the constitution of the committee by the applicant through the Interim Resolution Professional (IRP) or the Resolution Professional (RP) as the case may be after obtaining approval from the CoC through a 90% majority.

The insertion of section 12A in the Code through an amendment in 2018 is an enabling provision for the withdrawal of the application once filed in the National Company Law Tribunal (NCLT) under section 7, 9 or 10 so as to help the parties to settle the matter and honour the financial obligations to their creditors outside the IBC framework.

DEBTOR IN POSSESSION Vs. CREDITOR IN CONTROL

The Code seeks to shift the hitherto prevailing ‘debtor-in-possession’ regime to a ‘creditor-in-control’. In the earlier regime, the CDs continued to hold possession of the corporate and its assets during the pendency of the insolvency or winding up proceedings. However, the Code envisages that from the date of appointment of the IRP by NCLT - the AA, the management of the affairs of the CD shall vest in the IRP as provided under section 17(1)(a) of the Code. Section 17(1)(b) provides that the powers of the Board of Directors or the partners of the CD as the case may be, shall stand suspended and be exercised by the IRP. The officers and managers of the CDs shall report to the IRP and provide access to
Adherence to Timelines Is of Essence in Insolvency Resolution

such documents and records of the CD as may be required by the IRP. Section 17(1)(d) stipulates that the financial institutions maintaining the accounts of the CD shall act on the instructions of the IRP in relation to such accounts and furnish all information relating to the CD available with them to the IRP.

Section 17(2) provides that IRP vested with the rights to manage the affairs of the CD shall act and execute in the name of and on behalf of the CD, all deeds, receipts and other documents if any required and take such actions in the manner and subject to such restrictions as may be specified by the Board. This section also authorises him to access the electronic data, records, books of accounts etc.

The provision of ‘creditor-in-control’ followed by the apprehension of losing the business to the resolution applicant in the event of a successful CIRP or the eventual liquidation has instilled a sense of fear in the minds of the CDs which is visible in the slight improvement in the corporate repayment culture of the bank loans and resultant reduction in the non-performing assets (NPAs) of the banks in the recent years despite the adverse impact of COVID-19 pandemic on the trade and economy of the country.

**ALTERNATE DISPUTE RESOLUTION MECHANISM**

In the wake of such developments, there was a surge in the instances, where the CDs expressed their intent to arrive at a negotiated settlement with their financial creditors (FCs) if they were allowed to come out of the IBC framework. Accordingly, a need was felt to make an explicit provision in the Code by incorporating section 12A. The insertion of section 12A has opened a new window of exploring Alternate Dispute Resolution (ADR) channel and thus avoiding insolvency and liquidation. The settlement of disputes through ADR channel is less time consuming, cost effective and efficient. However, its failure may result in simple wastage of time and resources. The following comparative chart will explain the features and characteristics of these ADRs at a glance:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Arbitration</th>
<th>Mediation</th>
<th>Conciliation</th>
<th>Negotiation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neutral 3rd party</td>
<td>Arbitrator</td>
<td>Mediator</td>
<td>Conciliator</td>
<td>Facilitator</td>
</tr>
<tr>
<td>Nature of proceedings</td>
<td>Legally binding</td>
<td>Not legally binding</td>
<td>Not legally binding</td>
<td>Not legally binding</td>
</tr>
<tr>
<td>Level of formality</td>
<td>Formal</td>
<td>Informal</td>
<td>Informal</td>
<td>Informal</td>
</tr>
<tr>
<td>Level of confidentiality</td>
<td>As determined by law</td>
<td>Based on trust</td>
<td>As determined by law</td>
<td>Based on trust</td>
</tr>
</tbody>
</table>

Arbitration is a non-judicial process and also time consuming as it may take up to 18 months. It may not therefore be an effective and desirable remedy to the CIRP.

Conciliation and negotiation are generally adopted in resolving the industrial disputes like wage revision which are covered under the Industrial Disputes Act, 1947.
Mediation

In view of the foregoing discussions, it is considered desirable to examine the suitability of the process of mediation as an ADR platform in CIRP cases. The process of mediation involves engagement of a third party interventional expert in the field of corporate insolvency dispute resolution with a view to arrive at a mutually agreeable settlement. The outcome of the mediation would depend on mutually collaborative participation by the parties to the dispute. It calls for a flexible approach on the part of both the parties to help settlement of the issue amicably. The rigidity on the part of the parties or even one party could lead to a failure in resolving the dispute. Mediation basically would involve creative-problem-solving through the expertise of the Mediator. A successful resolution may help the mutual relationship to continue to be good. The existence of multiple FCs and other operational creditors (OCs) may enhance the complexities of the resolution as a different class of creditors will be having their competitive claims for the scarce assets of the CDs. Mediation has not been a very popular platform for resolution of insolvency disputes in India so far.

The insertion of section 12A enabling withdrawal of the CIRP case from NCLT and giving mediation a try might encourage the parties to adopt this route. To make the mediation more effective, the provision should be made for temporary withdrawal of the case from the NCLT and in the event of a mutually agreeable settlement, the parties should have the option to file their mutually agreed settlement before NCLT with a request to pass appropriate order to give such an arrangement a legal validity. The time taken for completing the mediation process should be excluded from the permissible outer time limit under the IBC framework. This will give a boost to the utilisation of the benefit provided by the insertion of section 12A and thus make it more popular. The IBC can have a provision for a single Mediator agreeable to both the parties mutually. Alternatively, both the parties be allowed to nominate one Mediator each and NCLT can nominate a neutral Mediator who shall be the Chairman of the mediation panel. Such Mediators can be sectoral experts from amongst the Insolvency Professionals, Registered Valuers (RVs) and other experts with domain knowledge. Such an arrangement can be helpful in reducing the burden of the workload in NCLT and also the time taken for completing the CIRP.

CONCERN OF THE IBBI FOR REDUCING DELAYS IN CIRP

The IBBI has released a consultation paper on April 13, 2022 inviting suggestions to reduce the delays in CIRP under the IBC framework. The need for such a consultation paper can be appreciated by the simple fact that despite clear provisions for completion of the CIRP having been spelt out under section 12 of the Code, the factual position is in sharp contrast and contrary to the expectations. The IBBI has already done its bit to streamline the timelines wherever it was considered feasible and reasonable. A few examples of such initiatives such as reduction in the number of days allowed for the appointment of an IRP by NCLT by doing it on the date of admission of the application, time allowed for constitution of the
CoC having been reduced etc., have not visibly improved the situation much as can be seen from the following table during the last two years:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of applications admitted under section 9</th>
<th>Average time taken for admission</th>
<th>No. of applications admitted in less than one year</th>
<th>No. of applications admitted in one to two years</th>
<th>No. of applications admitted in more than two years</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020-21</td>
<td>153</td>
<td>468 days</td>
<td>54</td>
<td>84</td>
<td>15</td>
</tr>
<tr>
<td>2021-22</td>
<td>207</td>
<td>650 days</td>
<td>39</td>
<td>86</td>
<td>82</td>
</tr>
</tbody>
</table>

(a) This table evidences substantial delay in admitting the applications by NCLT. But it is reported to be on account of inadequate information/documents provided by the OCs to establish the transaction and default at the time of filing application under section 9 in the first place and the objections filed by the CDs in the second, questioning the existence of the debt and default due to which the application could not be admitted within the permitted time of 14 days.

(b) Lack of cooperation to IRP/RP by the personnel of the CD to furnish required information to prepare information memorandum and avoidance transaction applications to be shared with the prospective resolution applicants. It is a crucial requirement to help prepare a fair resolution plan. Such lack of cooperation causes delay in completing the CIRP in a time bound manner.

(c) Dealing with avoidance application after closure of CIRP is another area to be explored as the role of the RP gets over with the approval of the resolution plan or initiation of the liquidation process and the RP demits his office. The avoidance transactions include preferential transactions, undervalued transactions, extortionate transactions and fraudulent transactions and seeking relief on account of these transactions, will deliver benefits to various stakeholders. CDs would normally contest such avoidance transactions and thereby leading to undue delay in completion of the CIRP. If the AA has not disposed of the avoidance transactions application filed by the RP or the appeal against the order of AA is pending, there is no clarity as to who and how to take such pending application to logical conclusion and ensure the required benefit to the eligible stakeholders. The IBBI has proposed to address this issue in their discussion paper dated April 13, 2022.

(d) There is often a significant difference found in the valuation report submitted by the two different valuers. It is therefore required to appoint a third valuer to determine the fair value and the liquidation value of the underlying assets of the CD in accordance with internationally accepted valuation standards. Regulation 35 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) provides that if in the opinion of the RP, the estimates of the values are significantly different, RP may appoint another RV who shall submit an estimate of the value computed in the same manner and the average of the two closest values shall be considered as the fair value or the liquidation value. The assessment of difference in the valuation has been left to the opinion of the RP leading to the scope for discretion. The valuation exercise is a critical
component in the CIRP as it forms the basis of decision making by CoC and serves as guidance for assessing the resolution plan.

The handbook on ‘Policy, Standards and Procedures for Real Estate Valuation by Banks and Housing Finance Institutions’, issued in the year 2011 by Indian Banks’ Association (IBA) and National Housing Bank (NHB) provides that where the value of property is more than ₹ 10 crore, two valuers of category A or B shall be appointed and if the difference in the valuations arrived by both the valuers is not more than 15%, then a third valuer who shall also be a senior valuer in the category A or B shall be appointed and a considered view on the value shall be taken by the bank/ housing finance institution.

The CIRP Regulations were amended on June 14, 2022 to provide a threshold of 25% for determination of significant difference in valuations made under the Code. Enlarging the gap from 15% as provided in the handbook jointly by IBA and NHB to 25% under CIRP Regulations may lead to a position contrary to the principle of the maximisation of the value of assets of the CD enshrined in the Code. It is therefore more desirable to incorporate 15% in the CIRP Regulations.

**NUMBER OF NCLT BENCHES BE ENHANCED**

The number of cases dealt with by NCLT benches till May 31, 2021 is reported to be 32,547 out of which 19,377 cases have been disposed of which is about 59.54% of the total cases leaving 13,170 cases (40.46%) pending. Such a large pendency is in spite of the fact that the disposal time for the resolution cases has been much higher than the outer limit stipulated in the IBC framework and a large number of cases going to liquidation due to such failure to adhere to the timelines.

The report of the Standing Committee on Finance on ‘Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions’ submitted in August, 2021 stated that more than 71% of the cases are pending for more than 180 days which points to a deviation from the originally intended objectives of the Code. However, the implementation of the Code has helped India improve its ranking in ‘Ease of doing Business’ from 155 in 2017 to 63 in 2020 which is a fair indicator of its success in such a short time. The time taken for resolution of insolvency has also improved from 4.3 years to 1.6 years in 2020.

Considering the large number of pending cases under the IBC i.e., 40.46%, it would be desirable to increase the number of the NCLT benches from 16 to 30 and also provide adequate manpower to avoid adjournments. More number of benches and adequate manpower will reduce the time taken for completing the CIRP significantly.

Another area of importance is the inordinate delay in filing the application before NCLT. The delayed initiation of the proceedings coupled with delayed resolution results in diversion of funds and assets by the CD even before the case is presented to NCLT. It is therefore suggested to stipulate a provision in the CIRP Regulations that the application for resolution of insolvency be filed without much loss of time, once the borrower’s account is classified as NPA. A time limit of 6 –12 months for filing the application may be stipulated.
Such provision will help better valuation of the assets of the CD and also significantly guard against diversions of assets/ funds from the business in a fraudulent manner. It will also bring down the number of avoidance transactions.

**WAY FORWARD**

Apart from streamlining the processes to help complete the CIRP/ liquidation proceedings in a time bound manner as proposed in the discussion paper dated April 13, 2022 by the IBBI, the process of mediation be institutionalised and appropriately integrated in the CIRP Regulations with adequate provision to exclude the time taken in the mediation process while reckoning the completion of CIRP within the stipulated timeframe of 180, 270, or 330 days. Enough safeguard be stipulated to deal with the cases of failed mediation *vis-a-vis* section 12A of the Code. Setting up of additional benches of NCLT and National Company Law Appellate Tribunal may be taken on priority to bring down the pendency and adhering to the stipulated timelines. Providing adequate and efficient manpower on a regular basis shall help reduce the pendency. Strict adherence to the timelines more particularly of 330 days to complete CIRP, will help bring down the number of cases being pushed to liquidation by default significantly while also ensuring preservation of the value of assets of the CD and thereby upholding the objective of maximisation of asset value for the benefit of stakeholders.
Prior to the advent of the present insolvency regime in India in the form of the Insolvency and Bankruptcy Code, 2016 (IBC/Code), the Indian insolvency landscape was governed by multiple laws including the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Recovery of Debts and Bankruptcy Act, 1993, and the Companies Act, 2013 dealing with insolvency and bankruptcy of companies. As a result, various courts and tribunals ranging from the District Courts, the Company Law Board, the Board for Industrial and Financial Reconstruction (BIFR), and the High Courts were exercising jurisdictions at various stages. While liquidation of companies was handled by the respective High Courts, individual cases were dealt under the twin Acts, viz. the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920. However, these laws and regulations were operating in silos, had several deficiencies and conflicts, and apparently failed to effectively address the insolvencies faced by the companies. In addition, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) dealt in a limited way, part liquidation of assets charged to the lenders, through a sale process defined under the said Act with jurisdiction of Debt Recovery Tribunal (DRT)/Debt Recovery Appellate Tribunal.

The IBC ushered in a paradigm shift in the approach to insolvency resolution which recognised that in the eventuality of business failure, the best remedy for the ecosystem is to have a speedy renegotiation between the stakeholders to preserve the economic value, in the process resorting to a new set of liabilities with a new management. A time bound process either ends in keeping the entity as a going enterprise or liquidates and distributes the assets swiftly to the various stakeholders.

**Evoluonary Path and Milestones**

The Code has seen a roller coaster ride since inception through interplay of various forces including legislative and regulatory initiatives and complemented by timely judicial interventions at every critical stage of the journey. A brief snapshot of the ride & evolution of the Code is illustrated below for a holistic perspective:

(a) **Rapid statutory amendments [IBC, SEBI, taxation etc.]**

(i) The first amendment was introduced on November 23, 2017\(^1\) which inserted section 29A in the Code which led to exclusion of promoters and their related
parties from corporate insolvency resolution process (CIRP). This provision eventually led to exclusion of promoter and its group entities from some mega corporate entities such as Essar Steel Ltd., Bhushan Steel Ltd. etc. and proved to be a real game changer.

(ii) The second amendment dated June 6, 2018 brought a series of major improvements in the Code some of which are listed out as under:

- Homebuyers were recognised as financial creditors (FCs) (Section 5(8)(f)). Also introduced mechanism of authorised representative of such homebuyers for ease of process.
- Defined the term ‘related party’ and ‘relative’ in the context of provisions of section 29A.
- Introduced section 12A enabling withdrawal of application and paved the way for settlement between parties at any stage before approval of resolution plan.
- Section 14 was also amended to clarify the position that moratorium under section 14 of the Code will not include action against guarantors, thereby clearing the deck for action against guarantors even while borrower is undergoing CIRP.
- Reduced the voting requirement for approval of resolution plan from original percentage of 75% to 66%.
- Introduced important changes to clarify position of creditors who become shareholders of corporate debtor (CD) under a restructuring plan and excluded them from the definition of related party for the purpose of section 29A.
- Exempted resolution applicants under the Code from adverse impact under section 29A, where account of CD acquired by it continued to remain NPA or where avoidable transactions were reported before approval of resolution plan.
- It also resolved another major issue related to compliances with the provisions of the Companies Act, 2013 as regards various resolutions/approval required on account of change in management and shareholding of the CD by inserting an explanation in section 30 of the Code.
- Insertion of new section 238A to clarify application of the Limitation Act, 1963 to the IBC.
- Section 240A inserted to exclude micro, small, medium enterprises (MSMEs) from application of clauses (c) and (h) of section 29A.
The third amendment was introduced on August 6, 2019 which, *inter alia*, prescribed and inserted provisions relating to:

- Widening of scope of resolution plan to include merger, amalgamation, and demerger [Section 5(26)].
- It also introduced the requirement under section 7 of the Code, requiring National Company Law Tribunal (NCLT) to record reasons if application is not admitted within the period of 14 days. It also prescribed maximum time of 330 days allowed for CIRP including time spent in litigation.
- From the lender’s perspective, it laid down requirement of minimum payment of their share of liquidation value to FCs who do not vote in favour of the resolution plan.
- Another critical amendment related to recognition of *inter-se* priority of charge among the lenders which was an issue of intense debate till then [Section 30(4)].
- Section 31 of the Code amended to clarify the legal position that on approval, a resolution shall be binding, *inter alia*, on the Central Government, any State Government, or any local authority, guarantors and other stakeholders involved in the resolution plan.
- The committee of creditors (CoC) was given greater powers to recommend liquidation of a CD at any stage during CIRP before plan approval (Section 33).
- Introduced the concept of authorised representative of a class of creditors and precise voting mechanism for effective representation of such class [Section 21 (6A)(b)].
- Later, vide Notification dated November 15, 2019, the Central Government brought into force provisions of Part III of the IBC, providing for insolvency and bankruptcy for personal guarantors (PGs) to CD.

The fourth amendment brought on December 28, 2019 provided for the following:

- Introduced two critical provisions in section 14 of the Code, by clarifying that that a license, permit, registration, quota, concession, clearance or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority shall not be suspended or terminated on the grounds of insolvency, subject to the condition that there is no default in payment of current dues arising for the use or continuation of such license or a similar grant or right during moratorium period.
- Introduced section 32A which facilitated a ‘clean slate transfer’ of the CD to new resolution applicant after approval of resolution plan. It provided
immunity to the CD and its new management from any liability or prosecution for offence committed prior to the commencement of CIRP.

- Provided further that for FCs who are allottees under a real estate project, an application for initiating CIRP against the CD shall be filed jointly by not less than 100 of such allottees under the same real estate project or not less than 10% of the total number of such allottees under the same real estate project, whichever is less.

- Introduced provisions for continued supply of critical goods and services of CD.

- On March 24, 2020, the Ministry of Corporate Affairs (MCA) enhanced the minimum threshold for initiating CIRP from ₹ 1 lakh to ₹ 1 crore.

(v) Vide amendment dated June 5, 2020, section 10A was introduced which suspended filing of section 7, 9 or 10 applications arising out of defaults occurring on or after March 25, 2020, until the specified period.

(vi) The sixth and latest amendment came on April 4, 2021 which introduced pre-packaged insolvency resolution process for corporate MSMEs.

(b) Timely regulatory responses

In order to fill the gaps in the Code and also to keep the regulatory framework aligned with frequent changes in the Code, the legislative initiatives were very well supplemented by proactive regulatory interventions by the Insolvency and Bankruptcy Board of India (IBBI), Reserve Bank of India (RBI) and others starting with withdrawal of various RBI schemes vide its circular dated February 12, 2018, later replaced by circular dated June 7, 2019 which is now in force for the purpose of recasting of distressed loans outside courts/ NCLTs. Similar interventions from other regulators like Securities and Exchange Board of India/ MCA/ Competition Commission of India/ Central Board of Direct Taxes too contributed to the process remarkably such as notifications/clarifications on related issues like reduction of capital, delisting norms, issuance of capital/takeover code, competition related issues, taxation relief etc.

(c) Judicial interventions

Equally potent contributions came from the judiciary especially in some large ticket cases. Jurisprudence evolution in the form of judgements and orders from the Supreme Court (SC) was constantly supplemented by High Courts/National Company Law Appellate Tribunal (NCLAT)/ NCLTs. This was significant since various contentious issues which were not adequately addressed by the aforesaid legislative changes were captured by various judicial pronouncements. Some of such landmark judgements addressing major issues are discussed below:

The principle propounded by NCLAT and later upheld by the SC was that before approval of a resolution, the Tribunal must ensure and satisfy itself as to -

- Whether the plan is fair and equitable or there is an unjust discrimination not envisaged in law.
- Whether the plan adheres to the object of the Code i.e., maximizes the value of assets and balances the interests of stakeholders.


- The SC upheld the constitutionality of the Code. This judgment has brought the focus back on the object of the Code to revive a CD.
- It was noted that the IBC is a beneficial legislation, acting for the benefit of the CD, and thus the admission of a company into CIRP cannot be seen from a traditional lens of proceedings.
- The SC has also imported fair and equitable treatment of operational creditors (OCs) as a requirement for approval of resolution plans. This was brought about by amendments to the Code/Regulations that provide that OCs needs to be paid ahead of FCs.

iii. *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta & Ors.*

The SC in this case settled many important issues related to the CIRP under the IBC and set aside the judgment of the NCLAT which had set aside the decisions of the CoC of Essar Steel Ltd. It held that the NCLT and NCLAT must not trespass upon a commercial decision of the CoC. The decision of how much and what to pay the creditors lies with the CoC which must reflect three parameters of maximising value of assets of the CD, balancing the interests of all stakeholders, and ensuring that the CD is kept as a going concern during CIRP. There is a difference between equal and equitable treatment and hence the FCs and OCs cannot be treated equally as it would defeat the scheme of the Code.

The SC struck the word ‘mandatorily’ from section 4 of the Amendment Act of 2019 according to which a CIRP is required to be ‘mandatorily’ completed within 330 days from the commencement date. The SC observed that in exceptional cases, the 330 days’ limit may be extended.

It also gave a go- ahead to the sale of Essar Steel India Ltd., thereby helping banks to recover almost 90% of their dues worth ₹ 40,000 crore.


The NCLAT struck down the PG’s right of subrogation arising after the acceptance of
the resolution plan. This was again reiterated in the case of Committee of Creditors of Essar Steel Ltd. v. Satish Kumar Gupta.

Further, the SC in Lalit Kumar Jain v. Union of India\textsuperscript{11} held that in order to achieve the Code’s larger goal of reviving corporate entities, the PG’s right to recover the guarantee from the CD ceases to exist when the guarantee is invoked by a creditor. The bench upheld the constitutional validity of the notification dated November 15, 2019, which brought into effect specific provisions of the Code, concerning PGs of CDs. This was a major departure which greatly enhanced rights of the creditors against guarantors/promoters.

v. \textit{Manish Kumar v. Union of India}\textsuperscript{12}

In the instant case, the petitioners who were mostly allottees under the real estate projects challenged the constitutional validity of sections 3, 4 and 10 of the Insolvency and Bankruptcy Code (Amendment) Act, 2020 that amended section 7(1) of the Code and prescribed few restrictions on such allottees to initiate CIRP and also inserted a new section i.e., 32A (supra).

The SC upheld the constitutional validity of the impugned amendments rejecting all the averments put forth by the petitioners. This ruling demonstrated the dynamic nature of the law as being evolved under the IBC and the forward-looking approach of the Apex Court.

vi. \textit{Ghanshyam Mishra and Sons Pvt Limited v. Edelweiss Asset Reconstruction Company Limited}\textsuperscript{13}

The Apex Court determined two major issues and observed that section 31 unequivocally states that once a resolution plan is approved, it would be binding on all the creditors (including the Central Government, State Government, or any local authority), CDs, its employees, and other stakeholders. Furthermore, it was observed by the SC that all the claims that were not included in the resolution plan shall stand extinguished and all the creditors would be barred from recovering any of the dues from the CD accruing before the transfer of the management of the CD to the successful resolution applicant.

This decision of the SC will prevent multifarious litigations and provide an opportunity to the CD to start with a clean slate with no burden of past liabilities.

\textbf{IBC IMPACT SO FAR}

A quick look at some of the critical data as regards cases filed/resolved/liquidated & realisations as captured in Table 1 to 4 below demonstrates a mixed bag of hits and misses during the last five years under the IBC. The figures in Table 1 point out high percentage (47%) of closures under liquidation, though on a deeper analysis it will be observed that out of the total liquidation cases, 76% were referred from BIFR regime with most of such cases being default accounts for over a decade and mostly defunct for years. The IBC has helped in fast pacing this asset enforcement through liquidation.
Besides it can be readily seen that the balance 53% cases are those which are either successfully resolved through resolution plan approval or by way of withdrawal or settlement which indicates a healthy level of performance by the Code.

**Table - 1**

<table>
<thead>
<tr>
<th>Status of CIRPs as of June 30, 2022</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Status of CIRPs</strong></td>
<td><strong>No. of CIRPs</strong></td>
</tr>
<tr>
<td>Admitted</td>
<td>5636</td>
</tr>
<tr>
<td>Closed on Appeal/ Review/ Settled</td>
<td>774</td>
</tr>
<tr>
<td>Closed by withdrawal under section 12A</td>
<td>643</td>
</tr>
<tr>
<td>Closed by Resolution</td>
<td>517</td>
</tr>
<tr>
<td>Closed by Liquidation</td>
<td>1703</td>
</tr>
<tr>
<td>Ongoing CIRPs</td>
<td>1999</td>
</tr>
</tbody>
</table>

*Source: IBBI Quarterly Newsletter April – June, 2022.*

The Code started off with quick resolution timeframe. Resolution under IBC of the 12 large assets referred in the initial phase is indicated in Table 2 below.

**Table - 2**

<table>
<thead>
<tr>
<th>Status of 12 Large Accounts*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resolution plan approved</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
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<tr>
<td></td>
</tr>
<tr>
<td>Ongoing CIRP</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Liquidation ordered</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

*Source: IBBI Quarterly Newsletter April – June, 2022.*

*FCs had an aggregate outstanding claim of ₹ 3.45 lakh crore against liquidation value of ₹ 73,220 crore in all these 12 accounts. In the eight CDs resolved, there was total outstanding claims of ₹ 2.26 lakh crore against liquidation value of ₹ 0.52 lakh crore. Further, realisable value for FCs through the approved resolution plans was ₹ 1.16 lakh crore, which is 221% of the liquidation value and 51% of the admitted claims.*
However, substantial process delays has become the order of the day owing to frivolous applications, inadequate infrastructure, COVID-19 pandemic issues, adverse industry cycles etc., as visible in Tables 3 & 4 below. The said concern appears to be true to a great extent and calls for prompt remedial steps for a mid-course correction before it is too late to resurrect sentiments about the Code as had happened with other preceding regimes under the SICA, SARFAESI, DRT or the Companies Act, 2013.

### Table - 3

<table>
<thead>
<tr>
<th>Timelines: Ongoing CIRPs [1999] as of June 30, 2022</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 270 days</td>
<td>61%</td>
</tr>
<tr>
<td>&gt; 180 days &lt; 270 days</td>
<td>10%</td>
</tr>
<tr>
<td>&gt; 90 days &lt; 180 days</td>
<td>13%</td>
</tr>
<tr>
<td>&lt; 90 days</td>
<td>16%</td>
</tr>
</tbody>
</table>

*Source: IBBI Quarterly Newsletter April – June, 2022.*

### Table - 4

<table>
<thead>
<tr>
<th>Timelines: Liquidation cases as of June 30, 2022</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 2 years</td>
<td>49%</td>
</tr>
<tr>
<td>&gt; 1 year &lt; 2 year</td>
<td>27%</td>
</tr>
<tr>
<td>&gt; 270 days &lt; 1 year</td>
<td>5%</td>
</tr>
<tr>
<td>&gt; 180 days &lt; 270 days</td>
<td>7%</td>
</tr>
<tr>
<td>&gt; 90 days &lt; 180 days</td>
<td>6%</td>
</tr>
<tr>
<td>&lt; 90 days</td>
<td>6%</td>
</tr>
</tbody>
</table>

*Source: IBBI Quarterly Newsletter April – June, 2022.*

It is notable to mention that the total admitted claims of the creditors against the CDs rescued when they entered the CIRP till June 2022 was ₹ 7.67 lakh crores. Liquidation value of the assets of such CDs was ₹ 1.31 lakh crore against which the amount realised was ₹ 2.35 lakh crore which is more than 171% of the liquidation value of these CDs. Though recovery is incidental under the Code, the creditors recovered 30.64% of their claims, which reflects the extent of value erosion by the time the CDs entered CIRP, yet it is the highest among all options available to creditors for recovery.

## ISSUES LEFT UNRESOLVED AND KEY CHALLENGES AHEAD

The unprecedented proactive and dynamic role played by the legislature, regulator and the judicial forum has been discussed in great detail hereinbefore. However, as it is said, a good legal ecosystem is always work in progress and needs to be regularly improved taking cues from the learnings made and lessons learnt during the journey. In this respect, some of the unresolved issues and challenges are highlighted below, which, if addressed in time will go a long way to add to the strength and vigour of the Code and attract better investors including overseas investors:

- Lack of clarity on status of secured creditors under waterfall mechanism during liquidation.
• Rampant intervention by authorities like Enforcement Directorate under the Prevention of Money Laundering Act, 2002, attachment by SROs etc.

• Absence of definitive timelines and prescriptive guidelines for renewal of licences and permits from government agencies like mining leases, infra projects like power, ports etc. pursuant to resolution plan approval.

• Issues related to homebuyers where group insolvency dynamics are applicable, especially in cases involving project wise resolution instead of the CD itself.

• Lack of adequate control for FCs on the liquidation process especially when faced with a hostile or non-cooperative Liquidators, removal of Liquidator similar to change of Interim Resolution Professional / Resolution Professional.

• Resorting to frivolous litigations by promoters of the CD on issues like stamp duty or limitations issues and some NCLTs entertaining the same despite clear rulings by the SC in many cases.

• Absence of any timeline for NCLTs for plan approval or admission of section 7 petition or for disposal of appeals by NCLAT.

• Issues raised by RPs at the stage of claim admission.

• Absence of any dedicated NCLT Benches for IBC cases and avoidance proceedings.

• No strict liability of directors for wilfully delaying /concealing insolvency of company.

• Overall administrative infrastructure (NCLT/NCLAT) commensurate with the volume of cases under the Code.

CONCLUSION

Despite certain challenges faced so far, it deserves to be recognised that the IBC has significantly contributed to consistent improvement in India’s ranking in the World Bank’s erstwhile ‘Ease of Doing Business’ over the years. Other key positive pointers include improved percentage growth in overall recovery as compared to conventional recovery modes under SARFAESI / DRT or liquidation under High Courts, a feat that has been attained under the Code within a short span of four to five years. This is appreciable if viewed in comparison to some of the developed legal ecosystems across the global.

Besides, the data specified in the Tables above does not reflect the large number of out of court settlements by the promoters that have taken place due to real fear of losing control of the CD. The successful resolution of some of the large cases like Essar Steel / Bhushan Steel etc., involving very high-profile stakeholders, proved to be a real game changer when it came to removal of the entrenched managements.

Overall, the resolutions under the IBC witnessed greater transparency in process driven by market led forces, thereby enhancing investor faith in the whole process. However, after having seen off the bigger resolutions, we are now entering a phase where the real challenge would be to resolve smaller cases mostly in the MSME sector which may not attract pool of interested investors. Hence next phase of evolution should cover fine tuning of areas like personal insolvency, pre-pack regime and cross border insolvency.
It is equally important that adequate institutional capacity is added so that the IBC does not meet the same fate as previous reform initiatives such as the DRTs. Undertaking all these steps would take time and careful planning. Timely changes/modifications of the existing legislation and expanding to new areas (group insolvency, pre-pack process for all assets, cross-border insolvency regime) would facilitate overall improvement in the insolvency resolution regime of the country.
In mid 70s, satellite imagery of northern Africa showed an asymmetrical dusky expanse some 400 square miles, in essence a hedged area filled with green grass, juxtaposed against vast expanse of dry, arid tracts of land outside the fence. Probing minds found that the oasis was a private property, divided into five sub-parts where the owners would 'position' the cattle in one part each year by rotation, giving the other four parts sufficient time to regain the vigour. The endowment effect, coupled with ownership bias for the comparatively small piece of land by the owners ensured an incentive to invest in the asset that stood in stark contrast to uncontrolled demand and supply dynamics being played at the much larger, yet drying area outside as the 'carrying capacity' of the ecosystem was pushed to the brink through ever increasing, unchecked quantum of needs and herds. The ensuing drought played spoilsport, devastating the fragile ecosystem to a great extent. The disparity, and destruction looked baffling at first.

As the world looked back, the answer had been given nearly 170 years ago by Oxford economist William F Lloyd, who had assessed the eventual devastation of 'common pastures' (non-privately owned land) and its herd against the better maintained adjoining private enclosures in faraway Britain, concluding that each human exploiter of the 'common' was guided by self-interest alone. While the gains of adding an animal would go to the herd man, the loss incurred by overloading the pasture would be 'commonised' amongst the community. Beyond threshold, this privatised gain would outpace the share of commonised loss, which at a mass scale, would distort the common asset. It would be nearly impossible to reverse the process, Lloyd proposed, since even when herdsmen understood the long-run costs of their actions, in general, they were sans recourse to avert such damage without some coercive means that could control the actions of each individual, bringing semblances of justice at group levels. Thus, federal regulations initiated in time, with a futuristic bent, have a profound impact on the evolving course of trajectory that shapes contours of a nation embarking on unparalleled growth with equity for all.

'Tragedy of the commons', as the above phenomenon is known, in terms of corporate India got averted through the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/ Code), as ‘self-interest' of individual was fine-tuned to meet the goal of ushering in greater good through structural changes, most important being positioning creditors at the core of the governance of corporate insolvency resolution processes (CIRPs) that has led to a surreptitious change in behavioural aspects of all the stakeholders, notably corporate
debtors (CDs) (while also nudging financial creditors (FCs) to evolve and adapt) that is steering forward the momentum as India seeks new highs in the rescripted world order, navigating through black swan events of pandemic and war.

The Cork Committee, whose approach paper in 1977 led to the formation of insolvency laws in UK in 1986, pushed for formal rehabilitation of revivable units, arguing insolvency laws were treated by the trading community as an instrument in the process of debt recovery and constituted, in many cases, the sanction of last resort for the enforcement of obligations; also insolvency laws were the means by which the demands of commercial morality could be met, through the investigation and the disciplinary measures and restrictions imposed on the bankrupt. Resolution was envisaged and embedded as a natural corollary in evolution of business and commerce to the next normal.

The enactment of IBC in May, 2016 was a watershed moment in India’s resolution to embrace a pragmatic, business conducive environment aligned with the ever-increasing globalised economy. Built on the fallen ramparts and edifices of the Presidency Towns Insolvency Act, 1909, the Provincial Insolvency Act, 1920, the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Recovery of Debts and Bankruptcy Act, 1993 as also the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 which individually, and in conjoined way did not yield desired results, the IBC was instrumental in improving India’s ranking in ease of resolving insolvency indicators internationally. India’s rank moved up to 52 from 136 in terms of ‘resolving insolvency’ in three years in the World Bank’s Doing Business Reports (overall rank now 63 from 142 in 2014) as IBC framework has been compared to those prevailing in better rated OECD countries. In the Global Innovation Index, India’s rank improved from 111 in 2017 to 47 in 2020 in ‘Ease of Resolving Insolvency’. Though, it is, still a ‘story in the making’ with the best part(s) yet to come.

The history of evolution of insolvency laws globally shows how public perception of insolvency of business has changed over time. Historically, insolvency was associated in a decidedly personal manner to the debtor, wherein facets of vanity, pride and an inflated propensity to speculate were often considered as reasons for insolvency, prompting the Roman notion of fallitus ergo fraudator (insolvent thus a swindler) labelling all bankrupts as dishonest. However, as bankruptcy systems slowly emerged with growth of trading and emergence of commercial towns in Europe, insolvency notions were detached from personal touch, with corporal punishments for debtors giving way to financial penalties and later by management ceding control. Multiple reasons for insolvency came to fore like business cycle movements, changes in credit market, rise and fall of many empires by the time joint stock companies emerged on the scene by mid-nineteenth century. Thus, insolvencies came to be decoupled from moral failure and allied to economic reasons for failure. It became easier for entrepreneurs to exit in case of non-wilful/honest business failure and come up with new businesses wherever feasible, thus keeping the giant wheels of the economy in perpetual, upwardly inclined motion.
Experiences demonstrate the extent to which the absence of orderly and effective insolvency procedure mechanisms can exacerbate economic and financial crises. Without effective procedures that are applied in a predictable manner, creditors may be unable to collect on their claims, which will adversely affect the future availability of credit. Without orderly procedures, the rights of debtors (and their employees) may not be adequately protected, and different creditors may not be treated equitably. In contrast, the consistent application of orderly and effective insolvency procedures plays a critical role in fostering growth and competitiveness and also assists in the prevention and resolution of financial crises: such procedures induce greater caution in the incurrence of liabilities by debtors and greater confidence in creditors when extending credit or rescheduling their claims later.

Some excerpts from the Report of Bankruptcy Law Reforms Committee of November, 2015, providing insight into why the Code was enacted and the purpose for which it was enacted, give a peek into the requirements that stressed upon preambles woven around low time to resolution, low loss in recovery and higher levels of debt financing across a wide variety of debt instruments:

....India is one of the youngest republics in the world, with a high concentration of the most dynamic entrepreneurs. Yet these game changers and growth drivers are crippled by an environment that takes some of the longest times and highest costs by world standards to resolve any problems that arise while repaying dues on debt.

....the recovery rates obtained in India are among the lowest in the world. When default takes place, broadly speaking, lenders seem to recover 20% of the value of debt, on an NPV basis.

When creditors know that they have weak rights resulting in a low recovery rate, they are averse to lend....

The key economic question in the bankruptcy process remains envisaging the best recourse when default occurs. Many possibilities can be envisioned. One possibility is to take the firm into liquidation (hitherto, facilitated by High Courts in India). Another possibility is to negotiate a debt restructuring, where the creditors accept a reduction of debt on an NPV basis and expect that the negotiated value exceeds the closing value. Another option is to sell the firm as a going concern and use the takeaway to pay creditors. Many hybrid structures of these broad categories can be envisioned thus.

As per the statement of objects and reasons of the IBC, and its preamble, the objective of the IBC is to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons (inclusive of partnership firms and individuals) in a time bound manner, inter alia, for maximisation of the value of the assets of such persons, promoting entrepreneurship and availability of credit, balancing the interest of all the stakeholders and matters connected therewith or incidental thereto.

Under IBC mechanism, the trigger for a FC’s application is non-payment of dues when they arise under existing loan agreements. It is for this reason that section 433(e) of the Companies Act, 1956 (‘...if the company is unable to pay its debts’) has been repealed by the Code, bringing a sea change in approach. Legislative policy now is to move away from the
concept of ‘inability to pay debts’ to ‘determination of default’. The cited shift enabled the FC to prove, based upon solid documentary evidence, that there was an obligation to pay the debt and that the debtor has failed in discharge of such obligation.

The first order objective of the Code is resolution. The second order objective is maximisation of value of assets of the firm and the third order objectives remains promoting entrepreneurship, availability of credit and balancing the interests of stakeholders which together create, nourish, and anchor a self-sustaining ecosystem boding well for the equitable and sustainable growth of economy. The trifecta of objectives should actually evolve, going forward, in strengthening the third objective to make the IBC truly the last resort.

The objective of the Code has three underlying elements that benefit the entire ecosystem as it gears towards better efficiency and transparency viz.:

**Prevention:** Prevention of financial stress in unavoidable circumstances while creating a conducive environment that dissuades promoters from operating below the optimum level of competence. The IBC stimulates them to make the best efforts towards avoidance of default, that spurs ceding control of enterprise eventually while nudging them to make settlements efforts with the creditor(s) at the earliest, preferably outside the Code. Also, the CIRP undoes avoidance transactions, and necessitates the beneficiary of such transactions to disgorge the value, thus taking away the incentive to indulge in vulnerable transactions *inter alia* ensuring a sea change in creditor-debtor relationship.

**Time value of money:** The Code necessitates resolution in a time bound manner as excessive delay is most likely to diminish the organisational capital of the company. When the company is not in the best of its health, protracted uncertainty about its ownership and control makes the prospects of resolution remote, thereby impinging on economic growth. The Code entitles the stakeholders to initiate CIRP as soon as there is threshold amount of default to limit the stress from expanding to unresolvable proportions. In early days of default, enterprise value is typically higher than the liquidation value and hence the stakeholders would be motivated to resolve insolvency of the company rather than to liquidate it. The Code requires that a CIRP shall mandatorily be completed within a timeline. Timeline is, in essence, the ‘unique selling proposition’ of the Code. The Code segregates commercial aspects of insolvency resolution from judicial facets and empowers stakeholders and the Adjudicating Authority to decide matters within their provinces expeditiously.

**Freeing up economic resources for a circular economy:** The Code provides a mechanism for a company, where resolution is neither possible nor desirable, to exit with the least disruption and cost and release idle resources in an orderly manner for fresh allocation to efficient uses since for a market economy to function efficiently, the process of creative annihilation should be adapted to weed out failing,uviable companies in a continual manner.
PRELUDE TO IBC

Between 2006-11, corporate India witnessed rapid disbursal of loans by banks/overlending, envisioning incremental demand led capital generation to anchor repayment obligations though commensurate investment activities did not yield desired fruits, resulting in humongous piling of stressed assets in the system. The asset quality review (AQR) mechanism of the regulator to recognise non-performing assets (NPAs) accelerated the labelling of bad loans, their percentage increasing from 4.6% in 2014-15 to 11.2% by end of March, 2018. The consequences for an emerging economy, with second largest population that was saddled with legacy baggage of recent past could be unparallelly disastrous, to speak the least. The gloomy mood in the banking community and the ensuing blame game could thwart the economic aspirations of the corporate India to a full stop as bankers would have been preoccupied in cleaning the balance sheet, with even worthy credit proposals biting dust in the slush pile. The IBC, in true sense, averted the ‘lost years’ tag for us, waiting in the annals of impending future.

In early 2014, establishment of Credit Repository of Information on Large Credits (CRILC) was a landmark event for the banking industry wherein the regulator bridged the information asymmetry prevalent among different banking entities for larger advances (above ₹ 5 crore), also bringing uniformity amongst bankers in initiating a quantifiable and effective co-ordinated action, particularly on classification and subsequent remedial measures front, for advances under consortium/multiple banking arrangement. AQR and CRILC gave the regulator a holistic systemic view, laying bare the maze that had knotted through the Corporate Debt Restructuring mechanism in the last decade as ‘ever greening’ had become a norm for certain counterparties under the guise of non-recognition of
incipient default, and thus non-classification of bad debts by banking system that was mothballing the issue with band-aids, though the rolling ball had gathered unsustainable momentum. The substantial number of failed restructurings necessitated an insolvency resolution mechanism thus and time was of utmost essence. While the borrowing class could secure very high amount of funding from the banking system, which itself has access to theoretically unlimited uncollateralised funding from the common persons essentially by virtue of its licence to carry out banking activities, the seemingly subordination of senior debt to equity (as borrowers had unending ‘recourse to restructuring loops’) was a threat to systemic equilibrium and future ability of banks to secure funding from the general public as trust capital was eroding fast. While many puritans have been busy pointing the comparatively lower realisations for lenders through the IBC on a sequential basis, they seem to ignore, ‘on purpose’, the frugal ‘opportunity cost’ and slim ‘efficacy’ of the alternate mechanisms and the bittersweet lessons learnt from the debt resolution mechanism, in vogue for one and a half decade that had essentially put the system closer to a ticking time bomb. Also, it would be worth to consider the time as well as process orientation envisaged by the Code, side stepping the onerous burdens embedded in alternative mechanisms’ limited effectiveness and efficacy while assigning the discount factors.

### Recovery rate for lenders under IBC

<table>
<thead>
<tr>
<th>Period</th>
<th>Realisable by FCs as a % of their claims admitted</th>
<th>Realisable by FCs as a % of their liquidation value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to March, 2020</td>
<td>45.96</td>
<td>183.37</td>
</tr>
<tr>
<td>Up to June, 2020</td>
<td>44.70</td>
<td>183.59</td>
</tr>
<tr>
<td>Up to September, 2020</td>
<td>43.56</td>
<td>185.15</td>
</tr>
<tr>
<td>Up to December, 2020</td>
<td>39.80</td>
<td>181.70</td>
</tr>
<tr>
<td>Up to March, 2021</td>
<td>39.30</td>
<td>179.90</td>
</tr>
<tr>
<td>Up to June, 2021</td>
<td>36.00</td>
<td>167.95</td>
</tr>
<tr>
<td>Up to September, 2021</td>
<td>35.89</td>
<td>166.57</td>
</tr>
<tr>
<td>Up to December, 2021</td>
<td>33.10</td>
<td>165.79</td>
</tr>
<tr>
<td>Up to March, 2022</td>
<td>32.90</td>
<td>171.40</td>
</tr>
</tbody>
</table>
## Movement of NPAs for SCBs: The Orderly Evolution

<table>
<thead>
<tr>
<th>Year (End of March)</th>
<th>Scheduled Commercial Banks</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Non-performing Assets</td>
<td>Non-performing Assets</td>
</tr>
<tr>
<td></td>
<td>Gross</td>
<td>Net</td>
</tr>
<tr>
<td></td>
<td>Amount</td>
<td>As % of gross advances</td>
</tr>
<tr>
<td>1996-97</td>
<td>473</td>
<td>15.7</td>
</tr>
<tr>
<td>1997-98</td>
<td>508</td>
<td>14.4</td>
</tr>
<tr>
<td>1998-99</td>
<td>587</td>
<td>14.7</td>
</tr>
<tr>
<td>1999-00</td>
<td>604</td>
<td>12.7</td>
</tr>
<tr>
<td>2000-01</td>
<td>637</td>
<td>11.4</td>
</tr>
<tr>
<td>2001-02</td>
<td>709</td>
<td>10.4</td>
</tr>
<tr>
<td>2002-03</td>
<td>687</td>
<td>8.8</td>
</tr>
<tr>
<td>2003-04</td>
<td>648</td>
<td>7.2</td>
</tr>
<tr>
<td>2004-05</td>
<td>574</td>
<td>4.9</td>
</tr>
<tr>
<td>2005-06</td>
<td>518</td>
<td>3.3</td>
</tr>
<tr>
<td>2006-07</td>
<td>505</td>
<td>2.5</td>
</tr>
<tr>
<td>2007-08</td>
<td>566</td>
<td>2.2</td>
</tr>
<tr>
<td>2008-09</td>
<td>700</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Over time, the Code has undergone continuous changes, overcoming barriers while adapting to the growing corporate and economic needs of the country, providing for reorganisation to rescue a distressed company if its business is viable or close it if its unviable, through a market driven process. Progress made under the Code and problems encountered have now opened up avenues for further refinements in the resolution processes. The IBC assigns the responsibility of reorganisation of a company in stress to FCs, not only because they have the wherewithal/competence to take appropriate business decisions and the willingness to restructure their claims, but largely because their interests are aligned with the interest of the company having going concern surplus, making it a ‘positive sum game’. The Code has been instrumental in getting rid of the ‘negative sum game’ where all the creditors would rush to stake claims and recover thereupon individual priority basis, triggering a run on the assets of the company in insolvency, jeopardising the economic interests without recourse for other concerns in stress and the business environment.
Inculcating a credit culture amongst borrowers has been the largest success of the nascent Code as it has rescripted the borrowers’ behaviour towards managing the affairs of the entity/company, a large part of whose resources are funded through FCs. The cleaning of the slate and the changed mentality of people running the show also aided the policy makers in firmly launching the slew of initiatives during the hazy and bleak days of pandemic through Emergency Credit Line Guarantee Scheme (ECLGS) that went a great length in stabilising the economy and reinvigorating the animal spirits now.

**ECLGS announcements for corporate India**

<table>
<thead>
<tr>
<th>PART 1</th>
<th>PART 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SN</strong></td>
<td><strong>ITEM</strong></td>
</tr>
<tr>
<td>1.</td>
<td>Emergency W/C Facility for Businesses, incl MSMEs</td>
</tr>
<tr>
<td>2.</td>
<td>Subordinate Debt for Stressed MSMEs</td>
</tr>
<tr>
<td>3.</td>
<td>Fund of Funds for MSME</td>
</tr>
<tr>
<td>4.</td>
<td>EPF Support for Business &amp; Workers</td>
</tr>
<tr>
<td>5.</td>
<td>Reduction in EPF rates</td>
</tr>
<tr>
<td>6.</td>
<td>Special liquidity Scheme for NBFC/HFC/MFIs</td>
</tr>
<tr>
<td>7.</td>
<td>Partial credit guarantee Scheme 2.0 for Liabilities of NBFCs/MFIs</td>
</tr>
<tr>
<td>8.</td>
<td>Liquidity Injection for DISCOMs</td>
</tr>
<tr>
<td>9.</td>
<td>Reduction in TDS/TCS rates</td>
</tr>
</tbody>
</table>
As per State Bank of India research undertaken in end of December, 2021, close to 13.5 lakh micro, small and medium enterprise (MSME) accounts were saved due to ECLGS (including restructured): Almost 93.7% of such accounts are in micro and small category. In absolute terms, MSME loan accounts worth ₹ 1.8 lakh crore were saved from slipping into NPA during the period. This is equivalent to 14% of the outstanding MSME credit being saved from becoming NPA. Around 1.5 crore workers could be saved from unemployment thus, also saving livelihood for 6 crore members of families).

Despite multiple efforts in the past, corporate finance remains skewed with nearly negligible corporate debt, non-bank loans, and unsecured loans vis-à-vis debt financing by banks. The act incentivises creditors - secured and unsecured, bank and non-bank, financial and operational, foreign, and domestic - to extend credit at lower costs, particularly when they have rights under the Code to initiate CIRP in case the CDs default on agreed repayment obligations. Through provisions for resolution and liquidation, the Code enables creditors to recover their dues through a slew of mixes/measures, thus bolstering credit dispensation to worthy suitors.

Further, the mounting bad debts create a vicious cycle where viable and feasible projects are elbowed out, with riskier projects getting the green signal, even at pricey terms. The Code, through provisions for resolution and liquidation, facilitates lenders to recover sans much hassles in a time bound manner while exerting a moral pressure on the promoters to do everything they can to keep the control with them. This ever-evolving dynamism in the system accelerates investments while enabling optimum utilisation of resources.

As the Report of the Working Group on Tracking Outcomes under the IBC released in November, 2021 rightly spells:

The Code has triggered a systemic response to the underlying attitudinal problems in the creditor-debtor relationship and is acting as a prophylactic for an acute condition. Initiation of insolvency proceedings at the early stage of default increases chances of resolution thereby enabling bankers to keep an earning asset on their books during the term of a loan. The difficulty in explaining the undue delay in using the Code may discourage any unholy ties between lender and borrower, consequently reducing the chances of high-value defaults and frauds. A deeper, healthy, and desirable change for banks is the obligation they now feel towards more responsible and clean lending, to begin with. For the business debtor, the threat of a resolution process shifting control of the company away from the promoters is real and is serving as an effective deterrent. They have every incentive to not default or operate at below optimal levels leading to distress conditions. The debtors are encouraged to settle default with the creditor(s) at the earliest, preferably before an IBC process is initiated.

There are also big macroeconomic objectives at play such as solving the twin balance sheet problem; evolving a deep, robust and vibrant corporate bond market in sync with cultivating the well-entrenched banking credit environment, consequently providing a fillip to India’s claims towards a competitive business destination in emerging global supply chain where most chaebols are looking at ‘Plus ONE strategy’, relocating part production from erstwhile factory to the world.
While the IBC has certainly helped in resolving companies with larger financial value, it has faced limitations in addressing distress situations for smaller enterprises. The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 was promulgated with a focused agenda for the corporate MSMEs in the form of the pre-packaged insolvency resolution process that involves very limited role of courts and thus looks set to provide a faster and efficient corporate rescue plan, broadening the scope and capacity of the IBC. It is a major advancement towards adopting out of court workouts as the way forward for achieving faster resolution and minimum distortion of value of assets. This not just impacts the corporate health of the country but translates into the overall growth prospects. Such provisions will act as incentives for greater investments and improve India’s position on several global indices. Increased focus on mediation and conciliation should augment the ecosystem even as more corporates and start-ups would be looking after hitting the street to mop up funds through equity financing route, giving millions a chance to own equity.

In its six years existence, the IBC has walked a chequered path, meeting a formidable nemesis in the form of COVID-19, delays and procrastination tactics through 'looking for loopholes' mentality and seeking multi-tiered legal recourses as also, of late dwindling recovery for classes of creditors but it would be imprudent to deny its towering presence and overarching impact on creating a conducive environment, within the ambit of laid down rules, that fosters efficiency, innovation and competitive ecosystem, quintessential ingredients for success of businesses in a globalised world.

Going forward, a slew of reforms like mandating reliance on Information Utilities (IUs) for establishing default, bringing enhanced clarity on continuation of proceedings for avoidable transactions and improper trading after CIRP, change in threshold date for look-back period of avoidable transactions aligning it with date of filing of application for initiation of CIRP instead of the date of commencement, timeline for approval or rejection of resolution plan, guidelines for standard of conduct of the committee of creditors, mandatory consultation by the Liquidator with the stakeholders’ consultation committee, amending secured creditor’s contribution (of those who step out of the liquidation process) in workmen’s dues or liquidator expenses in preserving assets, amending mechanism for terminating a voluntary liquidation process, amendment of section 224 of the IBC to empower the Central Government towards prescribing a detailed framework for contributions to and utilisation of the IBC fund and separate appellate mechanism for orders issued under section 220 by the Insolvency and Bankruptcy Board of India and its disciplinary committee should revive and reinvigorate this all-encompassing law. Also, the IBC provisions relating to individual insolvency dealing with fresh start process, proprietorship, and partnership firms and other individuals through Debt Recovery Tribunals are yet to come into force.

The transformational law, in a short lifetime, has seen volleys of rulings and judgements, alongside some conflicting ones that seemingly question the very essence of the purpose behind the enactment of the law i.e. the appropriate disposition of a defaulting firm is a business decision, and only the creditors should make it. The apprehensions that many CDs may use the recent judgement (SC judgement in *Vidarbha Ind. v. Axis Bank*, Civil appeal No. 1103 of 2021)
4633 of 2021) to shield from future proceedings by citing flimsy grounds that camouflage their ability to repay to FC, can in fact take the IBC to the road traversed by earlier SICA and its catastrophic consequences on the newfound economic vigour. While a few genuine exceptions are a given, tweaking this crucial pivot can push us to the pre-IBC hey days. The only problem is that the stakes are much higher for our country, the largest democracy and the fifth largest economy, this time as we embark on a $5 trillion economy status in next few years and seek to become the third largest economy that paves the way for joining the developed economies league by the time the young and restless nation turns 100. The country is emerging as a frugal hot bed of innovation, deeply leveraging technology and digital rails being put in place, upended by the India stack riding the smartphones and easy data availability wave that promises to incubate this can-do attitude. We definitely need a strong and willing banking system to anchor this positive exuberance in full.

Globally, the withdrawal of support measures for companies sets the stage for a gradual normalisation of business insolvencies. The Allianz Global Insolvency Index predicts likelihood of posting a +15% y/y rebound in 2022, after two consecutive years of decline (-6% forecast in 2021 and -12% in 2020), the underlying reason being massive state intervention that helped prevent one out of two insolvencies in Western Europe and one out of three in the US, resulting in a -12% drop overall in 2020. Going ahead, it is expected that a fine-tuned and step-by-step withdrawal of support to manage the pressure on companies’ liquidity and solvability amid the generally accommodative policy stance of monetary authorities should emerge. As a result, global business insolvencies are likely to remain at a low level in most countries in near term (further accentuated by lingering war in Europe), with the delayed normalisation only gaining traction once the situation normalises though, even then, they would remain below pre-COVID-19 levels in most countries (by -4% on average).

The IBC promoted IU’s, together with CRILC and Reserve Bank of India fraud registry should endeavour towards creating a self-sustaining ecosystem, striving to bridge information asymmetry that in particular disincentives the smaller players in a fast morphing environment where deep tech and deep pocket entities sway ever greater power on terms of trade. There should be a gradual yet structural shift to harmonise the different credit markets, facilitating the ‘big’ picture by joining the prints from informal borrowings and private credit markets vis-à-vis institutional sources, borrowings against pledged shares, inter-corporate deposits, evaluation of personal guarantees on an on-going basis etc. The IBC was conceptualised as a last recourse and it would be worth a shot to enhance information sharing and creating models with credit information companies to capture the industry specific trends emanating, pricing in the past trends from a sufficiently longer tenor appropriately to assemble leading indicators that induce remedial measures in time.

Bankers, as a class, suffer from inability to access empirical data (qualitative as also quantitative) that gives a peek into the causes and effects of deterioration in assets quality over years, the connect the dot synopsis between different industries viz. if cyclicals have
a bearing on non-cyclicals and vice versa, co-relation between various asset classes (*akin to finance*), if rising interest rates can alter foundation of certain sectors in long term and if pilferages from one country can have a cascading effect on others in the value chain. While the IBC can play its part in timely resolution and realisation, the ecosystem will have to look beyond the IBC framework in silos and strive to connect the dots towards the next. It is the concerted nudge by multiple policy initiatives, well sharpened by regulatory forbearance and fortitude and action at ecosystem level that ensures the economy taking meaningful strides in its pursuit of the next.

Ancient India had well documented laws, through *smritis*, that defined the concept of debt (*rinn*) and its repayments, binding the persons as well as successors/heirs/coparceners/sureties through legal, as well as moral loops, incorporating the concept of *infinite sin continuum* for an indebted person upon death if the payment is not made. Acts like the IBC have ensured enactment of speedy laws and bodies like the NCLT/NCLAT which are, in a sense, Governments within a Government (*imperium in imperio*), carrying out governance on behalf of Government in a defined framework. As the modern day *smriti*, it has done its job well, evolving into the public good that is essentially for the public, by the public, of the public in the larger interest of the public.
Part II
Improvement in Processes
Various consistent judgments of the Hon’ble Supreme Court stipulate what the Adjudicating Authority (AA) is supposed to look into in a resolution plan submitted for approval under the Insolvency & Bankruptcy Code, 2016 (IBC/Code). The power of the AA is very tightly circumscribed when it comes to approval of resolution plans under the Code. This concerns just one section – or rather sub-section 2 of section 30 of the Code. The irony is that this is the same thing that the Resolution Professional (RP) is also supposed to look into when he or she commends the resolution plans for approval of the Committee of Creditors (CoC). Every other compliance i.e., regulations 37, 38 and 39 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) is left to the CoC and is in the occupied field of the CoC’s commercial wisdom.

Why is this so? This is so because of several reasons –

(a) Firstly, the insolvency law balances several things – rescuing businesses, protecting the interest of creditors, ensuring higher recovery rates, immediate liquidation in the event of a failed resolution, freeing up resources for redeployment, removing the stigma associated with failure of business etc.¹

(b) Secondly, an AA is ill-equipped to go into the feasibility and viability aspect, and is best left to the CoC to decide, after taking expert opinion.

(c) Thirdly, report of the Bankruptcy Law Reforms Committee (BLRC) explicitly identified adjudicatory mechanisms as one of the two most important sources of speedy resolution. Therefore, any delay in this adjudicatory process will defeat the objective itself.

The Supreme Court recognises this in Ebix Singapore Pvt. Ltd. v. Committee of Creditors of Educomp Solutions Ltd. & ors.;² Speaking through Justice Chandrachud, it observes that upholding the procedural design and sanctity of the process is critical to its functioning. It goes on to sound a note of caution ‘the interpretative task of the adjudicating authority, appellate authority and even the Supreme Court, must be cognisant of, and allied with that objective.’³ It advocates that, ‘any claim – seeking an exercise of the Adjudicating Authority’s residuary powers under section 60(5)(c) of the IBC, the NCLT’s inherent powers under rule 11 of the NCLT Rules, 2016, or even the powers of the Supreme Court under Article 142
of the Constitution, must be closely scrutinised for broader compliance with the insolvency framework and its underlying objective'. The adjudicating mechanisms which have been specifically created by the statute, have a narrowly-defined role in the process and must be circumspect in granting reliefs that may run counter to the timeliness and predictability that is central to the IBC. Any judicial creation of a procedural or substantive remedy that is not envisaged by the statute would not only violate the principle of separation of powers, but also run the risk of altering the delicate coordination that is designed by the IBC framework and have grave implications on the outcome of the corporate insolvency resolution process (CIRP), the economy of the country and the lives of workers and other allied parties who are statutorily bound by the impact of resolution or liquidation of a corporate debtor (CD).

Broadly, there are four statutory provisions which deal with resolution plans substantively. These are - section 30(2) of the Code (submission of the resolution plan), regulation 37 of CIRP Regulations (which deals with the measures necessary for insolvency resolution of the CD), regulation 38 of CIRP Regulations (mandatory contents of the resolution plan), and regulation 39 of CIRP Regulations (approval of the resolution plan). If we are able to stick to the straight and narrow, as we indeed should, then there would be no problem as such.

Delay in the approval of the resolution plan will erode the substratum of the plan itself, thus defeating its purpose. The supremacy of the CoC’s commercial wisdom, and the fact that it is non-justiciable, has been stated in many judgments, most notably in *K. Sashidhar v. Indian Overseas Bank*, *Committee of Creditors of Essar Steel v. Satish Kumar Gupta*, *Maharashtra Seamless Ltd. v. Padmanabhan Venkatesh*, and further reinforced in *Kalpraj Dharamshi & anr. v. Kotak Investment Advisors Ltd. & anr.* Obviously, the AA would be well advised to have this in the back of the mind when approaching the question of grant of approval for resolution plans. But in practice, this is easier said than done.

Interlocutory applications (IAs) filed by various parties for a wide variety of reasons delay this seemingly simple process, sometimes for months on end. Invariably, around the time that the RP is filing the application for approval of the resolution plan, would come a spate of IAs. In my limited experience on the Bench, I can categorise them into following six classes -

(a) **Applications challenging the eligibility of the successful resolution applicant**

Of these, applications impugning the eligibility of the successful resolution applicant are somewhat challenging. These would invariably revolve around section 29A of the Code. The AA has no option but to hear, and hear expeditiously.

(b) **Applications filed by the unsuccessful resolution applicant or applicants challenging the process itself**

The next set of circumstances usually revolves around the fact that time was extended by the CoC as a result of which new players came in, or that there was a violation of the process document or the request for resolution plans document. These would amount to material
irregularity, at best. As far as such irregularities are concerned, we have the judgment of the Supreme Court in *Kalpraj Dharamshi & anr. v. Kotak Investment Advisors Ltd. & anr.* In this, the Supreme Court found that even if the RP had accepted the resolution plans submitted by others after the timelines had expired but within the overall CIRP period, it was quite alright since such actions had the blessings of the CoC.

(c) Applications stating that section 12A proposal filed by the promoters has not been considered by the CoC, or not considered seriously enough by the promoters.

Applications alleging that the section 12A proposal filed by the promoters have not been considered by the CoC, or not considered seriously enough by the promoters are fairly common, though one would imagine that it might not be so. The promoters wait till Form G is issued inviting expression of interest (EoI), the entire process of deliberations and voting to be completed, and then come up with a section 12A proposal. A section 12A proposal cannot be pitched alongside a resolution plan for comparison. If the CoC does not accept the section 12A proposal, there is nothing that the AA can do. There is nothing that it ‘should’ do.

(d) Applications challenging the constitution of the CoC, or the voting percentage of various constituents of the CoC

This again presents a fair bit of challenge, and it is something that will affect the outcome of the CoC’s voting. Therefore, such applications will have to be heard expeditiously. The main opposition to such applications will usually centre around the locus of the applicant to mount the challenge. In my view, the issue of *locus* should be treated as immaterial, since we are basically dealing with the sanctity of the CIRP itself. We must tackle the bull by its horns, and look into the challenge itself. Once it is brought to the notice of the AA that there may be a material irregularity in the constitution of the CoC, the challenge regarding *locus* must be brushed aside and the larger issue must be dealt with.

(e) Applications filed by creditors challenging the rejection of their claims by the RP

In many cases, the RP does not apply his mind to the documents submitted with the claim, and would rather err on the side of the safety. He does not accept the claim. The applicant then rushes to the AA. In most cases, when the RP is asked as to what further documents are required in support, we have found that the RP does not really have any answer. The RP really wants an order of court, just to obviate any questions later on from the Insolvency & Bankruptcy Board of India (IBBI). This is true in about 90% of the cases. The RP is afraid of committing an error, and having to face a show-cause notice from the IBBI. During the pendency of the application, there is no mention of the claim even in the information memorandum (IM). Therefore, the prospective resolution applicant is not put on notice. If it is a huge claim, then the prospective resolution applicant would really like to have a rethink on the issue. This impacts the IM itself. A wrong picture presented in the IM will not lead to the right prospective resolution applicants.
(f) Avoidance transactions applications

Here, there was really no problem until the judgment of the Hon’ble Delhi High Court came about in *Venus Recruiters Private Limited v. Union of India & ors.* Until then, resolution plans were being considered *de hors* such applications. But *Venus Recruiters* apparently threw a spanner in the works. That it is not so, is a different matter altogether. The question in *Venus Recruiters* was this - whether an application filed under section 43 for avoidance of preferential transactions can survive beyond the conclusion of the resolution process and the role of the RP in pursuing such applications. Para 84 of the judgment lays down that the applications cannot survive the CIRP itself, which comes to an end with the approval of the resolution plan. In para 88, the Court held that if there are any objectionable transactions, the order in respect thereof will have to be passed prior to the approval of the resolution plan. In para 92, it said that the parties will have to be left to their civil and other remedies in terms of the contract between them. Unfortunately, one stray sentence in para 89 is quoted to say that the RP or the resolution applicant can still maintain an application. This sentence reads, ‘the NCLT also has no jurisdiction to entertain and decide avoidance applications in respect of a corporate debtor which is now under a new management, unless provision is made in the final resolution plan’.

After this judgment, the resolution plans now come with a standard sentence: ‘if there are any avoidance applications pending, the same shall inure to the benefit of the creditors’. An omnibus paragraph like this will not do, since that was hardly the ratio of the judgment. Such transactions will have to be specifically identified in the plan itself, and the course it would take will have to be provided for.

A question naturally arises - why are avoidance applications pending? The answer is - regulation 35A of the CIRP Regulations is not complied with. There is no independent application of mind by the RP in arriving at a determination as required in sub-regulation (2) thereof. The RP simply acts as a conduit to place the report of the transactional auditor before the AA for orders. During my time on the Bench, I have not found any effective compliance with the judgment of the Hon’ble Supreme Court in *Anuj Jain, IRP of Jaypee Infratech Ltd v. Axis Bank Limited.* Para 31.1 of the judgment lists out the filtration process that the RP has to do with the preferential transactions. We have held in a number of cases that the timelines required to be followed in terms of regulation 35A should necessarily be done, and it cannot be an open-ended process – preliminary opinion within 75 days of commencement of CIRP, determination within 115 days, application to be filed within 135 days, and intimation to the IBBI within 140 days. If this is not done, then there is no way a CIRP can be concluded within the stipulated period of 180 days.

An order granting approval for resolution plans would invariably include details such as preliminary details on admission of the CD to insolvency, details of appointment of the RP, the date of constitution of the CoC, number of meetings of the CoC held and the dates thereof, date of issue of Form G inviting EoI under regulation 36A of CIRP Regulations, CoC meetings regarding extension of dates for submission of interest, date on which the CoC
considered the same, etc. The attachments to such applications could also be standardised, by listing out the enclosures that should invariably accompany such applications. Valuable time of the bench and of the research associates is lost in looking for details from the interlocutory applications, and such standardisation will help in trimming the timelines considerably.

Rather than cribbing about the undue delays, we could consider certain steps in this regard. One such step in the direction of speeding up the approval for resolution plans may be part- standardisation of the resolution plan order. The last part of such an order may be left to the AA to fill up. This part will pertain to the actual analysis of the plan and the orders passed thereon. The IBBI can consider issuing certain practice directions for use by the RPs in this regard.

2. Civil Appeal No. 3224 of 2020 with other appeals.
3. Ibid., para 115.
4. Ibid., para 116.
6. Civil Appeal No. 8766-67 of 2019 and Ors.
9. Ibid.
10. WP (C) 8705-2019 and CM APPL 36026-2019.
11. Civil Appeal Nos. 8512-8527 of 2019 with other appeals.
One of the objectives enshrined in the preamble of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) is to balance the interest of stakeholders during the resolution and liquidation process of the corporate debtor (CD). Balancing the interest of stakeholders involves understanding and respecting the aspirations of the stakeholders and protecting the interest of minorities by ensuring minimum entitlements. Financial creditors (FCs), having voting rights for making decisions, play a key role in insolvency sphere. The Bankruptcy Law Reforms Committee (BLRC), which conceptualised the Code, states that ‘Financial creditors are those whose relationship with the entity is a pure financial contract, such as a loan or debt security’. The sanctity of financial contracts during the insolvency regime is an important element of financial system stability. In the world of credit, it is normal practice to create inter-se rights amongst secured creditors to ensure that senior/first creditors establish the first charge on the debtor’s properties over junior/second in the event of the financial crisis. Further, a secured creditor takes a security interest to enforce its rights against collateral in case the debtor defaults on the secured obligation and to have precedence over unsecured creditors in the distribution during liquidation. Secured interests reduce the lender’s risk, which enables the lender to set a lower interest rate, cutting the borrower’s cost of capital. Treatment of security interests of differently bargained creditors and differential rights of such creditors in an insolvency system is a driving factor for evaluating the options available to secured FCs to actively participate in the resolution and liquidation process or corner it out from such processes.

The ambiguity in the language of section 53 of the Code and diverging jurisprudence, however, has perplexed the position of secured creditors for ascertaining the amount to be distributed. Of late, there has been considerable discussion regarding how the Code should address inter-creditor and subordinate agreements and classification of secured creditors based on the value of security interest during resolution and liquidation. Given that the creditors with strong security may have to accept a lower payment, in situations they have a small voting share in the committee of creditors (CoC). As a result, the financial institutions with the highest security would receive less money or a comparable amount than other CoC members with lower security interests in the CD’s assets. The situation is further impaired when the obstinate dissenting creditor sticks to its security interest (being ambiguities in the present framework) and expects the higher returns based on notional liquidation value, ultimately dragging the viable CD into liquidation. During liquidation, the connotation of section 53 also claims to pool all security interests irrespective of value under waterfall...
mechanism. Recent judgment\(^2\) of Hon’ble Supreme Court (SC) wherein government dues having priority of charge by virtue of statute construed as secured creditor, has swirled the position of secured FCs under section 53.

These uncertainties in pie distribution under the Code have posed grave and unique problems adversely affecting the rights of secured creditors resulting in ambiguity, litigation, dissatisfaction among secured creditor(s), inclination of dissenting FCs towards liquidation over resolution at micro and impacting the entire credit system and non-use of the Code mechanism for distressed assets by secured creditors at macro level. Therefore, it becomes important that the position of a secured creditor need to be clarified when the property/security interest comes under the ambit of insolvency laws.

During liquidation, section 52 of the Code details the rights and section 53 gives the position of secured creditors in the waterfall. A secured creditor in liquidation proceedings may:

(a) relinquish its security interest to the liquidation estate and if it does so, he shall be entitled to receive proceeds from the sale of assets by the Liquidator in accordance with the waterfall mechanism engrafted in section 53;

(b) realise its security interest in the manner specified in section 52 of the Code, and if the realisation from the secured assets is not adequate to repay debts owed to the secured creditors, the unpaid debts of such secured creditors are placed lower in priority in comparison to a secured creditor who has relinquished his security interest in the liquidation estate under section 53(1)(e). Conversely, if the realisation is more than the debts of the secured creditor, the excess amount become part of the liquidation estate.

Section 53(1) of the Code provides order and priority of distribution of proceeds from the sale of liquidation assets among the stakeholders of a CD and rank ‘debts owed to a secured creditor’ with no mention of security interest is posturing all secured creditors irrespective of value of the security interest at equal place as secured. In addition, Hon’ble SC in the matter of Rainbow Papers Limited\(^4\) has extended the definition of secured creditors to crown debts/government dues (operational creditor) having priority of payment via creation of first charge by the Statute. Further, by virtue of the ‘non-obstante clause’ in the opening of section 53, duly strengthened by the overarching section 238, the waterfall mechanism under the Code has an overriding effect over any other central or state government statutes. It has also been observed that in few cases, ‘non-obstante clause’ has been interpreted to override the Transfer of Property Act, 1882 (TOPA) which ensures the priority rights of first charge holders over second charge holders and viewed that first/senior charge holders to be treated at par with second/junior charge holders. In continuation, the priorities of charge executed under contractual arrangement between the first and second charge holders are also being restrained on account of interpreting the section 53(2) which provides that any contractual arrangement between recipients under section 53(1) with equal ranking, if the order of priority disturbing, shall be disregarded by the Liquidator.
Section 53 of the Code also guides cram-down provision and manner of distribution in a plan during resolution. Section 30(2)(b) of the Code specifies that payments to dissenting FCs shall not be less than the amount due to them in accordance with section 53 of the Code in the event of the liquidation of the CD. Further, the Code was amended to incorporate the principle of honouring priority and value of security amongst creditors while determining payments to stakeholders during resolution. Amended section 30(4) states that while assessing the feasibility and viability of the resolution plan, the manner of distribution of proceeds in resolution to FCs ‘may’ take into account the order of priority amongst creditors as stated in sub-section (1) of section 53 of the Code, including the priority and value of the security interest of a secured creditor. However, lack of clarity about treatment of priority of charges and security interest under section 53 of the Code, and the fact that the realisation of a dissenting creditor in the event of dissent is based on notional liquidation value (that too calculated as on insolvency commencement date) keeps the choice at best at a guesstimate. To make it more complex, the priority accorded to state tax claims at par with secured FCs in the matter of Rainbow Papers Limited (supra) has opened the pandora box for secured creditors.

On the bare reading of section 53(1)(b) of the Code, nothing has been provided with regard to sub-classification based on the value of security interest among the secured creditors and treatment of different priority of charges. During resolution, section 30(4) of the Code recognises such priority or valuing the security interest thereof, but the same is not mandatory per-se.

**TWO SCHOOLS OF THOUGHT**

There exist two schools of thought regarding treatment of inter-se priority of charges and classifying the secured creditor secured to the extent of security interest during liquidation. The first school of thought advocates the cardinal principle of ‘only similarly situated creditors be treated similarly’. The classification of creditors based on the nature of the debt and value of security interest is an essential requirement for any sound insolvency law. If pre-insolvency rights regarding security are not honoured, this will hamper credit culture and economic growth. The second school of thought, in contrast, argues that the credit would grow if it got delinked from security. Secured creditors should have equal rights irrespective of the priority of charge and value of security interest. Thus, the insolvency law should ignore pre-insolvency rights as the claims of all secured creditors together is inconsistent with the assets of the CD. If every creditor sticks to its pre-insolvency rights, neither resolution of distress CD is possible, nor can a creditor realise its dues.

**EVOlving AND DIvERGING JURISPRUDENCE**

*In the matter of M/s. Adhunik Alloys & Power Ltd.*

The National Company Law Tribunal (NCLT) dealt with the question of whether the creation of class among the FCs based on the nature of security interest is contrary to the Code. It held that ‘Creation of Class amongst the financial creditor is known to law and being
applied in cases in which successful resolution plan was approved...balancing the interests of financial creditors, the CoC can take appropriate decisions to classify creditors on the strength of security interest, as it is not contrary to law or against the settled proposition’.

**In the matter of Orissa Manganese & Minerals Ltd.**

The NCLT sanctioned the methodology adopted in the resolution plan of *Orissa Manganese & Minerals Limited* distributing the realisation proceeds based on the value of security interest.

**In the matter of Essar Steel India Ltd.**

The Hon'ble SC noted that it is important to value the security interests separately from the interests of creditors who do not have security. It further noted:

> The Code and the Regulations, read as a whole, together with the observations of expert bodies and the Supreme Court’s Swiss Ribbon judgment, all lead to the conclusion that the equality principle cannot be stretched to treating unequals equally, as that will destroy the very objective of the Code - to resolve stressed assets. Equitable treatment is to be accorded to each creditor depending upon the class to which it belongs: secured or unsecured, financial or operational.

**In the matter of Amit Metaliks Ltd.**

The Hon’ble SC held that during resolution, a higher amount to be paid referring to the value of the security interest to a dissenting FC cannot be suggested. The legislature did not intend for a security interest over a CD’s assets to give a dissenting FC any special right over other FCs to enforce the entire security interest and create an inequitable scenario by receiving more money than the receivable liquidation value proposed for the same class of creditors. Otherwise, the outcome would be liquidation with every secured FC standing on disagreement rather than resolution. Such an outcome would be contrary to the Code’s very purpose and cannot be countenanced.

**In the matter of GB Global Ltd.**

Indian Bank which was secured creditor and dissenting FC raised a similar contention. Relying on the judgment of the Hon’ble SC in *M/s. Amit Metaliks Ltd.* (supra), the National Company Law Appellate Tribunal (NCLAT) held that ‘The Judgment of the Hon’ble Supreme Court, in the above case, is that when the extent of value received by the creditors under Section 53 is given which is in the same proportion and percentage as provided to the other Financial Creditors, the challenge is to be repelled’.

**In the matter of Gujarat Oleo Chem Ltd.**

The NCLT Ahmedabad observed that the charges are sequential and not proportional. The whole stance in liquidation proceedings is to ensure parity and proportionality. However,
the concept of proportionality only applies to assertions of similar ranking. The value of the defaulted loan is directly based on the ranking of security interests. The concept of a distribution waterfall was present in both the Companies Act of 1956 and the Companies Act of 2013, and was not a concept that was exclusive to the Code. If, contractually, parties had placed Mr. A on first priority and Mr. B on second priority, there would be no parity in the law pushing back Mr. A to the same status as Mr. B. The Bombay High court in the case of *Sicon Limited v. State of Maharashtra*, III (2006) BC 304, held that:

> It is only with a view to bring the workmen’s dues pari passu with secured creditors, that Section 529-A was enacted...Only because the dues of the workmen and the debts due to the secured creditors are treated pari passu with each other, the same by itself, in our considered view, would not lead to the conclusion that the concept of inter se priorities amongst the secured creditors had thereby been intended to be given a total go-by’. NCLT further observed that ‘The issue of ranking of secured creditors have been discussed by the Supreme Court in *ICICI Bank V. Sidco Leathers Ltd.*, (2006) 10 SCC 452 – If the secured creditors relinquish their security interest and make claim on the liquidation estate, will the first/second ranking remain, or all secured creditors will be of the same ranking. In this case, the Supreme court discussed the legal position and maintained the ranking of the secured creditors.

Hence, the NCLT held that the inter-se priorities among the secured creditors shall remain valid and prevail in the distribution of assets in liquidation. However, on appeal, NCLAT\textsuperscript{11}, vide its order dated April 5, 2021, took a contrary view and held that a secured creditor holding first charge or second charge is material only if it elects to realise its security interest. If it opts to relinquish its security interest, the distribution of assets would be governed by section 53(1)(b)(ii), whereunder all secured creditors having relinquished security interest rank equally. Accordingly, it set aside the foregoing NCLT order and directed the Liquidator to treat the secured creditors relinquishing security interest as one class irrespective of priority charge. The matter is currently pending before Hon’ble SC, and vide its order\textsuperscript{12} dated June 29, 2021, had stayed the operation of the foregoing NCLAT order.

**In the matter of Bala Techno Industries Ltd.**\textsuperscript{13}

On 26\textsuperscript{th} May 2022, the NCLAT relied on the judgment of *Amit Metaliks Limited* (supra), *GB Global Ltd.* (supra) and held that the Appellant creditor, having first charge over the assets cannot claim priority over other secured creditors in the distribution of the proceeds from the sale of a secured asset once they have relinquished their security interest over the assets of the CD. Section 53 of the Code requires that after relinquishing the security, secured FCs have to share sale proceeds with other secured creditors on a pro-rata basis.

**In the matter of Rainbow Papers Ltd.**

In the recent judgment, Hon’ble SC (supra) held that the State is a secured creditor as per the Gujarat Value Added Tax Act, 2003 and are to be rank equally with secured debts under section 53(1)(b). As per section 3(30) of the Code, secured creditor means a creditor
in favour of whom security interest is created. Such security interest could be created by operation of law. The definition of secured creditor in the Code does not exclude any Governmental Authority. Therefore, the resolution plan ignores the statutory dues payable to any State Government or legal authority, the Adjudicating Authority is bound to reject the resolution plan.

The jurisprudence suggests that the Code is silent on the validity of priority of inter-se rights of secured creditors and classification of secured creditor based on underlying value of security interest. In summary, the following issues have emerged:

(a) To what extent the secured creditors are secured: Should secured creditors be treated as secured to the extent of underlying value of their security interest and leaving the remaining unsecured portion to be classified as unsecured creditor?

(b) How pre-insolvency rights of first-charge holder are protected: Whether the validity of inter-creditor/subordination agreement entered before insolvency to be maintained while considering the treatment of inter-se rights of secured creditors?

(c) How principle of equity applied during resolution: Whether similarly placed class of creditors (based on value of security interest) are to be treated equally or secured creditors irrespective of value of security interest are to be positioned at par.

(d) Minimum pay-out to the dissenting FC: Whether dissenting FC during resolution is assured of minimum pay-out reckoning on waterfall mechanism, contemplating value of its security interest and upholding priority of charges. Whether the entitlements to dissenting FCs during resolution to be pegged at the value ascertained on insolvency commencement date (ICD) by valuers or value in resolution plan determined by market (Notional liquidation value vs. Real)

(e) Whether Govt. dues are at par with secured FCs: Should the common law doctrine about priority of crown debts/government dues has envisioned to be continued under the IBC. Whether the arrears of tax due to the State to be accorded priority along with secured FCs debts under the waterfall mechanism design in the IBC.

INTERNATIONAL OUTLOOK- DEALING WITH SECURED CREDITORS

World Bank’s Principles for Effective Insolvency and Creditor/Debtor Regimes

World Bank’s Principles for Effective Insolvency and Creditor/Debtor Regimes, 2015 (World Bank principles) sets out a range of benchmarks, based on international best practices, for evaluating the effectiveness of domestic insolvency and creditor/debtor regimes. Regarding the treatment of priority of charges, it suggests that in order to preserve creditors’ legitimate expectations and promote greater predictability in business dealings, the rights of creditors and the priorities of claims established prior to insolvency proceedings under commercial or other applicable laws should be upheld in an insolvency proceeding. The interest of secured creditors in their collateral should not be subordinated to other priorities provided during the insolvency procedure without the secured creditor’s approval, and the priority
of secured creditors in their collateral should be protected.

The UNCITRAL Legislative Guide on Insolvency Law

The UNCITRAL Legislative Guide on Insolvency Law recognises the importance of ensuring equitable treatment of similarly placed creditors and stated that the objective of equitable treatment is based on the notion that, creditors with similar legal rights should be treated fairly in collective proceedings, receiving a distribution considering their relative ranking and interests. Not all creditors must be treated equally, but rather in a way that takes into account the various agreements each one has made with the debtor. If different creditors have made different commercial deals with the debtor, the ranking of creditors may be justified by the need for the insolvency system to acknowledge and respect the various deals, maintain reasonable commercial expectations, encourage predictability in business dealings, and promote the equal treatment of creditors in similar financial situations. In general, creditors would receive at least as much under the plan as they would have under liquidation procedures, and adequate protection for dissent creditors should be included in the plan. It states that if the creditors are secured, such creditor is to receive payment of the value of its security interest, and unsecured creditors/junior interests, including equity holders may receive nothing. There are various approaches for treatment of secured creditors during reorganisation. One approach is secured creditors are not precluded from enforcing their rights against the encumbered assets and there is no need to give these creditors the right to vote since their security interests will not be affected by the plan. Second, secured creditor with separate rights to encumbered assets forms a class of its own and these creditors to vote as separate classes on a plan can modify or affect the terms of their claims, or consent to be bound by the plan. Under third approach, where secured creditors are not fully secured, a number of insolvency laws provide that those secured creditors should vote with ordinary unsecured creditors in respect of the unsatisfied portion of the claim. The valuation of security interest/asset shall determine whether, and to what extent, a secured creditor is in fact secured and entitled to vote as unsecured creditors with respect to any portion of their claim.

The UNCITRAL Legislative Guide on Secured Transactions

The UNCITRAL Legislative Guide on Secured Transactions states that risk for creditors in case of secured credit is reduced considering the value inherent in underlying assets which serves as another source of recovery for creditors in the event of non-payment of the secured obligation. Insolvency law usually respects the pre-commencement priority of a security right (where the security right was made effective against third parties prior to commencement or after commencement but within a grace period), subject to any privileges for other claims that may be introduced by insolvency law.

US Bankruptcy Code

Section 506(a)(1) of the US Bankruptcy Code (US Code), which is applicable to both
reorganisation and liquidation, provides bifurcation of a debtor’s obligation to a secured creditor into secured and unsecured claims, depending on the value of the collateral securing the debt. It abolishes the use of the terms ‘secured creditor’ and ‘unsecured creditor’ and substitutes in their places the terms ‘secured claim’ and ‘unsecured claim’. The debtor’s obligation has been classified as ‘claims’ rather than ‘debts’ which means that a creditor who owed money on the basis of a prebankruptcy transaction is treated under the statute as the holder of either an unsecured claim or a secured claim. Section 510(a) under Chapter XI of the US Code contains the provision confirming the enforceability of subordination agreements during bankruptcy proceedings. As per section 1129 of the US Code, impaired secured creditors in a plan should be fairly and equitably treated. It allows a secured creditor to keep its lien and receives deferred cash payments with a present value of at least the value of its interest in the collateral securing its claim. The secured creditor’s lien, to the extent of the permissible amount of the secured claim, attaches to the sale proceeds if the collateral is sold to a third party. Absolute priority rule provides that senior creditors are paid in full before junior creditors are paid unless the senior creditors’ consent to subordinate some of their claims to those unsecured creditors.

**European Union Directive**

On June 26, 2019, the European Parliament and the Council of the European Union published a new EU Directive provides the separation of the secured and unsecured portions of a claim for reorganisation procedures and creditors only have secured status to the extent that their claims are covered by the value of collateral. It protects the creditors with best interest rule ensuring no dissident creditor is worse off under a restructuring plan than they would be in the case of liquidation and absolute priority rule enshrined in Articles 9 and 10.14

**United Kingdom**

During resolution, priority creditors have been protected under para 73 of schedule B1 ‘Administration’ of the Insolvency Act, 1986 by restricting an Administrator’s statement of proposals to affects the right of a secured creditors of the company to enforce his security provided the secured creditors have not consented for the same. During liquidation, rule 14.19 of the Insolvency (England and Wales) Rules, 2016 allows a secured creditor to realise its security interest its own and he may prove for the balance of his debt. It further provides that if a secured creditor voluntarily surrenders its security interest, then the whole of the creditor’s debt will be treated as unsecured. However, surrendering security interest is rarely opted as it seems no potential benefit.

**UNKNOTTING THE COMPLEXITIES**

The two schools of thought have its own perspectives for achieving the objectives of the insolvency law. One applies the common law principles and states that if the pre-insolvency rights of secured creditors are not honoured, the secured creditors will opt for
liquidation to enforce their security interest outside while other disregards such rights with a view that equal treatment of all creditors will lead to resolution. However, various other factors like credit system in the country, legal rights and expectations of creditors, supply of low borrowing cost, availability of credit, sanctity of commercial contracts etc requires holistic approach to govern the position of secured creditors in insolvency state. Barring few judgements, Indian Courts and International practices suggests that the insolvency system is designed to distribute assets of the CD as equally as possible among similarly situated creditors. and creditor cannot enjoy greater rights in an insolvency proceeding than they would enjoy under non-insolvency laws. The US Code separates the debt of secured creditor into secured claim and unsecured claim and applies the absolute priority rule for payment of senior rank claim which includes secured claim prior to junior. World Bank principles, UNCITRAL Legislative Guide on Insolvency Laws and Secured Transactions states that the pre-insolvency entitlements of secured FCs during an insolvency resolution and liquidation should be honoured. Apart from this, following considerations advocates the position of the secured creditors during the liquidation and resolution:

(a) Valuing collaterals:

- Under the scheme of the Code, if secured creditors opt to realise their security interest under section 52 of the Code, they would only be compensated to the extent of their security interest and would be entitled to any overdue amounts under section 53(1)(e) of the liquidation waterfall. Thus, section 52 ensures that the secured creditor will be entitled to the value lying in the security interest and maintains the pre-insolvency contractual agreements. The provision under the section 53 could not have been intended to provide secured creditors, who relinquish their security interest, priority of repayment for their entire debt regardless of the extent of their security interest, as it would amount to upholding a privilege that had never existed. If the definition of ‘debts owed to a secured creditor’ is not limited to the amount of the security, the priority granted by section 53(1)(b) can be misused. Those creditors who are not fully secured by their debt would rely on the fact that they can hold any value of security to recover the full amount of their unpaid dues in priority to all other stakeholders.

- Can secured creditor having one percent or less value of security interest be equally placed with secured creditor having 100% or good value of security interest. The financial world would certainly negate to treat such unequals as equals. The incentive to relinquish the security interest by secured creditor is to participate in the collective liquidation proceedings to enable the Liquidator to realise higher value for the assets of the CD as a whole/collectively. By no stretch of imagination can make the secured creditors fully secured irrespective of their value of security interest upon relinquishment of security interest i.e., mingling all security interests in a pool regardless its value and disincentivise the secured creditor holding good security interest from relinquishment, thereby defeating the very objective of maximisation of value of assets of the CD through collective process.
The Companies Act, 2013 in sections 77 to 87 contemplates mandatory registration of charges, and penalty in case of failure to do so. The purpose behind the registration and public information of charges is to enable sufficient notice to other creditors who seek to rely on subsequent charge or interest on a company’s properties, assets and undertakings. Section 53 of the Code does not contemplate the extinguishment of such creation of rights and invalidate priority of charges. Regulation 21 of the IBBI (Liquidation Process) Regulations, 2016 allows to prove the existence of security interest on the basis of - (a) the records available in an Information Utility, if any; (b) certificate of registration of charge issued by the Registrar of Companies; or (c) proof of registration of charge with the Central Registry of Sequestration Asset Reconstruction and Security Interest of India.

Report of Expert Committee on Company Law (2005) headed by Dr. J. J. Irani, which was constituted with the task of advising the Government for proposed revisions to the Companies Act, 1956 with the objective to have a simplified compact law and enable adoption of internationally accepted best practices, had recommended that rights and priorities of creditors established prior to insolvency under commercial laws should be upheld to preserve the legitimate expectations of creditors and encourage greater predictability in commercial relationship. The BLRC, in its interim Report (February 2015), took note of priority rights of secured creditors and stated that the priority rights of secured creditors on their security interests should be provided through the separate provision and first charge holder to be allowed for claims that existed on the date when such security interest was created. In 2020, with regard to valuing security interest to determine the position of secured creditor, the Insolvency Law Committee (ILC) stated that: 

The priority for recovery to secured creditors under Section 53(1)(b)(ii), which aims at replicating the benefits of security interest that is relinquished by a secured creditor, should be applicable only to the extent of the value of the security interest so relinquished by the secured creditor. No amendment was considered necessary in this regard as the correct interpretation of this issue is adequately clear from the aforesaid reasoning.

In view of the foregoing discussion, it is observed that despite recommendations of various Committees to value the collaterals for ascertain secured portion of secured FCs, such bifurcation based on value of security interest is changing with evolving jurisprudence. The unsettled position unrests the stakeholders, primarily FCs who are decision makers, and has potential to create a turbulent environment putting the expected outcome of the IBC in jeopardy. It is thus essential that section 53(1)(b)(ii) of the Code to be suitably amended to clarify that secured creditors are secured to the extent of undervalue of their security interest and for the balance, they will fall under the section 53(1)(d) and 53(1)(f) in case of FCs and operational creditors, respectively.
(b) Upholding pre-insolvency rights of first/senior charge holder:

- Pre-insolvency entitlements of secured creditors under inter-creditor agreements and subordination agreements govern the inter-se priorities among secured creditors. It is pertinent to note that while entering into the subordination agreement, the junior charge holder is well informed that its recovery rights on secured asset are subject to the rights of senior/first charge holder and as a compensation for such higher risk, it charges higher interest rate. During liquidation, if the senior charge holder chooses to realise asset(s) outside the Code under section 52, the junior charge holder would be entitled to the remaining sum, if any, after the complete satisfaction of senior charge holders’ dues. Therefore, section 53 of the Code, which shall be applicable in case the first charge holder relinquishes the security interest, cannot create pari passu rights for the junior charge holder which never existed prior to insolvency of the CD. It cannot be said that there is no correlation between the value of security relinquished and extent of priority accorded under section 53(1)(b)(ii) of the Code. The second charge holder having no value left in the security interest cannot be treated at par with secured creditor having full or substantial value of a security.

- Section 48 of the TOPA provides that claim of a first charge holder shall prevail over the claim of a second charge holder. Provisions of section 48 of TOPA cannot be obliterated in relation to a company that has undergone liquidation. Non-obstante clause used in section 53 of the Code is to be interpreted in the similar fashion as interpreted by the Hon’ble SC in the matter of ICICI Bank Ltd. v. SIDCO Leathers Ltd. & Ors. that the non-obstante clause in section 529A had to be construed as per the purport and object of the provision, and it could not be deemed that Parliament intended to deprive the first charge-holder of its valuable right. Section 53(2) can only be taken to empower the Liquidator to disregard contractual arrangements between the two categories of recipients under section 53(1) i.e., workmen and secured creditor. The provision of section 53(2) may not have an application to valid intercreditor and subordination agreements, which fall completely within section 53(1)(b).

- In 2018, the ILC held that section 53(2) in the context of section 53(1)(b) is to be applied with regard to any agreements between workmen and secured creditors, and not to inter-se agreements of secured creditors. In 2020, the ILC observed that despite clarification provided in its 2018 report, the confusion regarding the applicability of section 53(2) on inter-creditor or subordination agreements among secured creditors have persisted among various stakeholders. It, therefore, recommended that a necessary clarification may be provided by inserting an explanation under section 53(2) to clarify the correct interpretation of the said section. In line with recommendations of the ILC, it is necessitated to clarify the section 53(2) of the Code w.r.t maintaining the validity of inter-creditor or subordination agreements under the Code.
(c) Treatment of principle of fair and equitable:

During resolution, explanation 1 to section 30(2) of the Code incorporates the provision of ‘fair and equitable’ treatment to be applied in distribution to creditors. Equitable distribution does not mean equal distribution. Rather it permeates that there should be no discrimination between similarly situated creditors having similar legal rights and they should be treated fairly, receiving a distribution in accordance with their relative ranking and interests. Creation of class among secured FCs based on value of security interest is not barred in the Code. Principle enshrined in long title of the Code i.e., balancing the interest of stakeholders allows to bifurcate and protect the different kinds of creditors having different rights. To ascertain the similarly situated creditors, it becomes necessary to classify the secured creditors with respect to their security interest i.e., into secured to the extent of value of security interest and for balance, unsecured. Otherwise, there would be no relevance to proving the existence of security interest. Quality and value lying in the security interest assures the secured creditor with his minimum entitlement in case of default. Thus, creation of class based on value of security interest amongst the FCs is known to law and must be applied during resolution to meet the reasonable expectations of the stakeholders and for their active participation in the insolvency proceedings.

(d) Entitlement to dissenting FC:

- The clarity with regard to treatment of priority of charges and valuing collaterals under section 53 will also ensure minimum entitlements during the resolution to the dissenting FCs. As section 30(2)(b) of the Code provides for the payment to dissenting FCs i.e., ‘which shall not be less than the amount to be paid to such creditors in accordance with sub-section (1) of section 53 in the event of a liquidation of the corporate debtor’. The Code grants a particular protection of a minimum entitlement of the amount in the event of liquidation of the CD. However, owing to the definition of liquidation value contained in IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations), the entitlement to dissenting FC is presently being determined based on notional liquidation value as on ICD. It is pertinent to mention, the liquidation value provided by the Registered Valuers is guiding factor to facilitate the CoC for taking decision. The Code is an economic legislation and the most suitable metric of its efficacy and value arrival is the market forces which enable the process. A potential resolution applicant after undertaking due diligence is willing to pay an amount under a resolution plan for the CD. Post inviting bids from the universe, the value of the resolution plan is a better metric as per market standards, better indicator of the present market value and realistic enterprise value of the CD at a particular point in time.

- A dissenting FC considering hypothetical liquidation value nudges towards dissenting against a resolution plan assuming it may be economically more lucrative during liquidation. What this in turn does is incentivising liquidation which goes against the basic objective of the Code of resolution. The major issue with
such decision making is that if a large number of FCs dissent to a resolution plan in greed of higher entitlement based on notional liquidation value, it may push the CD towards liquidation ultimately defeating the objective of the Code, and also against the interest of such dissenting creditors, as their entitlement during liquidation is determined by actual realisation rather than notional liquidation value and with passage of time, the value of assets deteriorate.

- If the resolution value is less than the liquidation value, it is a testimony of the fact that the value of the assets has deteriorated or corrected against notional liquidation value and, in such cases, pegging the entitlement to a higher liquidation value as on ICD is not aligned to the Code and against the collective interest of creditors. To better achieve the purpose envisaged under the Code and to offer a minimum protection under section 30(2)(b) to the dissenting FCs, when the realisable value is lower than the notional liquidation value, the payment of debts of dissenting FCs should not be less than the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority in sub-section (1) of section 53. Further, in cases where the realisable value is more than the notional liquidation value, dissenting FC’s minimum entitlement should be governed by notional liquidation value as benefits along with risks affixed with higher realisable value should be awarded to the assenting FCs who voted in favour of resolution plan for revival of the CD. Moreover, regulation 38(1) of the CIRP Regulations ensures priority in payment to such dissenting creditors over FCs who voted in favour of the plan. Needless to mention that dissenting FC always has choice to stand in favour of resolution plan to receive realisation from the higher realisable value. Higher reward system will induce the FCs to consent for revival of the CD, resulting in meeting the objective of the Code and aligning the interest of stakeholders with economic goals.

(e) Government dues claiming priority:

- In Dena Bank v. Bhikhabhai Prabhudas Parekh & Co., the idea of crown debts taking precedence over secured loans was taken into account and the Hon’ble SC stated that the rule of necessity and public policy is the basis for the priority of government debts. The fundamental reason for the notion that public debts should be paid off first is based on the widely accepted idea that the state has the right to levy taxes since, absent sufficient tax revenue, the state would be unable to carry out its constitutionally mandated functions. As a sovereign, it is imperative that the State be able to carry out its fundamental governmental obligations, and in order to do so effectively, the State must have right to claim priority in respect of its tax dues. However, Hon’ble SC held that the common law doctrine of priority of crown debts would not extend to providing preference to crown debts over
secured private debts and the same shall be confined to have precedence over ordinary or unsecured creditors.

- Under IBC, by virtue of the ‘non-obstante clause’ at the opening of section 53 read with section 238, the waterfall mechanism under the Code has an overriding effect over any other central or state government statutes and government dues have been placed at section 53(1)(e) after the secured debts in section 53(1)(b). Rationale for positioning of government dues below the secured as well as unsecured FCs was stated by the BLRC in its report which reads as ‘for promoting the availability of credit and developing a market for unsecured financing (including the development of bond markets). In the long run, this would increase the availability of finance, reduce the cost of capital, promote entrepreneurship and lead to faster economic growth. The government also will be the beneficiary of this process as economic growth will increase revenues’. With this legislative intent, the Parliament has graved in the long title to the Code ‘An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution….. balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues’.

- In the matter of Monnet Ispat & Energy Limited, the Apex Court held that section 238 of the Code will override anything inconsistent contained in any other enactment, including the Income-Tax Act, 1961. In connection to Dena Bank (supra) and its progeny, making it clear that income-tax dues, being in the nature of crown debts, do not take precedence even over secured creditors, who are private persons.

- Interestingly to note that by amendment, section 31B was inserted in the Recovery of Debts and Bankruptcy Act, 1993 (RDDBA) (w.e.f. September 1, 2016) and section 26E was inserted in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) (w.e.f. January 24, 2020), with the words ‘security interest is created’ and ‘after the registration of security interest’ respectively, provides priority to secured creditors to realise secured debts over all other debts and government dues including revenues, taxes, cesses and rates due to the Central Government, State Government or Local Authority. The proceeds from the sale of secured assets can therefore be recovered by the secured creditors (Banks) in preference to government dues (despite the respective legislation have created first charge). However, the statutory charge on the property still exists and follows the property, thus the auction purchaser obliged to discharge such outstanding statutory dues to obtain clear title. Explanation to aforesaid section of RDDBA and SARFAESI clearly upholds the primacy of the IBC which reads as ‘on or after the commencement of the Insolvency and Bankruptcy Code, 2016, in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code’.
The Code is among biggest economic reforms in India with its unique features i.e., waterfall mechanism and resolution with fresh start and clean slate. The Parliament has designed the Code as structural reform and stepped down the position of crown debts below the secured financial debts to incentivise the all other stakeholders to exercise the Code and bestowed advantage to successful resolution applicant by getting the CD with clean slate. Hence, IBC has provided a unified law and one-stop solution for insolvency and bankruptcy, protecting the interests of banks and investors. Prioritising the government dues with secured financial debts would not only be against the narratives of the IBC but also drastically change the behaviour of secured FCs for initiating an action under IBC. Accordingly, drafting errors need to be suitably corrected to reposition the Code with its legislative intent. Thereby, either the government dues should be excluded under the definition of the secured creditors, or such creditors secured by virtue of law to be placed below the secured FCs under the waterfall mechanism.

CONCLUSION

The Code was implemented as a critical building block of India’s transition to a developed market economy. It thrusts upon predictable, market led and collective mechanism in resolving debtor insolvency, maximising the value of assets available to creditors for the benefit of all stakeholders, and facilitating the closure of unviable firms. The paradigm shifts from debtor-in-possession to creditor-in-control regime empowered FCs, secured and unsecured, represented by a CoC as supreme decision body. However, when it comes to applying it in more realistic circumstances, difficulties arise due to ambivalences in interpretation of provisions of the Code. The insolvency system anticipates that stakeholders will pursue their individual interests, which will culminate into the larger interest of the stakeholders. The harmonious interpretation of law relating to customary banking practices and pre-insolvency contractual rights mandates to ensure the secured FCs of their valuable security interest right and pre-insolvency entitlements in terms of priority of charge. Otherwise, quality and value of collaterals are not regarded during insolvency regime, it would discourage banks and other FCs to disburse loan at low cost and impact the credit market.

Efficacy of the Code in terms of resolution also necessitates the honouring of pre-insolvency entitlements and valuing collaterals for an informed decision to FCs and fairness of distribution amongst similarly situated creditors. Further, weighing factual over assumptions, the market determined resolution plan value during resolution in lieu of notional value should be offered to dissenting FC in cases market determined value of the CD less than valuers. Lastly but most importantly, literal interpretation over the purposive interpretation in positioning the government dues having first charge by operation of law has altered the narratives of the Code. The IBC was introduced with larger economic goals to revive the distressed viable CDs with collective efforts of the FCs as to convert non-performing assets as performing assets, promote entrepreneurship, employment, and credit by valuing capital invested in the project rather than selling in bits and pieces or
recovery mechanism. Mobilising money through resolution and liquidating unviable firms foresee to benefit the economy post-ante, generating revenues through going concern units and new investments. The Banks are financial intermediaries of the country. Access to credit with low cost and promote entrepreneurship, ex-ante, necessitates legal protections to secured FCs for pre-insolvency rights and collaterals. Revival of more than 500 companies contributing towards gross domestic product and generating employment, good credit behaviour, changing relationship among debtors and creditors, exploring ways to keep the CD as a going concern depict the remarkable journey of the IBC as a game changer. The IBC, having considerable experience of six years in approximate 3500 cases, need to settle the position of secured FCs in definite and lucid provisions leaving no room for different interpretation, to strengthen its framework and align the economic goals with interest of stakeholders.

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4. Supra Note 2
The Insolvency and Bankruptcy Code, 2016 (IBC/Code) has been one of the most radical legal movements in the economic sphere of India. The shift from the debtor-in-possession to creditor-in-control model, the suspension of the management of the corporate debtor (CD) and the resolution process conducted under the oversight of the committee of creditors by the Resolution Professional are all hallmarks of the IBC and the revolution that was brought about by these sweeping provisions of the statutory law of the IBC.

The Code is designed to give control to a creditor and the same is an integral component of the change that has been brought about in the legal system. Further evidence that a creditor is central to the scheme of the Code can be gauged from the fact that the law is modeled on the debt and default framework. It is an immaterial factor whether the CD is a solvent company qua other creditors. Therefore, if there is a debt and default, then the application under sections 7, 9 and 10 is required to be admitted.

Therefore, a creditor enjoys power in both initiating a resolution process and conducting the process. Needless to add, even in the process of liquidation, it is the creditor who enjoys a prominent role in terms of their stakes and the security interests. The present article deals with a sub-set of creditors, namely, secured creditors and how such a creditor could stake the claim of being a secured creditor during liquidation process and prove its security interest and avail the priority of claim over other creditors.

UNDERSTANDING THE RELEVANT PROVISIONS UNDER THE CODE

The Code under section 53 crystallises the distribution mechanism ranking the priority to be accorded to each claimant depending on their status. The waterfall mechanism seeks to do justice in relative terms. Therefore, a creditor enjoys a better standing to recover their dues than, say, an equity shareholder. A perusal of the same would show that while there is a differentiation of ranking of workmen dues, insolvency process costs, debts due towards the government; there is an inter se varying of the ranking of creditors on the basis of the security interest.

While (a) the debts owed to a secured creditor who relinquishes its security enjoys a higher rank than (b) the creditor who is unsecured; but the least amongst is the rank accorded.
Differentiating Between Statutory vis-à-vis Contractual Charge Holders – Relevance During Liquidation

to (c) a secured creditor who still has a debt to recover even after enforcing the security interest.

The Code defines a ‘secured creditor’ as a creditor under whose favour a security interest is created, whereas a ‘security interest’ means a right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, ‘charge’, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person.

This brings us to the provision of section 52 of the Code wherein a security interest of a creditor is relevant and such a creditor can choose if such security is to be relinquished or enforced. The same stipulates in the following terms:

52. Secured creditor in liquidation proceedings.—(1) A secured creditor in the liquidation proceedings may—

(a) relinquish its security interest to the liquidation estate and receive proceeds from the sale of assets by the liquidator in the manner specified in Section 53; or

(b) realise its security interest in the manner specified in this section.

(2) Where the secured creditor realises security interest under clause (b) of subsection (1), he shall inform the liquidator of such security interest and identify the asset subject to such security interest to be realised.

(3) Before any security interest is realised by the secured creditor under this section, the liquidator shall verify such security interest and permit the secured creditor to realise only such security interest, the existence of which may be proved either—

(a) by the records of such security interest maintained by an information utility; or

(b) by such other means as may be specified by the Board.

(4) A secured creditor may enforce, realise, settle, compromise or deal with the secured assets in accordance with such law as applicable to the security interest being realised and apply the proceeds to recover the debts due to it.

(5) – (8) ...

(9) Where the proceeds of the realisation of the secured assets are not adequate to repay debts owed to the secured creditor, the unpaid debts of such secured creditor shall be paid by the liquidator in the manner specified in clause (e) of sub-section (1) of Section 53.

Choice of secured creditors - realise or relinquish

Section 52 allows the secured creditor two options: (a) to either give up its security interest and recover the amount from the sale of assets by the Liquidator under section 53; or (b) the secured creditor may try and seek to recover its dues by making its own efforts using that secured asset.

A ‘secured creditor’ may enforce, realise, settle, compromise or deal with the secured assets in accordance with such law as applicable to the ‘security interest’ being realised and apply
the proceeds to recover the debts due to it.\(^5\) Prior to that, a ‘secured creditor’ in order to realise its ‘security interest’ under section 52(1)(b) is mandated to inform the Liquidator of such ‘security interest’ and identify the asset subject to such ‘security interest’ to be realised.\(^7\)

Furthermore, before any such ‘security interest’ is realised by a ‘secured creditor’ under section 52, on receipt of an application, the Liquidator is required to verify such ‘security interest’ and only after proof of the existence of such ‘security interest’, any permission may be granted to the ‘secured creditor’ to realise the interest from such assets.\(^8\)

Section 52(2) of the Code provides that in the event of the secured creditor choosing to realise the security interest, it shall inform the Liquidator of such security interest and identify the asset subject to such security interest be realised. The Liquidator must verify such security interest and permit the secured creditor to realise only such security interest the existence of which is proved in the prescribed manner.\(^9\)

The provision of section 52 is also crucial because even before an Adjudicating Authority (AA) passes an order of liquidation and assigns the assets of the company to the Liquidator for distribution in terms of section 53 of the Code, the security interest of the secured creditors, if any, are to be decided in terms of section 52.\(^10\)

After a ‘security interest’ is enforced under section 52(4), if an amount by way of proceeds is in excess of the debts due to the ‘secured creditor’, the ‘secured creditor’ is required to deposit the same in the account of the Liquidator.\(^11\) Therefore after enforcement of a right under section 52(4) by one of the ‘secured creditor’, no other secured creditor can enforce its right subsequently for the realisation of the amount for the same secured assets as the excess amount by way of proceeds pursuant to the first enforcement is to be deposited into the account of the Liquidator.\(^12\)

The procedure of sections 52(2), (3), (4) is mandatory before any assistance of the AA is sought in terms of section 52(5) read with 52(6) in seeking recovery of the secured assets. Otherwise, such an application under section 52(6) is held to be not maintainable.\(^13\)

**Current position of law on secured creditors under the Code**

Coming to the issue at hand, the term secured creditor becomes the focal point of discussion. The AA in the case of *Bharat Heavy Electricals Limited v. Anil Goel and Anr. (BHEL)*\(^14\) was confronted with the issue if the claimant before it was a secured creditor on the basis of the lien and charge over the goods sold and lying in its possession and used in the erection of plant and machinery. Correspondingly, the issue also became if the provisions of the Code over the provisions of sections 45 to 48 of the Sale of Goods Act, 1930 and section 55(4)(b) of the Transfer of Property Act, 1882. The claimant argued that since there is no conflict between any of the provisions of the Code with the aforementioned provisions of the Sale of Goods Act, 1930 and Transfer of Property Act, 1882; hence there is no cause for the invocation of the *non obstante* clause under section 238 of the Code.
Differentiating Between Statutory vis-à-vis Contractual Charge Holders – Relevance During Liquidation

The AA, in its analysis, went on lengths in explaining the provisions of ‘security interest’ under the IBC. It referred to the definition of a ‘secured creditor’ that defines it as a creditor in favour of whom security interest is created,15 and laid emphasis on the word ‘created’. Then it noted that the definition of ‘security interest’16 which covers the situation of creation as well as provision of a right, title or interest or a claim to a property in favor of a secured creditor to secure payment or performance of an obligation at the first instance. The AA on comparing observed that the scope of the mode and manner of creation of security interest has been widened in the definition of ‘security interest’, since as per the definition of the word ‘secured creditor’ under section 3(30) only the word ‘created’ has been used, whereas in the definition of ‘security interest’ not only the word ‘created’ but the word ‘provided’ has also been used. The NCLT opined that the crucial part, however, is the inclusion of creation or provision of interest through agreement or arrangement between the parties.17

In a composite interpretation of the terms ‘security interest’, ‘secured creditor’, ‘transfer’, ‘transaction’, and ‘property’, the NCLT held that the word ‘created’ is of paramount importance as the Code provides a specific mechanism in regard to what is the security interest and how such security interest is created and/or provided for by the parties.

The NCLT resultantly concluded that only those interests could tantamount to a security interest wherein the action or process of creation is done consciously or explicitly. As a corollary, the NCLT held that a security interest that arises due to the operation of law or due to any event other than a deliberate act of creation or provision by the parties would not be covered under the definition of ‘secured creditor’ and ‘security interest’ in terms of the Code.

In this case, the NCLT noted that there is no formal agreement between the parties and the terms of the notice inviting tender and the letter of award do not contain any clause wherein any security interest gets ‘created’. Therefore, the claim of the claimant for being a secured creditor was rejected. The NCLT also noted that the initial arrangement between the claimant and the CD had provided that the original payment would be secured by a letter of credit, however the same was waived off without any alternative arrangement. The same prompted the NCLT to peruse the terms of contract and observe that there is no clause in the same that could show any creation of a security interest.

In appeal, when the matter went to the NCLAT, the Appellate Tribunal in BHEL observed the following:

[a]lthough we do not hold that that provisions of Sale of Goods Act and Transfer of Property Act are inconsistent or contrary as such to IBC, we hold that considering the provisions (as discussed in detail by the Adjudicating Authority) as found in Section 3(30) which defines “Secured Creditor” and Sections 3(31), 3(33) read with Section 238 of IBC, if benefit is to be taken under the provisions of IBC, it can be done if there was a contractual arrangement/transaction creating security interest in favour of the Creditor. It has to be a security interest which is “created” as such. IBC is complete Code in itself. The Appellant is claiming to be Secured Creditor on statutory basis. Admittedly, the Appellant is not relying on any contractual provision, or transaction creating security interest to claim benefits of lien/charge...18
These observations formed the major crux of the issue. Whether a charge has to be necessarily shown through a contractual arrangement in order for the same to be considered a security interest in terms of the Code and cloth such creditor with the status of a secured creditor for the purposes of liquidation. The same carries crucial implications for several creditors who may stake claim during liquidation, thereby mandating deeper discussion and analysis.

**ANALYSING THE ISSUE**

**Jurisprudence on status of creditors during liquidation prior to the Code**

The distinction of statutory charge *vis-à-vis* a contractual charge does not seem to be a part of the previous liquidation process under the Companies Act, 1956. In *K Saradambal*, the CD had entrusted two machineries belonging to it to the creditor for carrying out certain repairs. The creditor while carried out repairs by supplying certain spare parts, stood unpaid by the debtor. Subsequently, the debtor went into liquidation and the Liquidator rejected the claim of the creditor on the ground that the charge was not registered in terms of section 125 of the Companies Act, 1956. The creditor, in turn, specifically contended that it is entitled to a ‘statutory lien’ on the machineries and is a secured creditor, and that appropriate directions should be given for the sale of the machineries for adjustment of the amount due to it and for deposit of the remaining balance.

Now specific issue arose when the creditor claimed two sorts of rights, namely, (a) a lien in the capacity of being an unpaid vendor of the spare parts supplied for carrying out the repairs to the machineries. The same fell in the ambit of section 46 of the *Sale of Goods* Act, 1930; and (b) a lien in the capacity of repair charges. The same was claimed in the nature of ‘bailment’ as defined under section 148 of the *Indian Contract Act*, 1872 and in terms of section 170 of the said Act, which pertains to the right of retention of the bailee on the goods over which it has provided service, till the bailee is paid.

Both the facts were not disputed, namely, that the creditor had sold spare parts and had made use of those spare parts in carrying out the repairs of the machineries as well as it had carried out repairs.

The major thrust of the Liquidator was on the fact that the charge was not registered. The High Court here opined that the provision of section 125 of the Companies Act, 1956 required registration of only that charge which is created by a company and not to a charge arising by operation of law. The Court, therefore, held that the fact that the lien claimed by the creditor is not registered would not disentitle it seeking its claim arising under the statutory lien.

Then, referring to section 529 of the Companies Act 1956, the High Court held that the holder of a statutory lien could stake claim of a secured creditor during the winding up proceedings against insolvency of CDs. The Court referred to the definition of ‘secured creditor’ under section 2(e) of the *Provincial Insolvency Act*, 1920 that defined a secured creditor as ‘a person holding a mortgage, charge or lien on the property of the debtor or any part thereof as a security for a debt due to him from the debtor’.
On the basis of the same, the High Court concluded that section 529 of the Companies Act, 1956 read with the relevant provisions of the insolvency law, the holder of a statutory lien or the holder of a lien created by contract and registered as required by section 125 is a secured creditor in the matter of winding up of the insolvent company.

This position is to be contrasted with what BHEL did. The NCLT on a study of the terms ‘security interest’, ‘secured creditor’ interpreted that there is a requirement of ‘creation’ and on how these provisions seem to stipulate a specific mechanism with regards to what a security interest is and how such security interest can be created and/or provided for by the parties. It is crucial to understand that section 3(31) defines a security interest in the following manner:

“security interest” means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person.

The definition while contains a definitive first part, also contains an ‘inclusive’ definition in its second part when it stipulates that a security interest could include a ‘charge’ and ‘any obligation of any person’. A statutory right certainly helps in securing performance of the obligation on the debtor.

Furthermore, section 3(4) of the Code defines a charge as ‘an interest or lien created on the property or assets of any person or any of its undertakings or both, as the case may be, as security and includes a mortgage’. The same is much similar to the definition of a ‘secured creditor’ as defined under section 2(e) of the Provincial Insolvency Act, 1920 meaning ‘a person holding a mortgage, charge or lien on the property of the debtor or any part thereof as a security for a debt due to him from the debtor’. The definition of ‘charge’ under the Code is similar to the definition of the term ‘charge’ as contained in the Companies Act, 2013.

The emphasis laid down by the NCLT on ‘creation’ still does not answer on why a statutory creation is not a creation of a legitimate right.

The legal jurisprudence on property law even goes so far to hold that on certain occasions, a statutory charge such as the charge held by a buyer under section 55(6)(b) of the Transfer of Property Act, 1882 inherently contains a deeming provision where the notice of such charge is presumed even on any subsequent purchaser. In Abdul Hamid Khan, it was held that the charge under section 55(6)(b) of the Transfer of Property Act, 1882 for the pre-paid purchase money comes into existence the moment the buyer pays part of the purchase money towards the sale transaction and that the same is available not only against the seller but also against the purchaser from the seller irrespective of the question whether the said purchaser had or had not noticed a charge.

Such is the privilege leveled to a statutory charge as against a contractual charge.

The previous position of law, prior to the Code, in the Companies Act, 1956 also offers a crucial insight into the issue. There again no such issue of contractual security interest
vis-à-vis a statutory interest seems to be relevant. Rather, the Court applied the statutory provisions of the Transfer of Property Act, 1882 to decide who enjoyed the priority of claim. At the most, the discussion has been on whether inter-creditor agreements stand diluted in light of the distribution arrangement suggested for the liquidation process under the Companies Act, 1956.

In Sidco Leathers, the Apex Court was dealing with the issue of inter se dispute between secured creditors and interpretation of sections 529 and 529A of the Companies Act, 1956 became the focal point. Admittedly, the respondent before the Supreme Court, namely, the Punjab National Bank (PNB) held a second charge over the mortgaged asset, whereas the appellant had the first charge. However, issue arose with regard to section 529A of the Companies Act, 1956 which the respondent PNB argued to contain a non obstante clause wherein no distinction has been made with regards to the priority over the claim amongst the secured creditors inter se. In other words, the respondent contended that the appellant could not claim a priority over the claim of the respondent.

The Supreme Court referred to section 48 of the Transfer of Property Act, 1882 to opine that the rights of the first charge holder prevail over the interests of the second charge holder. The Court then added that such a crucial right has to be understood to be in the knowledge of the Parliament when it had enacted section 529A of the Companies Act, 1956. In other words, the Court opined that while enacting the Companies Act, 1956, the Parliament could not be held to have intended to deprive the first charge holder of the said right.

With respect to the IBC, the Insolvency Law Committee (ILC) in its Report of March, 2018 undertook similar discussion. The ILC was constituted by the Ministry of Corporate Affairs to conduct a detailed review of the IBC in consultation with key stakeholders. Many of the recommendations were subsequently adopted by the legislature by way of amending the Code. Therefore, the views of the ILC on the issue of differential treatment on account of subordination agreements within the liquidation process under the Code, is relevant.

Here, again no such issue seemed to arise on the contractual vis-à-vis statutory interest. The query before the ILC was raised that section 53(1)(b)(ii) of the Code may be subjective to varied interpretation where inter-creditor or subordination agreements would lose meaning once a creditor relinquished its security and came within the liquidation waterfall in section 53. The aforesaid provision stipulates:

the following debts which shall rank equally between and among the following:

(i) workmen’s dues for the period of twenty-four months preceding the liquidation commencement date; and

(ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52;

The ILC herein reiterated that statutory provisions of section 48 of the Transfer of Property Act, 1882 do not stand obliterated on account of the ranking provided for under section 53(1)(b) of the Code.
It is submitted that while the statutory rights regulated by the Transfer of Property Act, 1882 are intact, there seems to be unease with the insistence on contractual creation of security interests and the consequent overriding and exclusion of all statutory charges.

It is essential to note here that while the Sidco Leathers and the report of the ILC opine that the statutory provisions of section 48 are applicable in liquidation under the ‘special act’ of the Companies Act, 2013 and IBC respectively, the same is done on account of the special provision in the general act of the Transfer of Property Act, 1882. On the other hand, in BHEL, the NCLT had directly held that the Code overrides the provisions of the Transfer of Property Act, 1882 in defining the term ‘security interest’. As discussed, the NCLAT in BHEL refrained from holding that any such conflict exists between the Code and the Transfer of Property Act, 1882 or the Sale of Goods Act, 1930, while upholding the ruling of the NCLT in BHEL adding that only a security interest which is ‘created’ as such is the valid security interest.

**Inconsistency in judicial discourse vis-à-vis non registration of a contractual charge**

If the decision of the NCLAT in BHEL is to be taken into consideration, then there arises an additional issue. If a contractual charge is sufficient to cloth a creditor with the status of a secured creditor, then whether should non-registration of such a contractual charge be a valid reason to exclude a creditor from the category of secured debt.

As noted earlier, section 52(2) of the Code provides that in the event of the secured creditor choosing to realise the security interest, it shall inform the Liquidator of such security interest and also identify the asset subject to such security interest to be realised. It is the duty of the Liquidator to verify such security interest and permit the secured creditor to realise only such security interest the existence of which is proved in the prescribed manner.\(^{30}\)

Section 52(3) of the Code provides as under:

> Before any security interest is realised by the secured creditor under this section, the liquidator shall verify such security interest and permit the secured creditor to realise only such security interest, the existence of which may be proved either -

1. by the records of such security interest maintained by an information utility; or
2. by such other means as may be specified by the Board.

The provision was a subject matter of discussion in Volkswagen Finance,\(^ {31}\) where the appellant - car financier of the CD claimed that it should be treated as a secured creditor since it held a charge by way of hypothecation, entered in the registration certificate under the terms of section 51 of the Motor Vehicles Act, 1988. The Liquidator rejected this contention on the ground that the claim of the car financier was not registered under section 77 of the Companies Act, 2013 and the car financier was unable to furnish proof in terms of regulation 21 of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 (Liquidation Regulations). The NCLAT held that the Liquidator rightly rejected the claim as the regulation 21 of Liquidation Regulations was not complied with.
Regulation 21 of the Liquidation Regulations stipulate as under:

The existence of a security interest may be proved by a secured creditor on the basis of-

(a) the records available in an information utility, if any;

(b) certificate of registration of charge issued by the Registrar of Companies; or

(c) proof of registration of charge with the Central Registry of Securitisation Asset Reconstruction and Security Interest of India.

Noting that neither the charge was registered with the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI), nor with the Registrar of Companies (ROC) or the information utility (IU), the NCLAT rejected the claim. Resultantly, it was held that the appellant could not be termed as secured creditor. However, the appeal is currently pending before the Supreme Court.

It must be noted here that the word used is ‘may’ in regulation 21 of the Liquidation Regulations and the same was also a subject of discussion in the BHEL decision. While the NCLT specifically adjudicated on this issue, the NCLAT ruling is silent on the same.

The NCLT therein had opined that the provision under regulation 21 is directory and discretionary, since the same pertains to only providing for various modes of proving a security interest. The NCLT reasoned that a claimant could also rely on other modes (not mentioned in the regulation 21) to prove its security interest. It, however, added that the stage of proving a security interest could only arise once when the status of the creditor is already ascertained to be one that of a secured creditor. The NCLT noted that while the definition of a ‘charge’ is same in both the Companies Act, 2013 as well as the IBC, however, unlike section 77 of the Companies Act, 2013, there is no compulsion under the Code requiring mandatory registration. The NCLT had specifically rejected the argument of the Liquidator wherein it was pleaded that unless a charge is registered under section 77 of the Companies Act, 2013, the Liquidator will not entertain such a claim into consideration. The NCLT held that the Code attains precedence over the Companies Act, 2013 and even if a charge could be proved by other modes (other than certificate of registration of charge issued by the ROC), the Liquidator could still adjudicate on the issue of security interest.

However, the NCLAT in another case of Indiabulls Housing Finance had also declined the claim of a creditor to be a secured creditor on account of the contractual charge being not registered in terms of section 77 of the Companies Act, 2013. The appellant staked claim on account of having given loan to the CD sometime in 2012 and against which received the title deed of premises belonging to the CD and thereby creating a right of an equitable mortgage.

Section 77(1) speaks of the duty on the company on which the charge is created to get the same registered with the ROC. Section 77(2) entails that a copy of the registered charge will be given to the person in whose favor the charge is created. Section 77(3) stipulates that the Liquidator or any creditor shall consider no charge, if the same is not registered.
Differentiating Between Statutory vis-à-vis Contractual Charge Holders – Relevance During Liquidation

Section 125 of the Companies Act, 1956 also stipulated that a charge will be void against a Liquidator and any creditor of the company, unless registered in terms of the Act.

Since there was no charge registered in terms of the Companies Act, 2013, the NCLAT held that the creditor could not claim to be a secured creditor. Furthermore, the NCLAT held that since the charge was registered post the approval of a resolution plan, the same would not allow the appellant - creditor to stake claim of being a secured creditor.\(^\text{35}\)

Therefore, while the NCLAT in other cases insists on the registration of a charge, the same sits in contrast with its approval of the reasoning in \textit{BHEL} which only requires that a charge be ‘created’ consciously and/or explicitly by the parties.

\textbf{CONCLUSION}

The law postulated under the Code had received overwhelming support from every corner of the legal ecosystem. The legislature and the Courts have worked in tandem in ironing out several of the issues that crop up during the implementation of the framework laid down under the Code. The judicial interpretation has been generally on those issues where any gap is witnessed in the provisions of the Code. For instance, in \textit{Innoventive Industries},\(^\text{36}\) the NCLT emphasized the need for the compliance of the principles of natural justice and issuance of notice by the NCLT to the CD before admitting any application for insolvency against it. The ruling in \textit{BHEL}, however, constitutes a major rereading of the statutory provision. It is even more startling that the NCLAT in \textit{BHEL} reiterated the findings of the NCLT but without upholding the premise over which the decision of the NCLT was based upon in interpretation. A secured creditor, if could only, claim a security interest if the same is contractually or consciously created, then the statutory mandate of the Transfer of Property Act, 1882 and the Sale of Goods Act, 1930 are rendered nugatory and otiose. This becomes even more astonishing when the NCLAT itself in several other cases such as \textit{Indiabulls Housing Finance, Volkswagen Finance} (as discussed earlier) has consistently held that a contractual charge if not statutorily registered, would not constitute a valid security interest for the purposes of sections 52 and 53 of the Code. Certainly, the issue requires a more in depth analysis from the Supreme Court and the NCLAT as the present understanding on this issue may result in an intended creation of conflict between two statutory laws, one in which only a creditor holding a security interest stands to lose.
Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill
Section 170 - Bailee's particular lien.

Unpaid seller's rights.
Section 52(3), IBC.
Section 52(2), IBC.
Section 52(4), IBC.
Section 3(31), IBC.
Section 3(30), IBC.
Section 46, The Sale of Goods Act 1930, stipulates:

(i) it is hereby clarified that at each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each
of the debts will either be paid in full, or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full; and
(ii) the term 'workmen's dues' shall have the same meaning as assigned to it in Section 326 of the Companies Act, 2013 (18 of
2013).

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(i) any amount due to the Central Government and the State Government including the amount to be received on account
of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the
period of two years preceding the liquidation commencement date;

(ii) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;

Equitable shareholders or partners, as the case may be.

Any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under
that sub-section shall be disregarded by the liquidator.


Subject to the provisions of this Act and of any law for the time being in force, notwithstanding that the property in the goods may
have passed to the buyer, the unpaid seller of goods, as such, has by implication of law— (a) a lien on the goods for the price while
he is in possession of them; (b) in case of the insolvency of the buyer a right of stopping the goods in transit after he has parted with
the possession of them; (c) a right of re-sale as limited by this Act.

Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of
withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit where the property has passed to the
buyer.

Section 170, The Indian Contracts Act, 1872, stipulates:
Section 170 - Bailee's particular lien.

Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill
in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due
remuneration for the services he has rendered in respect of them.

The High Court here in K. Saradambal noted the ruling in Oudh High Court in Hukmichand v. Pioneer Mills Ltd. where it was held that
that section 109 of the Companies Act, 1913 was applicable only to a charge created by the company by contract and not to a charge arising
by operation of law. The same principle was applied in context of section 125 of the Companies Act, 1956 by the High Court.

Supra Note 5.
Supra Note 14, para 27.
Supra Note 14, para 25.
Supra Note 14, para 26.


K. Saradambal v. Jaiganthan and Brothers (Automobile Engineers & Motor Works (P.) Ltd.), 1972 42 COMP CASE 359 (Madras); 1971 SCC
OnLine Mad 273.

Distribution of assets.

(1) Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being
in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such
period as may be specified, namely—

(a) the insolvency resolution process costs and the liquidation costs paid in full;
(b) the following debts which shall rank equally between and among the following—
(i) workmen’s dues for the period of twenty-four months preceding the liquidation commencement date; and
(ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in
Section 52;
(c) wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation
commencement date;
(d) financial debts owed to unsecured creditors;
(e) the following dues shall rank equally between and among the following—
(i) any amount due to the Central Government and the State Government including the amount to be received on account
of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the
period of two years preceding the liquidation commencement date;
(ii) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;
(f) any remaining debts and dues;
(g) preference shareholders, if any; and
(h) equity shareholders or partners, as the case may be.
(2) Any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under
that sub-section shall be disregarded by the liquidator.
(3) The fees payable to the liquidator shall be deducted proportionately from the proceeds payable to each class of recipients under
sub-section (1), and the proceeds to the relevant recipient shall be distributed after such deduction.

Explanation. — For the purpose of this section—

(i) it is hereby clarified that at each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each
of the debts will either be paid in full, or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full; and
(ii) the term 'workmen’s dues' shall have the same meaning as assigned to it in Section 326 of the Companies Act, 2013 (18 of
2013).

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Differentiating Between Statutory vis-à-vis Contractual Charge Holders – Relevance During Liquidation

Section 55(6), The Transfer of Property Act, 1882, stipulates:
Section 55 - Rights and liabilities of buyer and seller.
In the absence of a contract to the contrary, the buyer and the seller of immovable property respectively are subject to the liabilities, and have the rights, mentioned in the rules next following, or such of them as are applicable to the property sold:
(1) – (5) …
(6) The buyer is entitled -
(a) where the ownership of the property has passed to him, to the benefit of any improvement in, or increase in value of, the property, and to the rents and profits thereof;
(b) unless he has improperly declined to accept delivery of the property, to a charge on the property, as against the seller and all persons claiming under him, to the extent of the seller's interest in the property, for the amount of any purchase-money properly paid by the buyer in anticipation of the delivery and for interest on such amount; and, when he properly declines to accept the delivery, also for the earnest (if any) and for the costs (if any) awarded to him of a suit to compel specific performance of the contract or to obtain a decree for its rescission. An omission to make such disclosures as are mentioned in this section, paragraph (1), clause (a), and paragraph (5), clause (a), is fraudulent.

For instance - Amendments to sections 8, 9, 10, 12 amongst several others by the legislature by way of Act No. 26 of 2018.
Supra Note 9.
Volkswagen Finance Private Limited v. Shree Balaji Printopack Pvt. Ltd. & Anr., Civil Appeal No(s). 3858/2020 (Supreme Court).
Indiabulls Housing Finance Ltd. v. Mr. Somir Kumar Bhattacharya, Company Appeal (AT) (Insolvency) No. 830 of 2019.
Section 77, The Companies Act, 2013, states:
Section 77 - Duty to register charges, etc.
(1) It shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation:
...
(2) Where a charge is registered with the Registrar under sub-section (1), he shall issue a certificate of registration of such charge in such form and in such manner as may be prescribed to the company and, as the case may be, to the person in whose favour the charge is created.
(3) Notwithstanding anything contained in any other law for the time being in force, no charge created by a company shall be taken into account by the liquidator appointed under this Act or the Insolvency and Bankruptcy Code, 2016, as the case may be, or any other creditor unless it is duly registered under sub-section (1) and a certificate of registration of such charge is given by the Registrar under sub-section (2).
(4) Nothing in sub-section (3) shall prejudice any contract or obligation for the repayment of the money secured by a charge.
Supra Note 33.
M/s. Innovative Industries Ltd. v. ICICI Bank & Anr., Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017. Similar findings were given by the High Court in Sree Metalliks Limited & Anr. v. UOI, Writ petition 7144 (W) of 2017 (Calcutta High Court).
secured creditors of a company have both a personal right to be repaid the debt due to them from the debtor and a proprietary right to recover the debt due to them from the property of the debtor that serves as their security interest. Given that their bundle of rights is stronger than the rights of ordinary unsecured creditors of a debtor, these are typically recognised and translated into greater rights in the debtor’s insolvency.

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) too, has provisions that allow for the recognition of the special rights of secured creditors. One such provision is section 52 (read with section 53) of the Code, which allows for a secured creditor to either ‘stand outside’ the liquidation process or ‘relinquish’ its security interest and participate in the liquidation process. This option is not available to unsecured creditors. Moreover, even after security is relinquished, such secured creditors are treated as a special class of creditors, who are given priority over other creditors of the corporate debtor (CD). However, the scope of this special status is still unclear. This article aims to unpack the scope of this special status.

This article first analyses the mechanism for ‘relinquishment’ under section 52 read with 53 and lays out the issues that this has given rise to. Second, it unpacks the manner in which these issues have been dealt with judicially and considers the implications of prevalent interpretations. Finally, it suggests alternative interpretations that reconcile this special status with the concept of relinquishment.

RELINQUISHMENT UNDER THE CODE

Liquidation is a collective insolvency procedure, which usually envisages the piece-meal sale of the debtor’s assets for the benefit of all its creditors. To ensure that this process remains collective, a moratorium is put in place that prevents creditors from seeking to enforce their debts against the debtor individually. However, secured creditors are historically allowed an option to opt out of this collective process to the extent of the debt due to them that is secured by their proprietary interest.1

This option is available to secured creditors even under section 52 of the Code. Broadly, section 52 provides that:

(a) Secured creditors may choose to enforce or realise their security interests ‘in accordance with such law as applicable to the security interest being realised and to the
secured creditor’. This means that secured creditors can opt out of the collective liquidation process and realise their security interest outside of this process. Any recoveries made from such realisation would be used to extinguish the proprietary interest of the secured creditor and repay the debt due to the CD. If even after realisation, any further debt remains due, the secured creditor can prove the balance debt in the collective liquidation process of the CD and be repaid as part of this process in accordance with the waterfall for distributions provided in section 53 of the Code.

(b) Secured creditors may also choose to relinquish their security interest and participate in the collective liquidation process to the extent of their whole debt. This would mean that the Liquidator would be able to sell the secured asset as part of the collective liquidation process and distribute the recoveries from this to all the creditors of the CD in accordance with the waterfall for distributions provided in section 53 of the Code.

In the detailed waterfall mechanism provided under section 53, secured creditors have a special position regardless of whether they choose to relinquish or realise their security interest. If the secured creditor chooses to realise its security interest, and then prove for the balance of the debt, the creditor only has a personal (and not a proprietary) right against the debtor for the balance amount. Consequently, they should ordinarily be treated as other unsecured creditors for this balance amount. Similarly, if a secured creditor chooses to relinquish its security interest, implies that a secured creditor has given up its security. Ordinarily such relinquishment ought to result in its treatment as an ordinary unsecured creditor.

However, section 53 provides that:

(a) if the secured creditor realises its security interest, for the balanced unsecured amount, it receives payment under section 53(1)(e)(ii). This is at a priority below other unsecured financial creditors, who are paid out at priority at section 53(1)(d). Therefore, if a secured creditor chooses to realise its security interest, the balance due to it as a conceptual ‘unsecured’ creditor will be paid out to it after all other unsecured financial creditors are paid out.

(b) if a secured creditor relinquishes its secured interest, it receives payment under section 53(1)(b)(ii). This is at a priority above other conceptual unsecured financial creditors, who are paid out at priority at section 53(1)(d). Therefore, if a secured creditor chooses to relinquish its security, despite being conceptually ‘unsecured’, it is paid at priority to unsecured creditors. However, this special status gives rise to various concerns.

**INTERPRETATION OF SECTION 53(1)(B)**

The special status granted to creditors who have relinquished security gives rise to the following two inter-related issues. First, does section 53(1)(b) give preference to the entire debt of the secured creditor who relinquishes her security interest? Secondly, does section 53(1)(b) take into account differential priorities amongst secured creditors who have relinquished their security interest?
While judicial authority on these issues is still evolving, the most authoritative judgement till date has been pronounced by the National Company Law Appellate Tribunal (NCLAT) in Technology Development Board v. Anil Goel. While this order has been stayed by the Supreme Court (SC) vide its order dated June 29, 2021, the reasoning and conclusions of the NCLAT are relevant to examine. Specifically, the NCLAT has held that:

8. Once a Secured Creditor elects to relinquish its security interest to the liquidation estate, it ranks higher in waterfall mechanism under Section 53 to a Secured Creditor who has enforced its security interest but failed to realise its claim in full and for the unpaid part of its claim ranks lower to the Secured Creditor who has relinquished its security interest...

It is significant to note that Section 53 has been given overriding effect and the non-obstante clause contained in the very opening words of the Section leaves no room for doubt that the distribution mechanism provided thereunder applies in disregard of any provision to the contrary contained in any Central or State law in force. Of course, first charge holder will have priority in realising its security interest if it elects to realize its security interest and does not relinquish the same. However, 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.

9. Once they elected for relinquishment of security interest, for distribution of assets they would be governed by the waterfall mechanism recognised under Section 53 of the Company Appeal (AT) (Insolvency) No. 731 of 2020 I&B Code mandating equal ranking amongst the Secured Creditors. Sale proceeds in such case have to be distributed equitably amongst the Secured Creditors who rank equally and it would be irrespective of any charge they were holding prior to relinquishment of security interest.

The NCLAT’s holding that secured creditors who relinquish their security interest will be paid out under section 53(1)(b) notwithstanding the extent of their charge has the following implications:

(a) The entire debt due to a secured creditor, even if the creditor is not fully secured would be paid in priority to other unsecured creditors.

(b) The differential priorities between first charge holders and second charge holders would not be taken into account, and all secured creditors whether holding first charge or second charge would be paid in proportion to their debt due from the CD.

The NCLAT relies on the overriding effect of section 53(1) of the Code which does not clearly specify that a creditor would be considered to relinquish its security interest. Nor does section 53(1) clarify how the unsecured portion of the debt due to such creditors will be treated. Contrast this with the clear provision (section 53(1)(e)) for treating the ‘debts owed to a secured creditor for any amount unpaid following the enforcement of security interest’.

While not explicitly stated, the NCLAT could also have relied on section 53(2) to hold that inter se priorities between secured creditors would have to be disregarded by the Liquidator.
Relinquishment of Security Interest in Liquidation: Key Issues and Concerns

Finally, the NCLAT could have arguably also relied on the idea that relinquishment of security essentially strips the secured creditor of right to its security interest, therefore, section 53 could only have meant to treat these creditors in their new avatar i.e., as equally unsecured creditors in priority.

However, the NCLAT, observes the exact opposite and opines ‘While it is true that the relinquishment of security interest affects the order of distribution, it is equally true that the Secured Creditor does not lose its status of being a Secured Creditor though he has elected to forego his right of enforcing security interest’. If this were the case, then all principles applicable to security holders in general law would have to be followed. Section 53 could not have imported the concept of security interest and simultaneously overridden the basic features of such an interest.

Despite the stay on this judgement, the NCLAT has adopted a similar stance in subsequent cases as well. Specifically, in Oriental Bank of Commerce v. Anil Anchalia, the NCLAT has held that once security is relinquished by a creditor, it may only be paid pro-rata with other secured creditors. In the specific facts of the case, the Appellant had argued that it deserved the entire sale proceeds from the secured assets on account of having a sole and exclusive charge. This cannot be correct as on relinquishment, one subjects oneself at the least to the payment priority in section 53, which means that the proceeds from the asset are placed in a common pool and distributed first towards payment of corporate insolvency resolution process (CIRP) costs and liquidation costs and then pari passu between workmen and secured creditors who have relinquished their security interest. To that extent, the NCLAT’s observations that one subjects itself to the distribution mechanism under section 53 on relinquishment is correct. However, what is worrying is that the NCLAT has relied on the SC’s judgement in India Resurgence ARC Private Limited v. Amit Metaliks Limited and Anr. In this case, the SC had held that section 30(4) of the Code only entitles the Committee of Creditors (CoC) to consider the value and nature of security interest. However, if the CoC in its commercial wisdom considers payment to all secured creditors in proportion to their admitted claims, notwithstanding the value of their security, such payment would be appropriate. While the SC had given this judgement in context of the CIRP, without expressly considering the language of section 53, the NCLAT has extended the interpretation to liquidation through this judgement.

However, with respect both India Resurgence and Oriental Bank do not adequately consider that even upon relinquishment of security interest, who is a ‘secured creditor’ is to be determined on the basis of security. Therefore, while it is inarguable that secured creditors are to be paid pro-rata as per section 53 of the Code, the pro-ration ought to be done not on the basis of the absolute claims of each creditor, but on the basis of the claim that can be said to be secured, which can only be assessed in reference to the underlying security interest. The remaining part of the claim ought to be paid as an unsecured claim. Section 30(4) arguably provides flexibility in considering nature of security since it applies both to payments to assenting and dissenting creditors, and as such, if creditors agree for the value of their security not to be considered fully, that is permitted by the language in section 30(4). However, while assessing the minimum entitlement of a secured financial
creditor, which is the liquidation value under section 30(2), section 53 would have to be considered separately from section 30(4). In not doing that in *India Resurgence*, the SC lost an opportunity to appreciate the better interest of fully secured creditors over partially secured creditors in CIRP. Worse still, by extending the SC’s reasoning which relied on the commercial wisdom granted under section 30(4), to section 53 which does not envisage any calibration by creditors, the NCLAT has, unfortunately extended this flawed reasoning to liquidation proceedings as well.

The consequences of adopting such an interpretation are also absurd. Specifically, such an interpretation would result in creditors who are severely under-secured being treated at par with creditors who have superior security. This would be tantamount to treating unequally placed creditors equally, i.e., fully secured and partially secured creditors equally and equally placed creditors unequally i.e., partially unsecured creditors in respect of their unsecured debt and unsecured creditors unequally. This disrespect of pre-insolvency entitlements then serves to increase the cost of finance *ex ante*.

It would also undercut the rationale of providing ‘secured creditors’ special rights. For one, the special status to secured creditors who relinquish security interest appears to have been granted to promote collective liquidation. The Bankruptcy Law Reforms Committee report specifically notes that there are advantages in considering collective action instead of piecemeal enforcement even in liquidation.⁸ In other words, this special status appears to have been granted to incentivise sales of the business as a going concern or slump sales, which might result in maximising the value of the debtor’s assets. However, if secured creditors with valuable security reasonably believe that under-secured creditors would be treated equally with them, they would be incentivised to withdraw their security under section 52, and not participate in a collective liquidation process. Since this reasoning would extend even to CIRPs, this would again incentivise piecemeal action by secured creditors instead of their opting for collective insolvency proceedings. In other words, creditors may prefer to enforce their security interest using the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 or specific debt enforcement remedies, instead of making an application for commencement of CIRP.

More fundamentally still, the recognition of superior rights of secured creditors even in insolvency proceedings recognises the function of security i.e. the bonding effect they have over their security interests, which prevents the debtor from disposing off its secured assets and squandering the proceeds.⁹ If creditors know that regardless of the value of their secured asset, they would be treated at par with other secured creditors in liquidation, their incentive to take security would fall and the functions of ‘security’ would be undermined.

**ALTERNATIVE INTERPRETATIONS**

Given the difficulties of adopting the kind of interpretation put forth by the NCLAT, alternative interpretations ought to be considered.
Relinquishment of Security Interest in Liquidation: Key Issues and Concerns

The Insolvency Law Committee suggests one possible way of interpreting this section. It notes that:

that the Code aims to promote a collective liquidation process, and towards this end, it encourages secured creditors to relinquish their security interest, by providing them second-highest priority in the recovery of their dues, as under Section 53(1)(b). Thus, they are not treated as ordinary unsecured creditors under the Code, as they would have been under the Companies Act, 1956. It was noted that, to some extent, this provision intends to replicate the benefits of security even where it has been relinquished, in order to promote overall value maximisation. However, even if secured creditors realise their security interest, they would only recover to the extent of their security interest, and would claim any excess dues remaining unpaid under Section 53(1)(e) of the liquidation waterfall. Thus, the Committee was of the view that this provision could not have been intended to provide secured creditors who relinquish their security interest, priority of repayment over their entire debt regardless of the extent of their security interest, as it would tantamount to respecting a right that has never existed... the Committee agreed that the priority for recovery to secured creditors under Section 53(1)(b)(ii) should be applicable only to the extent of the value of the security interest that is relinquished by the secured creditor.10

Under this interpretation therefore, the security interest (and all rights attached to the security) are given to the liquidation estate and any monies received from sale of the security is also held in trust for all the creditors, to be paid out as per the waterfall. However, to the extent that the erstwhile secured creditor was actually secured, it would be paid out before other unsecured creditors due to the preference given in section 53(1)(b). Thus, the Insolvency Law Committee suggests that only that amount of debt of secured creditor that is actually secured by the value of its security interest would be given priority under section 53(1)(b). The part of their debts that would not be covered by security interest should then be interpreted to either fall under the category of ‘financial debts owed to unsecured creditors’ i.e., section 53(1)(d) if the security covers an underlying financial debt, or ‘any remaining debts and dues’ i.e., section 53(1)(f), if the security covers a non-financial debt.

Moreover, since the Committee opines that the priority accorded would have to be consistent with the actual value of the security interest, by implication, the priority of charges would also be respected in its view. The Committee also opined that section 53(2) would not prevent such differential priority of charges from being taken into account since section 53(2) which provides that ‘any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under that sub-section shall be disregarded by the liquidator’ only refers to any agreements between creditors at 53(1)(b)(i) and (ii) i.e., workmen and secured creditors, that subordinate one to another, even though section 53(1) intends for both to be treated equally.11

Another interpretation that could be considered is to reimagine what relinquishment in context of sections 52 and 53 mean. Given that section 53 continues to use the term ‘secured creditors’ for creditors who have ‘relinquished their security’, this arguably implies that these creditors have not lost their rights as secured creditors, which has also been noted
by the NCLAT in *Technology Development Board*, extracted above. In this context, it may be possible to argue that relinquishment of security interest would mean only relinquishing the right to stand outside liquidation and subjecting oneself to payment priority under section 53, but otherwise retaining all other rights in the security.

This would then mean that although the Liquidator would be able to take the decision to sell the assets collectively and distribute proceeds from a common pool under section 53(1), all rights relating to the security interest are not relinquished. This would include the right to claim priority over lower charged secured creditors. Therefore, the order of priority under section 53(1)(b) itself envisages that first charge-holders would be paid over second charge-holders, and therefore section 53(2) would not be attracted.

Moreover, as the security interest continues (subject to the relinquishment of the right to stand outside liquidation, and subject to the payment mechanism in section 53), the value of security interest would be the determining factor to ascertain to what extent they are secured, which has to be determined while making payments under section 53(1)(b). Therefore, here too, to the extent that the creditor continued to be secured, it would be paid out in section 53(1)(b). The part of its debts that would not be covered by security interest would then either fall under the category of ‘financial debts owed to unsecured creditors’ i.e., section 53(1)(d) if the security covers an underlying financial debt, or ‘any remaining debts and dues’ i.e., section 53(1)(f), if the security covers a non-financial debt.

Although similar to the interpretation offered by the Insolvency Law Committee in its effect on distributions/ payments due to such creditors, this interpretation would preserve the rights of the secured creditor, other than the right to stand outside liquidation or deviate from the waterfall under section 53. Rights linked to security, such as enforcement rights under third-party contracts, etc. would continue to survive as though the security interest continues to exist. This would arguably replicate the benefits of security during liquidation even better and provide greater incentives to secured creditors to relinquish their security interest. At the same time, this would indicate a break with the commonly understood concept of relinquishment of security interest.

Both interpretations present superior alternatives to the interpretation suggested by the Hon’ble NCLAT, and ought to be adopted by the SC while settling this issue. Alternatively, the legislature may consider amending the Code in line with the above interpretations and provide certainty to all market players.

**CONCLUSION**

Despite the relative importance of settling the rights of creditors who relinquish their security interest both for effective conduct of liquidations as well as CIRPs, their status remains unclear. Limited judicial guidance on this issue results in absurdities and disregards legislative intent behind providing relinquishing creditors special status.
It is important that the status of relinquishing creditors be clarified to respect the basic principle that creditors are only secured to the extent of their security interest. This would mean that section 53(1)(b) should be read to ensure that creditors with superior security (either due to a preferential charge or due to a better underlying asset) are not treated at par with creditors with inferior security. Equally, creditors who are under-secured should not be given the benefit of security over their entire debt, as this would unreasonably disregard the entitlements of other unsecured creditors.

* The author would like to thank Ms. Misha and Ms. Charu Bansal of Shardul Amarchand Mangaldas & Co. for their valuable inputs on this article.

5. C.A. No. 2206/2021 (XVII).
6. CA (AT) (Ins.) No. 547 of 2022.
8. Report of the Bankruptcy Law Reforms Committee, November, 2015, paras 5.5.6-5.5.7.
Resolution Professionals (RPs) and Liquidators tend to spend a significant amount of time during the insolvency resolution and liquidation processes investigating into the affairs of the corporate debtor (CD), in an attempt to unearth ‘avoidance transactions’. Based on data from the Insolvency and Bankruptcy Board of India (IBBI), 777 avoidance applications had been filed as of March 31, 2022 for an aggregate claim amount of ₹ 2.2 lakh crore. Yet, despite the enormous potential for unlocking value, avoidance actions have not generated sufficient attention both from research scholars and the judiciary, with the disposal rate of avoidance applications being abysmally low. There are also several areas of ambiguity in the evolving jurisprudence on avoidance actions, as well as some questions that are yet to be considered by the Adjudicating Authority (AA) and policy makers. This article discusses the relevance of avoidance transactions within the larger objectives of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) and explores the need for reforms in this area.

It first discusses the significance of avoidance actions within the broader context of the IBC and its objective of maximising value for creditors. The author then explores the track record of disposing avoidance applications under the IBC and the possible reasons for such applications being accorded a very low priority by the AA. It thereafter discusses two important cases on the treatment of avoidance applications under the IBC, including the time period for their completion and the intended beneficiaries of avoidance applications. The article concludes by pointing out additional issues that need to be addressed to increase recoveries from avoidance actions and deal with them more efficiently, and the importance of providing creditors with flexibility on how to pursue avoidance applications post completion of a resolution plan.

WHY ARE AVOIDANCE ACTIONS IMPORTANT?

Avoidance actions is the collective name given to preferential, undervalued, extortionate credit and fraudulent transactions (wrongful trading or transactions intended to defraud creditors) under sections 43 to 50 and section 66 of the IBC. Broadly, these are transactions where the CD has given preferential treatment to one of its creditors over others, transactions that are detrimental to the interests of the CD or were carried out with the intent of siphoning assets away from the CD to put them beyond the reach of its creditors in insolvency. If the CD has carried out such transactions during the relevant time period in
the run up to the insolvency commencement date, the IBC permits the AA to ‘avoid’ such transactions by passing orders intended to put the parties in the same position as if the transaction had not occurred at all, popularly termed as ‘claw back’.

The IBC differentiates between avoidance transactions where the counterparty is a related party of the CD and those where the counterparty is an unrelated third party. In the case of related parties, any preferential, undervalued or extortionate credit transactions that occurred in the two year period prior to the insolvency commencement date may be avoided while the time period for transactions with unrelated third parties is one year. The reason for this distinction is, of course, that unscrupulous promoters are more likely to siphon off their assets to related parties over which they have control than to unrelated third parties, making related party transactions in the lead up to insolvency subject to greater scrutiny.

Provisions for avoidance transactions and clawbacks are prevalent in insolvency legislation in most jurisdictions. The UNCITRAL Legislative Guide on Insolvency Law too recognises the importance of avoidance proceedings:

Transactions are typically made avoidable in insolvency to prevent fraud (e.g. transactions designed to hide assets for the later benefit of the debtor or to benefit the officers, owners or directors of the debtor); to uphold the general enforcement of creditors’ rights; to ensure equitable treatment of all creditors by preventing favouritism where the debtor wishes to advantage certain creditors at the expense of the rest; to prevent a sudden loss of value from the business entity just before the supervision of the insolvency proceedings is imposed;... Avoidance provisions can be important to an insolvency law not only because the policy upon which they are based is sound, but also because they may result in recovery of assets or their value for the benefit of creditors generally and because provisions of this nature help to create a code of fair commercial conduct that is part of appropriate standards for the governance of commercial entities.

This line of reasoning applies to the role of avoidance actions in the context of the IBC where they are an important tool for fulfilling two of the IBC’s objectives – maximising value for stakeholders and bringing about behavioural change. By its nature, the IBC is not a punitive legislation. Its purpose is not to punish a debtor whose business is in distress, but to find an orderly resolution or exit in such a situation that maximises value and balances the interests of all stakeholders. However, the fact remains that many companies enter the corporate insolvency resolution process (CIRP) owing to mismanagement or fraud on the part of the promoters and senior management. Conversely, as a company moves towards financial or economic distress, unscrupulous promoters tend to take steps to maximise their personal gain at the expense of creditors by diverting revenues or siphoning off assets away from the debtor company. This is where avoidance transactions come into picture. If properly implemented, avoidance transactions can play an important role in maximising value and recoveries for all stakeholders. In addition, they could serve as a deterrent to siphoning off of assets and other fraudulent practices in the lead up to insolvency, as well as a deterrent for individual creditors to enter into bilateral arrangements with the promoters without the knowledge of other creditors.
AVOIDANCE TRANSACTIONS UNDER THE IBC: THE JOURNEY SO FAR

Unlike the rest of the IBC that deals largely with the insolvency resolution or liquidation processes, the provisions relating to avoidance transactions are largely stand-alone provisions that are not dependent on the rest of the process. At the same time, these sections of the IBC do feed back into the CIRP and liquidation process as both RPs and Liquidators are empowered to investigate into and make applications regarding such transactions to the AA. The IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations), for example, specifically require the RP to form an opinion on whether the CD has been involved in avoidance transactions and submit applications to the AA for the avoidance of such transactions within 135 days of the insolvency commencement date. In addition, the RP is required to report to the AA on such transactions at the time of submitting a resolution plan for approval and the resolution plan is itself required to include information on how avoidance applications will be dealt with.

In light of the duty cast on RPs and Liquidators and the significant potential value in avoidance actions, in the author’s experience, many RPs and Liquidators arrange for transactional audits to identify avoidance transactions and file applications with the AA. However, these applications very rarely get resolved during CIRP or liquidation. Of the 777 applications that had been filed as of March 31, 2022, orders had been passed in only 71 cases, resulting in a total recovery of ₹ 50 crores.

In the author’s view, there appears to be two primary reasons that avoidance transactions do not get closed during the CIRP or liquidation period. First, unlike other processes in the IBC, there are no timelines in the statute or regulations for the completion of avoidance applications. In addition, as avoidance applications are not bottlenecks to the completion of a CIRP or liquidation, these applications are often not prioritised both by the tribunals and the parties concerned. In situations where tribunals are already clogged with severe backlogs, avoidance applications are an easy target to be ignored. Second, the nature of avoidance applications is such that the AA will have to examine a significant amount of evidence, including forensic records, before making a decision. In addition to being time consuming, such applications go against the grain of the typical proceedings before the tribunals, which are clearly not intended to be trial courts. Seen in this context, it is hardly surprising that avoidance transactions have been placed on the back burner for now.

CAN AVOIDANCE APPLICATIONS CONTINUE POST CIRP?

Timelines are indeed crucial for resolution and liquidation and given the complexity of avoidance transactions, it is not realistic to expect them to always be completed within the CIRP or liquidation time periods. The question that arises then is whether and in what circumstances avoidance applications can or should continue to be pursued following completion of the CIRP or liquidation processes. Two judgments, the Delhi High Court’s judgment in Venus Recruiters Pvt Ltd. v. Union of India & Others (Venus Recruiters) back in 2020 and the National Company Law Appellate Tribunal’s (NCLAT’s) more recent decision in 63 Moons Technologies Limited & Ors v. Administrator of Dewan Housing Finance Limited
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(63 Moons Technologies), shed light on some of these issues, though ambiguities and gaps still remain.

**Venus Recruiters** involved an avoidance application that was filed by the RP in the insolvency resolution process of Bhushan Steel. While the order of National Company Law Tribunal (NCLT) approving the resolution plan submitted by Tata Steel for the takeover of Bhushan Steel did not mention the avoidance applications, the NCLT subsequently issued notice to the counterparties in the avoidance applications (one of whom was Venus Recruiters). This led Venus Recruiters to file a writ petition filed in the Delhi High Court challenging the NCLT’s jurisdiction to hear an avoidance application post-completion of the CIRP as well as the RP’s authority to pursue the application. The Delhi High Court ruled in favour of Venus Recruiters, holding that an avoidance application cannot continue once a resolution plan has been approved by the NCLT and the resolution applicant has taken control of the CD. The court’s decision was based largely on the jurisdiction of the NCLT and the authority of the RP to pursue such cases after completion of the CIRP. The purpose of the IBC’s provisions on avoidance applications was for the benefit of the insolvent company and its creditors, rather than for the resolution applicant or the new management of the insolvent company. There was, therefore, no plausible reason for avoidance transactions to continue once a resolution plan was implemented as the intended beneficiaries could no longer benefit from these actions.

The Delhi High Court’s judgment, however, left open one possibility. If the resolution plan provides that the avoidance applications may continue to be pursued following implementation of the resolution plan, they may continue following completion of the CIRP. Following the judgment in **Venus Recruiters**, several resolution plans do stipulate that avoidance actions will continue to be pursued and that any recoveries from these actions will be distributed to creditors. Moreover, the most recent amendment to the CIRP regulations requires the resolution plan to mandatorily include a statement on how avoidance applications will be dealt with.

The NCLAT’s judgment in **63 Moons Technologies** builds on the **Venus Recruiters** decision but goes a step further in considering an additional question on the intended beneficiaries of avoidance transactions. In **63 Moons Technologies**, the resolution plan for Dewan Housing Finance Limited provided that the recoveries from avoidance transactions under sections 43 and 45 would be distributed to the creditors. However, the resolution plan further stipulated that the possible recoveries from the fraudulent transaction applications filed under section 66 were valued at a nominal value of ₹ 1 and any benefits from these applications would flow to the resolution applicant. The question before the NCLAT was whether such a statement in the resolution plan was contrary to law or if it was within the bounds of the committee of creditors’ (CoC) commercial wisdom to decide to deliver the benefits of avoidance transactions to the resolution applicant/CD.

The NCLAT, relying on **Venus Recruiters**, held that the benefit of avoidance transactions could, under law, only flow to the creditors of the CD and not to the successful resolution applicant or the CD in its new avatar. It further held that this was a matter of law and the
CoC did not have the discretion to stipulate otherwise. In coming to its conclusion, the NCLAT cited various authorities on the rationale for avoidance transactions, including the UNCITRAL Legislative Guide on Insolvency Law (2004), the Report of the Bankruptcy Law Reforms Committee and the practice in other countries, all of which suggested that the purpose of avoidance transactions was fairness and maximising recovery for the creditors. It is also clear that the NCLAT took into consideration the enormous amounts claimed in the avoidance applications that creditors could potentially recover.

In the circumstances, it is of utmost importance to see that there should not be any unjust enrichment at the cost of lakhs of creditors of the company whose money has been defrauded by the corporate debtor’s promoters. It is also important to mention that Government Agencies like CBI, a Special Fraud Investigation officer of the Ministry of Corporate Affairs and other agencies are also investigating the fraudulent transfers of money from the corporate debtor account to the shell companies rerouting them from there. In such a scenario, chances of recovery are very high. If any such recovery is made from these avoidance transactions, the benefit should go to the creditors of the company as per the prevailing practice in other countries.

The NCLAT’s decision in 63 Moons Technologies has been appealed to the Supreme Court and the question of whether the benefits of avoidance transactions can flow to the resolution applicant is, thus, far from closed.

**PENDING QUESTIONS ON AVOIDANCE TRANSACTIONS**

The high pendency of avoidance applications and the potentially enormous amounts they can unlock all suggest that it would be beneficial for avoidance transactions to be allowed to continue post completion of CIRP or liquidation. Indeed, the most recent report of the Insolvency Law Committee (ILC) has suggested a clarificatory amendment to the IBC to the effect that such proceedings be permitted to continue post approval of the resolution plan. The report also rightly points out that it would be important for the resolution plan to provide clarity on how these claims would be pursued post the implementation of the CIRP and the manner of distribution of the recoveries from avoidance actions.

Once the question of whether avoidance actions should be permitted to continue beyond the CIRP has been addressed, several related questions on the how arise. The first question is who should continue to litigate and bear the costs of these actions. As the creditors are the ones who would typically benefit from these cases, it should usually be a nominee of the creditors or the CoC that continues (or decides whether to continue) these litigations, with the costs being divided among the creditors. The issue, however, is that these avoidance applications are technically claims filed on behalf of the CD and, in this sense, are inherited by the successful resolution applicant. While the resolution applicant may permit a nominee of the CoC to carry out the litigation, the benefits or recoveries, if any, would only inure to the benefit of the CD in its revived form. It is, for this reason, that resolution plans and any agreements signed by the resolution applicant will need to explicitly provide for the benefits of the avoidance applications to pass through for the benefit of the creditors in the manner determined by the CoC.
While it appears logical that the creditors of the CD should be the typical intended beneficiaries of the recoveries from avoidance transactions, it is worth asking if this must always be the case as the NCLAT suggested in *63 Moons Technologies*. In the author’s view, there may be situations where the resolution applicant or some other party that funds the litigation may be better placed to pursue these litigations and benefit from them. For example, members of the CoC may not have the inclination to seriously pursue these avoidance transactions post approval of the resolution plan as they might have already recorded the recovery from the CD’s account based on their certain payouts in the resolution plan and written off the balance amounts. They may also not want to expend significant resources in pursuing litigation where the outcome is, by its nature, uncertain. In such a scenario, they may prefer to assign their rights to the recoveries from avoidance transactions to another party (including the resolution applicant) in exchange for an upfront payment.

Interestingly, the February, 2020 Report of the ILC also stated that while the recoveries from avoidance actions should ordinarily pass through to the benefit of the creditors, the AA may decide on this point depending on the factual matrix in a particular case: ¹³

The Committee discussed that the Resolution Applicant has usually not factored in these recoveries in her proposed Resolution Plan. Further, the key aim of avoiding certain transactions is to avoid unjust enrichment of some parties in insolvency at the cost of all creditors (see paragraph 1.4 above). Thus, in most cases it may be better suited to distribute recoveries amongst the creditors of the Corporate Debtor. While the Committee agreed on this principle, it noted that factual factors such as - the kind of transaction being avoided, party funding the action, assignment of claims (if any), creditors affected by the transaction or trading, etc. -may need to be taken into account when arriving at a decision regarding distribution of recoveries. Thus, it was recommended that instead of providing anything prescriptive in this regard, the decision on treatment of recoveries may be left the Adjudicating Authority.

It is important to keep in mind that the approach suggested above does not deny the creditors the benefits arising from avoidance transactions, but instead allows them to decide whether they would forego these future contingent benefits in exchange for a definitive pay out in the near term. It is also worth noting that the IBBI (Liquidation Process) Regulations, 2016 allow for precisely this possibility when they allow the Liquidator to assign contingent claims to third parties prior to closing the liquidation process.¹⁴ The author hopes that the Supreme Court, in considering the appeal in *63 Moons Technologies*, would take a more flexible approach in allowing the CoC to assign its rights to receive the benefits of avoidance applications to a third party, including the successful resolution applicant.

A final and important question to consider is also the capacity of the NCLT to hear and dispose of avoidance applications. While clarifying the manner in which avoidance applications are to be pursued will help clear ambiguities and provide more time for avoidance applications to be completed, this alone will not reduce the pendency of avoidance applications or guarantee that the NCLT benches will dispose of them efficiently. As things stand today,
it is more than likely that NCLT benches will continue to prioritise CIRP and liquidation applications that are essential for completion of the process and avoidance applications are likely to be left pending for years. Further, as discussed previously, hearing and disposing of avoidance applications requires considerable judicial resources. In this context, it is worth considering if there should be a different procedure for hearing avoidance applications, such as a separate bench or more detailed rules and regulations on sifting evidence for avoidance applications. Yet another related question to think about is whether there should be some outer time limit following a CIRP within which the applications must be disposed of, to provide finality to all stakeholders. While there are no obvious answers, these questions will need to be considered by policy makers to realise the full value of prosecuting avoidance transactions under the IBC.

CONCLUSION

Avoidance transactions could potentially unlock significant value, but the likelihood of success and recovery is also highly uncertain. Given the complexity and factually intensive nature of avoidance transactions, it has now been accepted by most stakeholders that such applications cannot be expected to be completed prior to approval of a resolution plan. However, the manner in which they are to be pursued, for whose benefit and at whose cost are important considerations that will need to be taken up by policy makers to improve how avoidance actions under the IBC are dealt with. In the author’s view, the long time horizon for such claims and their continent nature suggests that they are most likely to be taken up by litigation funds and other similar stakeholders and it is hoped that sufficient flexibility will be permitted for the CoC to assign their rights to the benefit of avoidance applications going forward.

Coupled with these reforms must be a re-think of how the AA deals with avoidance applications. As avoidance applications cannot be dealt with in summary proceedings, it may be necessary to develop the capacity of the tribunals to hear these applications. Equally important is to consider the most efficient way for the NCLT to pass orders in avoidance applications without compromising on the rigour of the analysis required. Without these changes, avoidance applications in many cases may continue to be kept pending until they die a natural death.
Avoidance Actions under the IBC: Learnings and Challenges

1 IBBI Quarterly Newsletter January – March, 2022.
3 It should be noted that there is no relevant time period for fraudulent transactions under sections 49 and 66 of the IBC.
4 UNCITRAL Legislative Guide on Insolvency, Part I and II (2004), paras 151 and 152.
5 Section 25(j) and 35(i), IBC.
6 Regulation 35A, CIRP Regulations.
7 Regulation 38, CIRP Regulations. It should be noted that the requirement for the resolution plan to mandatorily include how avoidance transactions will be dealt with, was added in June 2022 vide an amendment to the regulations.
8 Supra Note 1.
10 Company Appeals (AT) (Insolvency) Nos. 454, 455 and 750 of 2021.
11 Ibid., para 9.127.
12 Report of the Insolvency Law Committee, May, 2022, paras 2.16 to 2.32.
Every economy has entities that carry with them systemic risk, which is essentially the risk that failure of such entities could result in financial contagion through a sort of domino/cascading effect on the economy. The contagion effect multiplies manifold if such an entity has cross-border operations and linkages. These entities are considered systemically important and are universally termed as being ‘Too Big To Fail’ (TBTF).  

There is evidence, across the world, of how an unceremonious failure of a large financial firm can lead to a financial catastrophe across geographies. The Global Financial Crisis (GFC) witnessed a significantly large amount of financial sector defaults, resulting in failure of large banks, insurance companies and other systemically important financial institutions (SIFIs). The collapse of Lehman Brothers, one of the largest investment banks in the US, shook through the global financial markets with a widespread ripple effect. Other defaults by financial institutions such as Bear Stearns and several bank failures, resulted in negative ripple effects on economies across the globe. According to a report by the Federal Deposit Insurance Corporation (FDIC) of the US, during 2008 to 2013, 489 banks that held $686 billion in assets were closed. Governments responded through several emergency reforms, such as bailouts, funding programmes, etc. to mitigate the effects of the crisis. For instance, the bailout of American International Group (AIG), an insurance company considered TBTF. According to a report, the Federal Reserve knew that a failure of AIG would have dramatic, far-reaching consequences. Further, according to the same report, the Government ultimately considered AIG TBTF and committed a massive $180 billion to its rescue, while recognising that without the bailout AIG’s default and collapse could have brought down its counterparties, causing cascading losses and collapses throughout the financial system. On the other side of the Atlantic, the Royal Bank of Scotland had to be bailed out by the government through injection of about £45.5 billion in equity owing to the GFC.

This, however, highlighted the need for significant reforms in the bankruptcy laws (including special regimes for insolvency of financial sector entities) which were introduced in the aftermath of the crisis by several countries across the globe. Because of the implications of such a multitude and the inter-dependencies such entities create, it is understandable that the process of resolution/ insolvency for such entities might warrant special focus and cannot not be the same as that of any other entity. Therefore, there is a need to contain the default through a systematic insolvency framework - a framework which not only provides for resolution of the sick entity, but also helps in containing the risk of spreading the
distress. As such, jurisdictions all over have taken serious steps to put in place a special regime for insolvency of TBTF financial sector entities. Later part of this article garners a global perspective on insolvency regimes for financial entities.

There are similar examples, closer home. Rising levels of non-performing assets, poor corporate governance etc. led to the fall of some of the best-known names in the country, including Dewan Housing Finance Corporation Limited (DHFL), Infrastructure Leasing & Financial Services (IL&FS), Reliance Capital, etc. In India too, there have been efforts to address the concerns. Multiple committees and working groups have worked on the mandate for recommending financial sector reforms, including those for resolution of financial entities. However, it was only with the enactment of the Insolvency and Bankruptcy Code, 2016\(^8\) (IBC/Code), that the machinery was put into action. The IBC substantially revamped the law relating to insolvency proceedings by consolidating and amending the scattered laws dealing with insolvency; however, by design, IBC is not intended for ‘financial service providers’ (FSPs).

Going by the definitions of ‘corporate debtor’ (CD)\(^9\) and ‘corporate person’,\(^10\) a ‘FSP’ is not a CD. An FSP is one which provides ‘financial services’. ‘Financial services’, in turn, has been defined to include a list of services like accepting deposits, offering various services pertaining to financial products (securities, insurance, deposits, credit facilities, etc.). Hence, the entities which provide such a financial service cannot be ‘resolved’ or ‘liquidated’ under IBC, except in case an entity (or a class of such entities) is notified under section 227\(^11\) by the Central Government. The Central Government has thus notified non-banking financial companies (NBFCs) [including Housing Finance Companies (HFCs)] having asset size of ₹ 500 crore or more as FSPs (Notified NBFCs). The insolvency resolution and liquidation process of FSPs, as notified separately through rules, is different in certain aspects as it needs regulatory involvement at different stages.

In this article, the authors discuss the need for a specific framework for insolvency resolution of systemic financial firms and study whether the present framework for insolvency resolution and liquidation of FSPs is sufficient. The authors also present a view as to how the construct of the definition of ‘FSP’ is quite specific and is different from the popular meaning assigned to typical financial entities engaged in lending activities. As such, notifying all NBFCs (with or without asset thresholds), without any regard to the function or activity being carried out by the NBFC, may not sync with the design and intent of IBC. The article also explores a global perspective on the coverage and scope of the resolution framework for financial firms.

**NEED TO HAVE SPECIALISED INSOLVENCY FRAMEWORK FOR SYSTEMIC FINANCIAL ENTITIES**

**Unique nature and role play**

The need for a specialised resolution framework for systemic financial entities has been emphasised unequivocally by experts, global institutions and authorities.
A report by the International Monetary Fund\textsuperscript{12} on the need for a special resolution regime for financial institutions states that ‘the failure of financial institutions can cause disruption and major negative externalities, such as a liquidity crunch, the fire sale of assets, and spillovers via the interbank market’.

The Committee to Draft Code on Resolution of Financial Firms (FRDI Committee) thus explains, ‘financial firms are different from other firms, and their failure may be handled differently’, and such difference arises because of factors like -

- Compared to their own resources, financial firms handle large amount of consumers’ money (including a large part of the savings of households and firms).
- Some of the financial firms are also systemically important, as their failure may disrupt the financial system and hurt the real economy.
- Standard insolvency and bankruptcy processes are usually not considered suitable for financial firms, especially those handling consumer funds, and those considered to be of systemic significance.
- Such processes, even if they are efficient, tend to drag on for longer periods of time than are acceptable for instances of financial firm failure, exacerbating the threats to consumer funds and systemic stability.
- The fear of a financial firm going into a long-winded process may trigger ‘runs’ on these firms even when they have not really failed.

Scattered and non-standardised approach

The insolvency framework in India for financial sector entities had been fragmented. For financial entities like banks, insurance companies, etc., the specific laws incorporate certain provisions, for example, those in the Banking Regulation Act, 1949\textsuperscript{13} (BR Act), the Reserve Bank of India Act, 1934\textsuperscript{14} (RBI Act), or in the Insurance Act, 1938\textsuperscript{15}. For NBFCs, the RBI Act empowers the RBI to file an application for winding up of the NBFC on various grounds, including the ground of ‘inability to pay debts’. On such scenario, all provisions of the Companies Act, 2013 would apply in relation to such application.

FRAMEWORK FOR RESOLUTION OF FSPs UNDER IBC

As mentioned above, IBC specifically excludes FSPs from the definition of ‘corporate person’. Such exclusion was pursuant to the deliberations of the Bankruptcy Law Reforms Committee (BLRC), which noted that ‘The Code will not cover entities that have a dominantly financial function, whose resolution is covered by the Resolution Corporation in the draft Indian Financial Code, proposed by the Financial Sector Legislative Reforms Commission’. Still, there is section 227, under which, the Central Government has notified NBFCs (including HFCs) with an asset size of ₹ 500 crore or more (as per their last audited balance sheet) and has customised the resolution/liquidation processes by way of the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to
Adjudicating Authority) Rules, 2019\(^{16}\) (FSP Rules/ Rules) vide Notification dated November 15, 2019, and then, vide Notification dated November 18, 2019\(^{17}\) (FSP Notification).

The FSP rules draw from the structure of IBC, but with certain modifications, as discussed below:

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<tr>
<th>Particulars</th>
<th>Process under the Code</th>
<th>Process under FSP Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initiation of corporate insolvency resolution process (CIRP)</td>
<td>May be done by a financial creditor (FC), operational creditor (OC). Self-filing is allowed under section 10.</td>
<td>Only on an application by the concerned financial sector regulator, which shall be treated akin to an application by an FC.</td>
</tr>
<tr>
<td>Interim Moratorium</td>
<td>No interim moratorium as such.</td>
<td>Immediately applicable from date of filing CIRP application; ceases at the time of admission/rejection of application.</td>
</tr>
<tr>
<td>Appointment of Insolvency Professional (IP)</td>
<td>Interim resolution professional (IRP) is proposed by FC and then appointed by the Adjudicating Authority (AA). In case the applicant is an OC, it is not mandatory to recommend an IP.</td>
<td>An Administrator is proposed by the regulator, who shall be appointed by AA. The rights and duties of such Administrator are the same as that of a Resolution Professional (RP)/ Liquidator, as the case may be.</td>
</tr>
<tr>
<td>Advisory Committee</td>
<td>There is no concept of an Advisory Committee to the RP.</td>
<td>Where deemed necessary the appropriate regulator may constitute an Advisory Committee to advise the Administrator.</td>
</tr>
<tr>
<td>Committee of Creditors (CoC)</td>
<td>Applicable and relevant.</td>
<td>Applicable and relevant.</td>
</tr>
<tr>
<td>Resolution plan/liquidation or dissolution order</td>
<td>Resolution plan has to be approved by CoC. The CoC may decide to liquidate. The Liquidator files an application for dissolution.</td>
<td>The resolution plan, before being submitted to the AA for approval, has to get ‘no-objection’ (or deemed ‘no-objection’) of the financial sector regulator. Also, before the AA orders liquidation (under section 33) and dissolution (under section 54) of an FSP, an opportunity of being heard is to be given to the financial sector regulator.</td>
</tr>
<tr>
<td>Voluntary liquidation</td>
<td>Approval of shareholders and approval of creditors.</td>
<td>Besides shareholders and creditors, prior approval of the regulator is required.</td>
</tr>
</tbody>
</table>
Definition of FSP - too narrow or too wide?

As discussed above, the process for an FSP is different (and somewhat more complicated) than that for a general CD. Notified NBFCs would thus be subjected to stricter norms.

Here, it might be important to discuss if the intent of IBC was to exclude such NBFCs as FSPs in the first place. To put it differently, it would be important to examine if at all, all NBFCs, irrespective of the business it undertakes, would fit in the definition of FSP under IBC, merely because it has assets worth ₹ 500 crore or more.

Section 3(17) of IBC defines an FSP as ‘a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator’. There are two apparent aspects that stem from the definition above. The first being that an FSP should be engaged in the business of providing ‘financial services’, which is defined under IBC; and, second being that the financial services provided are in terms of an authorisation/ registration issued by a ‘financial sector regulator’, which is also a term defined under IBC.18

‘Financial services’ too, under section 3(16), is an inclusive definition, which talks about several things - accepting of deposits, safeguarding and administering assets consisting of financial products, effecting contracts of insurance, managing assets consisting of financial products, etc. While ‘financial product’, by definition under section 3(15), means ‘credit arrangements including loans and advances by banks and financial institutions’; however, the definition of ‘financial service’ does not talk about effecting or entering into credit arrangements.

In an article titled, ‘NBFC and IBC: A Lost Connection’,19 the author has discussed the nature of activities covered under various clauses of ‘financial services’. For instance, acceptance of deposits would refer to deposits accepted by banks and deposit-taking NBFCs, as a part of the ‘services’ such entities offer - as such, an inter-corporate deposit does not fall in this category. Similarly, managing/safeguarding financial products would be the task of investment managers, custodians. The functions enumerated under section 3(16), thus, pertain either to capital markets or to highly consumer-centric business involving public funds like acceptance of deposits. Offering credit facilities are not covered under the definition. Thus, classification of an entity as an FSP should be integrally linked to its systemic significance, which again, is dependent on various factors (discussed later). Further, the regime under IBC is more curative than protective. IBC is more driven by creditors’ supremacy, than regulatory supremacy which should be exercised in the public interest. As discussed later in this article, the committees and working groups constituted to study financial sector reforms and insolvency reforms emphasised on the need of a distinct framework for systemic financial firms.

Also, to say that section 3(16) is inclusive enough to cover all NBFCs as well; one would be negating the principle of ejusdem generis. On a reading of section 3(16), it becomes apparent that the services mentioned therein deal largely with activities crucial to public interest. These activities are carried out by entities closely linked to the capital market and
so, their effective functioning is essential in order to avoid a breakdown of the economy. It may also be noted that both the definitions, viz. that of ‘financial service’ and that of ‘financial product’ do not offer any flexibility so as to notify further inclusions.

It is quite evident from the above that financial sector entities such as banks, insurance companies, deposit taking NBFCs, etc. would fall under the definition of FSP and the test to determine whether an entity is an FSP or not would be the business being carried out by the entity. If an entity does not provide a ‘financial service’ in terms of section 3(16) of IBC, as it stands today, one cannot conclude that the entity is an FSP and thus IBC should not apply on such entities, except under section 227. Further, any entity which does not pass the test of definition of ‘FSP’ cannot be considered for ‘notification’ under section 227; let alone be taken for a regulator-driven insolvency process.

However, in a few rulings, namely, Randhiraj Thakur, Director Mayfair Capital Private Limited v. Jindal Saxena Financial Services Private Limited and HDFC Ltd. v. RHC Holding Pvt. Ltd. (both rulings prior to FSP Rules and FSP Notification), the Appellate Tribunal refused to initiate a case against an NBFC on the ground that such NBFC would be an FSP. In contradistinction, in Apeejay Trust v. Aviva Life Insurance Co. India Ltd. an application for insolvency was admitted against an FSP (specifically an insurance company in this case) despite FSPs being excluded from IBC. Hence, the judicial perspective in this matter does not seem to be settled.

EFFORTS TO DEVELOP SPECIALISED RESOLUTION MACHINERY FOR FINANCIAL FIRMS

Amidst the clumsy set-up, and the obvious need of a distinct resolution regime, there have been discussions to have a well-defined systematic framework separately for financial and non-financial firms, with specific focus on systemic financial entities. Such efforts, in the Indian context, are discussed below.

Financial Sector Legislative Reforms Commission and Draft Indian Financial Code

IBC was not the initial choice of the law-makers. In fact, before the constitution of BLRC in August, 2014, the Central Government (Ministry of Finance) had already constituted the Financial Sector Legislative Reforms Commission (FSLRC) in March, 2011. FSLRC’s task was to holistically ‘review and redraft the legislations governing India’s financial system’, which included ‘resolution’ of financial sector entities.

FSLRC in its Report in March, 2013, advocated the need of a separate framework for systemically important entities, a speed-oriented resolution corporation (which must stop the financial firm when the firm is not yet bankrupt), ‘that will deal with an array of financial firms such as banks and insurance companies. It will concern itself with all financial firms which make highly intense promises to consumers, such as banks, insurance companies, defined benefit pension funds, and payment systems. It will also take responsibility for the graceful resolution of systemically important financial firms, even if they have no direct links
to consumers’. FSLRC called for a methodology for identification of systemically important firms on the basis of data and information and due public engagement, while at the same time, acknowledging that:

financial firms can be adversely affected by being designated systemically important and being called upon to face higher regulatory standards and supervisory focus...financial firms must have an opportunity to appeal this designation to ensure that the FSDC’s decisions comport with basic principles of regulatory governance. The process followed in this field must, hence, follow a carefully structured set of steps ...

Accordingly, the draft Indian Financial Code (Draft IFC) provides for specification of systemic indicators on the basis of factors, like, the nature of the financial service or financial product provided by the FSP; the size of the FSP; the interconnectedness of the FSP with the financial system and other segments of the economy; the substitutability of the financial service, the financial product or the FSP in the financial system etc.

The Draft IFC has not been able to materialise so far. Note that, BLRC excluded such financial firms from the ambit of IBC, which were proposed to be dealt with under Draft IFC.

**RBI Working Group on resolution regime for Financial Institutions**

RBI set up a high-level Working Group (WG) in January, 2013 to, *inter alia*, examine the existing resolution regime/framework for the entire financial sector as a whole as also the current resolution tools and powers vested with the respective regulators of financial institutions/Government of India and also to identify the current gaps in the national resolution regime/framework *vis-à-vis* the Financial Stability Board Key Attributes of Effective Resolution Regimes (FSB Key Attributes). The WG submitted its report in January, 2014.

The WG highlighted that there are several gaps between the existing resolution powers and options available with the regulators and the FSB Key Attributes. Further, the WG acknowledged the importance of a special or separate resolution framework for financial institutions from the corporate insolvency regime for such institutions. The WG specified that the special regime should ‘extend to all financial institutions - banks as well as non-banking financial institutions and be robust enough to address failures of small and medium financial institutions as well as failures of large complex financial institutions’.

The WG advocated the need of an institution called ‘Financial Resolution Authority’, which would be responsible for the resolution of all financial institutions, which should be provided with a credible set of tools (like liquidation, purchase and assumption, bridge institution, good-bank and bad-bank, bail-in and temporary public ownership) and associated powers to the resolution authority to deal with failures and capabilities to intervene sufficiently early and quickly in a failing institution. Government control was also recommended as a ‘last option’. For taking early action by regulators, it was recommended to put in place a prompt corrective action (PCA) framework that incorporates graded triggers at pre-specified levels.
PCA framework\textsuperscript{30} was issued by RBI initially in 2017, via the revised PCA Framework for Scheduled Commercial Banks (revising the PCA framework of December 21, 2002 read with RBI notification dated June 15, 2004) and then again in 2021, providing for measures like restriction on distribution of dividend, infusion of equity by promoters/shareholders, restriction on leverage, restrictions on branch expansion, etc.

**Committee to Draft Code on Resolution of Financial Firms, and The Financial Resolution and Deposit Insurance Bill, 2016**

Pursuant to the announcement by the finance minister in the budget speech of 2016-17 of a comprehensive Code on resolution of financial firms, the Ministry of Finance constituted the FRDI Committee to draft a code on resolution of financial firms. The FRDI Committee submitted its Report on September 21, 2016\textsuperscript{31} and also submitted a draft of ‘The Financial Resolution and Deposit Insurance Bill, 2016’.\textsuperscript{32}

The recommendations broadly included, *inter alia*, an independent Financial Resolution and Deposit Insurance Corporation (FRDIC) that would perform resolution functions for a wide range of financial firms and provide deposit insurance to banks. The resolution framework would be integrated with a prompt corrective action framework, wherein the roles of the respective regulators and the FRDIC would be clearly defined. Once a financial firm is at the stage at which it is to be resolved, the FRDIC would be deemed to be its receiver, and would be able to apply a range of resolution powers (like transferring the whole or part of the assets and liabilities of the covered service provider to another person; bailing-in the liabilities; merger, amalgamation or acquisition; liquidation; or a combination of these instruments), which would enable it to resolve or liquidate a financial firm.

FRDI Committee sought to cover broadly two categories of financial firms in the special regime - (a) covered service provider and (b) insured service provider (a banking institution). According to the recommendations, a covered service provider would include most regulated FSPs (financial market infrastructure institutions, banking institutions, insurance service providers, and other financial institutions as well as SIFIs to be identified by the Central Government), except those that would be notified under section 227 to be covered under IBC. The exception was because of the view that ‘Only certain financial firms that do not handle consumers’ money and do not pose systemic risk may be covered under the Insolvency and Bankruptcy Code, as the rationale for covering under a specialised resolution regime does not apply to such firms’. Accordingly, Schedule 2 of the FRDI Bill also named ‘any NBFC’ as a covered service provider, while exception was carved out for entities notified under section 227.

The FRDI together with IBC was thus expected to provide a comprehensive resolution mechanism for the economy to provide a comprehensive framework for insolvency of non-financial and financial sector entities respectively. But, FRDI Bill was withdrawn a year later for several concerns.\textsuperscript{33} However, the discussions have seemingly revived on drafting a fresh legislation.\textsuperscript{34}
GLOBAL APPROACH ON INSOLVENCY OF FINANCIAL INSTITUTIONS

FSB Key Attributes

A key role of the Financial Stability Board (FSB)\(^{35}\) is to promote the reform of international financial regulation and supervision.\(^{36}\) G20 Leaders called on the FSB to propose possible measures to address TBTF problems associated with SIFIs at the Pittsburgh Summit in 2009.\(^{37}\) Further, in 2010 at the Seoul Summit the G20 Leaders endorsed the FSB framework for reducing the moral hazard of SIFIs (the SIFI Framework).\(^{38}\)

As part of the SIFI Framework, the FSB framed the ‘Key attributes of Effective Resolution Regimes’\(^{39}\) which is part of an integrated set of policy measures to address SIFIs.

According to FSB, ‘the aim of the Key Attributes is to make it possible to resolve any financial institution in an orderly manner without severe systemic disruption or exposing taxpayers to the risk of loss, by protecting the firm’s functions that are critical to the financial market or the real economy and ensuring that losses are borne by shareholders and creditors of the failing firm, as they would be in insolvency’.\(^{40}\)

The FSB Key Attributes point out important features that should be a part of every jurisdiction’s resolution regime for any financial institution that could be systemically significant or critical:

(a) **Resolution authority** - Any jurisdiction should have a designated administrative authority or authorities, with operational independence, expertise and sufficient resources, responsible for exercising the resolution powers over firms within the scope of the resolution regime

(b) **Resolution powers** - Regime should provide for timely and early ‘entry into resolution’ (basis suitable indicators of non-viability) before a firm is ‘balance-sheet’ insolvent, and before all equity has been wiped out. Resolution authority/authorities should have broad range of resolution powers, including establishing temporary bridge institution, etc.

(c) **Set-off, netting, collateralisation, segregation of client assets** - Legal framework governing set-off rights, contractual netting and collateralisation agreements and the segregation of client assets should be clear, transparent and enforceable. Should early termination be nevertheless exercisable, the resolution authority should have the power to temporarily stay such rights where they arise by reason only of entry into resolution or in connection with the exercise of any resolution powers. Such stays however should be subject to adequate safeguards for protecting the integrity of financial contracts.

(d) **Safeguards** - Creditor hierarchy shall be respected, with certain degree of flexibility to depart from pari passu rule with transparency about the reasons for such departures, if necessary to contain the potential systemic impact of a firm’s failure or to maximise the value for the benefit of all creditors as a whole. No creditor shall be left worse off than in liquidation.

(e) **Funding of firms in resolution** - Authorities should not be constrained to rely on
public ownership or bail-out funds as a means of resolving firms. A privately-financed
deposit insurance or resolution funds, or a funding mechanism with ex-post recovery from
the industry should be in place.

(f) Other key attributes cover legal framework conditions for cross-border cooperation,
maintaining Crisis Management Groups for global SIFIs, institution-specific cross-border
cooperation agreements, resolvability assessments, recovery and resolution planning,
access to information and information sharing.

The intent of the FSB Key Attributes, as is clear from the preamble and the scope, is to
provide a framework for effective resolution of entities that are systemically important. The
scope states that ‘Any financial institution that could be systemically significant or critical if it
fails should be subject to a resolution regime that has the attributes set out in this document’. The
scope further extends to financial market infrastructures and global SIFIs.

United States - FDIC and Title II of the Dodd-Frank Wall Street Reform and Consumer
Protection Act of 2010

In the US, there exists a separate framework for insolvency of systemically large banks and
other financial institutions. The major changes in the insolvency framework ensued post
GFC through introduction of the Dodd-Frank Wall Street Reform and Consumer Protection
Act of 2010 (Dodd Frank Act).41

The Dodd Frank Act introduced a special resolution regime under Title II dealing with
‘Orderly Liquidation Authority’, which aims at resolving such systemically important
institutions rapidly and in an orderly manner in the event that they become distressed. The
Dodd Frank Act also introduced Title I, which imposed enhanced prudential standards for
SIFIs. Title I extends to the following entities -

(a) all bank holding companies with total consolidated assets of $50 billion or more; and

(b) any NBFCs that the Financial Stability Oversight Council (FSOC) designates as
systemically important.

The special resolution regime in the US focuses on SIFIs. Further, non-bank financial
companies would have to be designated as systemically important by the FSOC as stated
above. Non-SIFIs would be resolved as per their respective laws.42

United Kingdom - Special resolution regime under the Banking Act, 2009

The UK has, under the Banking Act, 2009 (BA), a Special Resolution Regime (SRR) for
resolution of UK institution which has permission under Part 4 of the Financial Services
and Markets Act 2000 (FSMA Act) to carry on the regulated activity of accepting deposits
within the meaning of section 22 of the FSMA Act, taken with Schedule 2 and any order
under section 22 (which would broadly include banks and investment firms). The relevant
authorities under the Act are (1) The Treasury, (2) The FSA and (3) The Bank of England.
Further, SRR has listed the following objectives of the framework -
(a) To protect and enhance the stability of the financial systems of the UK.
(b) To protect and enhance public confidence in the stability of the banking systems of the UK.
(c) To protect depositors.
(d) To protect public funds.
(e) To avoid interfering with property rights in contravention of a Convention right (within the meaning of the Human Rights Act 1998).

European Union - Bank Recovery and Resolution Directive

The EU, like other major economies, introduced a specialised framework for resolution of financial entities post GFC. The specialised framework in the EU is the Bank Recovery and Resolution Directive (BRRD). Further, the ‘Single Resolution Mechanism’ (SRM) is another piece of legislation in the EU. While the BRRD provides a set of uniform rules for the EU, the SRM sets out the institutional and funding architecture for these rules in the member states participating in the bank union.

The key feature of the BRRD is that it is in line with the FSB recommendations. The scope of BRRD includes deposit-taking banks and large investment firms, similar to that of the UK SRR.

RECENT APPROACHES USED IN INDIA FOR RESOLVING INSOLVENCIES IN FINANCIAL SECTOR

The discussion hereunder covers three different approaches taken by regulators/courts for resolution of financial sector entities. These are as follows -

(a) Administrative control under section 241/242 of the Companies Act, 2013;
(b) Scheme of reconstruction by RBI under the powers conferred by the BR Act;
(c) Initiation of proceedings under the FSP Rules provided under IBC.

IL & FS

In 2018, the well-known IL&FS defaulted on its obligations, which triggered a crisis in the NBFC that had far reaching consequences on the financial system. In October, 2018, Union of India (acting through the MCA) filed a petition with Hon’ble NCLT seeking immediate suspension of the Board of Directors of the company and appointment of a new Board of Directors, amongst others, on the grounds of mismanagement and compromise in corporate governance norms and risk management by the erstwhile Board of the company and that the affairs of the company being conducted in a manner prejudicial to the public interest. NCLT vide its order dated October 1, 2018 allowed the petition and appointment of six new Directors to the Board of the company.
The NCLT observed that the provisions of IBC did not apply to IL&FS (being an FSP). Thus, the NCLT held that the provision of section 242 of the Companies Act, 2013 and the remedy can be granted after being satisfied that the affairs of the company are mismanaged. Further, NCLAT vide its orders dated February 4, 2019 and February 11, 2019 directed the appointment of Hon’ble Justice D K Jain (Retd. Justice of the Supreme Court of India) to supervise the resolution process for the IL&FS group.

IL&FS along with its 348 group companies are still undergoing the process of resolution till date. As of 2022, of the 348 entities under the IL&FS Group, a total of 246 entities stand resolved, leaving 101 entities to be resolved in the next financial year.  

**Yes Bank**

On March 5, 2020, Yes Bank was placed under moratorium, owing to the inability of the bank to raise capital to address its losses, fall in deposits, along with serious governance issues and practices. The moratorium was imposed by the Central Government on an application made to it by RBI under section 45 of the BR Act. Further, in exercise of its powers conferred under section 36ACA of the BR Act, RBI superseded the board of Yes Bank for a period of 30 days and an Administrator was appointed under section 36ACA(2) of the BR Act.

Later, RBI came out with a scheme of reconstruction for revival of Yes Bank. The final scheme was notified on March 13, 2020, pursuant to which, SBI acquired 49% stake in Yes Bank, among several other highlights. The Yes Bank case is different from that of DHFL and others, in that, the mechanism for resolution used for Yes Bank was through the powers conferred on RBI under the BR Act. There were no resolution proceedings initiated under the FSP Rules. Further, this method seemed to prove effective, as the moratorium was lifted and the reconstruction scheme was implemented. In an interview, the MD & CEO of Yes Bank stated that ‘The reconstruction of the bank has been completed and we are back into the business with full bang. We are very comfortable on the capital side with the 20% capital adequacy and on liquidity also we are seeing very good traction from both retail as well as corporate deposits. We are meeting all the regulatory, liquidity requirements from the RBI’.

**DHFL**

Post the introduction of the FSP Rules, RBI superseded the Board of DHFL, pursuant to the powers conferred under section 45-IE (I) of the RBI Act, and then CIRP was initiated. DHFL, one of the country’s largest and amongst the renowned NBFCs, was the first to be resolved under the FSP Rules at ₹ 38,000 crore.

Other financial firms taken to IBC under the same approach are SREI Infrastructure Finance Limited, SREI Equipment Finance Limited, and Reliance Capital Limited, wherein the boards of these financial entities were superseded under section 45(IE) of the RBI Act and then CIRP was initiated under IBC read with FSP Rules.

Thus, India has experimented with approaches and so far, the route under section 227 seems to be more preferred as compared to other routes. However, IBC, in its application
to systemic financial firms like DHFL, may not constitute a sufficient framework. IBC does not have all the preferred attributes required of a resolution machinery for financial firms - for instance, there is no provision for a 'resolution authority' (e.g., a resolution corporation as envisaged by FRDI), there are no detailed provisions for set-off, netting, etc. in financial contracts, etc. Further, the insolvency scheme of financial firms would need to have more clarity and detail on the nature, classification, and priority of payments owing to unique kinds of stakeholders, e.g., depositors (in case of banks and deposit-taking NBFCs), policy-holders (in case of insurance companies), etc. In case of IBC, a representative body of FCs, that is, CoC takes all the decisions, and such decisions have often been put to challenge, for example, in case of DHFL, the tussle is still continuing on appropriation of recoveries from loans listed in avoidance application by the resolution applicant.53

CONCLUSION

The article has discussed broadly two concerns. First concern is the inclusion of entities like non-deposit taking NBFCs in the FSP category, in spite of the fact that the definition of FSP do not seem to cover non-deposit taking NBFCs, even if their asset size makes them fall into systematic significance in RBI parlance. Even a core investment company, by definition having no public interface, may be systemically important, but it cannot be contended that such an entity is any different from a group holding company of an operating company/companies. A deposit-taking NBFC accepting deposits from the public should qualify to be an FSP, and the approach taken by NCLAT in Randhiraj Thakur (supra) ruling to take inter-corporate deposit as a case of public deposits is not in line with the intent of having a separate regime for FSPs. Minus a systemic significance capable of affecting financial stability, deviating from a regular creditor-controlled regime to a regulator’s protected or supervised insolvency regime makes a dent in supremacy of creditors’ interest, a key feature of insolvency laws globally. Depending on regulatory action may put creditors’ interest to prejudice. There is anecdotal evidence of several such NBFCs which are defaulting to their creditors and the financial regulator has not initiated action.

Second concern is the lack of a distinct resolution framework for FSPs. While section 227 of IBC can be used as a placeholder; however, it is undeniable that the IBC regime has not been crafted for systemic financial firms. It is true that no systemic financial firm has been notified under section 227 so far (except for notified NBFCs, which the authors argue, may be contestable in view of the definition of FSP); however, any economy cannot wait for a disaster to happen and then build rehabilitation centers. Growing interdependencies and partnerships among financial firms further enhances the problem statement. In view of the above, one should expect a new law in India specifically meant for resolving systemically financial entities. The fact the route followed under section 227 of IBC might have worked for one entity, does not absolve the need for a separate protective framework. The IBC route would be put to real test as the approach is now applied to more and more cases. While, at present, it is too soon to say whether the separate framework under section 227 is a success or a failure, one cannot deny the need for a separate framework for resolution of systemic financial firms.
Resolution Regime for Systemic Financial Firms: The IBC Way or the Other Way?

1. For more on 'Too Big To Fail', refer Cetorelli N., Traina J. (2018), “Resolving Too Big to Fail”, Federal Reserve Bank of New York Staff Reports, June.
3. An analysis by Harvard Business School on Lehman Brothers: 1850-2008. Global Impact of the Collapse, describes the aftermath as ‘The collapse of Lehman Brothers followed by the close of its London office and other international subsidiaries sent shock waves through the global financial markets with a widespread ripple effect. Defaulted loans on houses in the United States, for example, could be linked to mortgage-backed securities issued to investors in Europe or Asia. Additionally, Lehman Brothers had been a major issuer of short-term debt in the form of commercial paper, and its collapse caused a credit freeze of this vital source of lending throughout the world. Decrease in both consumer spending and exports to the United States severely affected the flow of goods, manufacturing, and job growth in Europe and Asia. Stock markets plunged, resulting in the worst economic downturn in global markets since the Great Depression of the 1930s. Major debt crises ensued in Ireland, Spain, Greece, Portugal, and Cyprus. Stimulus packages enacted by China and by the G-20, the forum for the world’s major economies, eventually began to stabilize the global markets.’
4. Supra Note 2.
6. Supra Note 2.
8. The Insolvency and Bankruptcy Code, 2016.
9. Section 3(8) of IBC – ‘corporate debtor’ means a corporate person who owes a debt to any person.
10. Section 3(7) of IBC – ‘corporate person’ means a company as defined in clause (20) of section 2 of the Companies Act, 2013 (16 of 2013), a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008 (6 of 2009), or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider.
11. MCA Notification S.O. 1817(E) dated May 01, 2018.
13. For instance, Section 36ACA provides for supersession of board of the banking company by RBI; Section 36AE deals with the power of Central Government to acquire undertakings of banking companies in certain cases; Section 45 deals with the power of RBI to apply to the Central Government for suspension of business by a banking company and to prepare scheme of reconstitution or amalgamation; Part 3 in general deals with suspension of business and winding up of banking companies. Section 35AA was inserted vide Banking Regulation (Amendment) Act, 2017, Section 2 (w.e.f. May 4, 2017) (after IBC came into effect) whereby the Central Government can authorise RBI to direct any banking company to initiate CIRP in respect of a default under IBC.
14. For instance, section 45-IE deals with supersession of Board of directors of NBFC (other than Government Company), section 45MBA deals with resolution of non-banking financial company.
15. For instance, ‘insolvency’ can be one of the grounds for winding up. Sections 53 to 61 deal with various aspects pertaining to winding up and insolvency of an insurer. Section 52A to 52G deals with management by Administrator.
17. MCA Notification S.O. 4139(E) dated November 18, 2019.
18. Section 3 (18) of the Code states that ‘financial sector regulator’ 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.
23. The Hon’ble National Company Law Tribunal, Principal Bench at New Delhi vide its order dated November 4, 2019 in the matter of Apeejay Trust v. Aviva Life Insurance Co. India Ltd., has initiated CIRP against the CD despite it being an FSP under the Code.
26. Ibid., p 96.
28. Ibid., p. v.
29. Supra Note 27, p. vii.
30. RBI notification RBI/2021-22/118 dated November 2, 2021. Further, vide notification RBI/2021-22/139 dated December 14, 2021, the PCA Framework was also made applicable to NBFCs (with certain exceptions). The PCA framework for NBFCs will come into effect from 01 October, 2022.
34. Verma S. (2022), “To handle insolvency in financial companies, modified FDRI Bill up for discussions”, The Indian Express, 03 January.
35. Initially the Financial Stability Forum (FSF) was founded in 1999 by the G7 countries and later, in 2008, the G20 leaders called on the FSF to expand its membership and thus, the FSF was established in 2009 as a successor to the FSF.
36. History of the FSF, FSB website.
42. For more on the special regime in the US, refer Congressional Research Service, “Regulatory Reform 10 Years After the Financial Crisis: Systemic Risk Regulation”, April, 2018.

FAQ on the EU BRRD, European Commission.


The Insolvency and Bankruptcy Board of India (IBBI) established under the Insolvency and Bankruptcy Code, 2016 (IBC/Code) is a key pillar of the ecosystem responsible for implementation of the IBC. It has regulatory oversight over the Insolvency Professionals (IPs), Insolvency Professional Agencies (IPAs), Insolvency Professional Entities (IPEs) and Information Utilities (IUs). It has also been designated as the ‘Authority’ under the Companies (Registered Valuers and Valuation) Rules, 2017 for regulation and development of the profession of valuers in the country. The IBBI is uniquely placed as it regulates the profession as well as processes.\(^1\)

**REGULATORY POWERS OF IBBI**

Under IBC, no person can function or render services as IPA, IP or IU (collectively referred to as ‘regulated persons’ hereinafter) unless registered with the IBBI under the provisions of IBC. The IBBI has further made several regulations for regulating the conduct of their professions/businesses. As part of its regulatory and supervisory powers under IBC, the IBBI has the power to call for any information and records, carry out inspections and investigations, and monitor the performance of regulated persons, and pass such orders or directions as may be required for compliance of the provisions of IBC and the regulations issued thereunder.\(^2\)

In terms of section 217 of the Code, any person aggrieved by the functioning of a regulated person may file a complaint to the IBBI in such form, within such time and in such manner as specified in Insolvency and Bankruptcy Board of India (Grievance and Complaint Handling Procedure) Regulations, 2017 (Grievance Regulations). Where such complaints are received or if the IBBI has reasonable grounds to believe that the provisions of IBC or the rules or regulations made or directions issued thereunder have been contravened by the regulated persons, it may, at any time by an order in writing, direct\(^3\) any person or persons to act as an investigating authority (IA) to conduct an inspection or investigation of the regulated persons. The IA may after providing detailed reasons also require\(^4\) any other person who is likely to have any relevant document, record or information to furnish the same, and such person shall be bound to furnish such document, record or information. The IA also has powers\(^5\) to enter any building or place and seize any document, record or information relating to the subject matter of inquiry.
ENFORCEMENT POWERS OF IBBI

The investigation reports of IA are considered by a disciplinary committee (DC) constituted by the IBBI under section 220(1) of IBC. The DC is empowered to impose a monetary penalty or suspend or cancel the registration of the regulated persons. The monetary penalty shall be (a) three times the amount of the loss caused, or likely to have been caused, to persons concerned on account of such contravention; or (b) three times the amount of the unlawful gain made on account of such contravention, whichever is higher. Further, where such loss or unlawful gain is not quantifiable, the total amount of the penalty imposed shall not exceed more than one crore rupees.⁶

As mentioned before, the powers of the IBBI and the general procedure to be followed for disciplining errant regulated persons are expressly given in the Code and the Regulations made thereunder. There are certain aspects of the procedure which are so vital, the non-compliance of which shall render the whole process invalid.

Fairness in hearing

Fortescue J. while writing a judgement as a part of the King’s Bench of the United Kingdom in *The King v. The Chancellor, Masters and Scholars of the University of Cambridge*⁷ opined that even God himself did not pass sentence upon Adam, before he was called upon to make his defence. The English Courts,⁸ have held that despite the lawful authority and just cause to act against a party charged with misconduct, the proceeding if taken without hearing her answer or reasonable warning is void and shall not bind being against justice and right. In other words, no one ought to suffer any prejudice, without having first an opportunity of defending herself.

In *State of Orissa v Binapani Dei*,⁹ the Supreme Court of India held that even an administrative order which involves civil consequences, must be made consistently with the rules of natural justice. Some statutes provide for the procedure to be followed and others remain silent on the procedure. Generally, the regulators concerned, and the courts modulate the procedure depending upon the circumstances. But there are three basic principles of natural justice which are required to be followed. First, the person likely to be affected by the enforcement or administrative order is granted an opportunity of being heard. Second, the deciding authority is required to be neutral, impartial and should provide a fair and transparent procedure. Third and final is the proper application of mind and disposal by a speaking or reasoned order.

As per regulation 11 of the IBBI (Inspection and Investigation) Regulations, 2017 (Investigation Regulations), if IBBI is of the *prima facie* opinion that sufficient cause exists to take actions under the relevant provisions of IBC, it shall issue a show-cause notice to the service provider or an associated person. Further, in terms of regulation 13 of the said Regulations, the DC, after providing an opportunity of being heard to the noticee, shall dispose of the show-cause notice by a reasoned order. Similarly, regulation 7 of the Grievance Regulations also provides for issuance of show cause notice to the service
provider in terms of the aforesaid Investigation Regulations. Thus, the Regulations have specifically provided for the procedure to be followed for satisfying the principles of natural justice.

In a 2020 High Level Committee Report on enforcement mechanism of the Securities and Exchange Board of India (SEBI), it was recommended that while regulators are required to adhere to the principles of natural justice in the course of its proceedings against a regulated person, such adherence cannot be meant to extend the application to such an extent that permits holding the system hostage at the cost of compromising the very interest of the investors. Therefore, there cannot be a straitjacket formula in this regard, and the level and degree of application of these principles of natural justice may vary case to case for achieving the desired purpose of the regulation/enforcement.

**Oral hearing**

In the context of fair hearing, whether the term ‘opportunity of being heard’ available in the statutes will include ‘oral hearing’ has always been engaging the attention of regulators and even courts on many occasions. The persons affected argue that an oral hearing gives them a better chance to present their point of view and not providing such a chance, vitiates the entire process.

The crux of the principles of natural justice or fair hearing is that regulators do not come to any adverse finding without giving the affected party an opportunity of defending the allegations or charges. One may also argue that such opportunity is effectively discharged through a written representation. The Supreme Court in a catena of judgements has held that once a show-cause notice is issued and opportunity to reply is afforded, natural justice is satisfied, and it is not mandatory to give oral hearing.

**Discretion in exercise of power**

Regulators draw power from their parent statutes. There are always provisions in the statutes which confer plenary powers on the regulators for effective regulation, which is like a catch-all provision. Especially in cases of economic legislations, the wisdom and discretion of the regulators concerned are respected. More often than not, the Courts do not question the existence of power but may question the manner in which such power is exercised.

In *Reliance Airport Developers (P) Ltd. v. Airports Authority of India*, the Supreme Court held that it is trite law that exercise of power, whether legislative or administrative, will be set aside if there is manifest error in the exercise of such power or the exercise of the power is manifestly arbitrary. Professor de Smith has summarised the principles governing the exercise of discretionary powers as under.

(a) The authority in which a discretion is vested can be compelled to exercise that discretion, but not to exercise it in any particular manner.

(b) In general, a discretion must be exercised only by the authority to which it is committed. That authority must not act under the dictates of another body or disable itself from exercising a discretion in each individual case.
(c) In the purported exercise of its discretion, it must not do what it has been forbidden to do, nor must it do what it has not been authorised to do.

(d) It must act in good faith, must have regard to all relevant considerations and must not be influenced by irrelevant considerations, must not seek to promote purposes alien to the letter or to the spirit of the legislation that gives it power to act, and must not act arbitrarily or capriciously.

De Smith has grouped the above principles in two main categories: (a) failure to exercise a discretion, and (b) excess or abuse of discretionary power, and categorically stated that these two classes are not, however, mutually exclusive. He came to the conclusion that discretion may be improperly fettered because irrelevant considerations have been taken into account, and where an authority hands over its discretion to another body it acts *ultra vires*.

**Discretion in quantum of penalty**

The provisions of IBC and the regulations framed thereunder prescribe the maximum amount of penalty that can be imposed by the DC on the regulated persons. The important question here is what level of discretion can be exercised in deciding the quantum of penalty. The amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default; the amount of loss caused as a consequence of the default, the repetitive nature of the default etc. are definitely relevant for this purpose. Regulation 12(2) of the Investigation Regulations states that it shall take into account (a) the nature and seriousness of the alleged contraventions, including whether it was deliberate, reckless or negligent on the part of the noticee; (b) the consequences and impact of the alleged contravention, including unfair advantage, loss caused, or likely to be caused, and the conduct of the noticee after the occurrence of the alleged contravention, and prior to the alleged contraventions. The apex court in the case of *Adjudicating Officer, SEBI v. Bhavesh Pabari* held that the factors in section 15J of the Securities and Exchange Board of India Act, 1992 (SEBI Act) are illustrative in nature and have to be taken into account whenever such circumstances exist but it does not mean that there can be no other circumstance(s) beyond those enumerated and that the adjudicating officer is not precluded in law from considering while deciding on the quantum of penalty to be imposed. The words ‘but not limited to’ in the Investigation Regulations clarifies that the factors identified in the said Regulations are illustrative and not exhaustive.

In *State of U.P. v. Sanjay Kumar*, the Supreme Court examined the issue of sentencing policy and came to the conclusion that principle of proportionality, as followed in various judgments of the Court, prescribes that the punishments should reflect the gravity of the offence and also the criminal background of the convict, and therefore the graver the offence and the longer the criminal record, the more severe is the punishment to be awarded. The Court further opined that by laying emphasis on individualised justice and shaping the result of the crime to the circumstances of the offender and the needs of the victim and community, restorative justice eschews uniformity of sentencing. It is a settled position.
that the prime objective of penal powers are imposition of adequate, just, proportionate punishment which is commensurate with the gravity and nature of the offence and manner in which the offence is committed.

The judicial pronouncements, therefore, recognise the discretion vested in the Adjudicating Authority while adjudging the quantum of penalty. It is thus within the realm of the Adjudicating Authority to prescribe the maximum penalty or completely waive it off or decide the amount somewhere in between, depending upon the extent, frequency and seriousness of the offence.

In one case, the Supreme Court observed as under:

Penalty will not also be imposed merely because it is lawful to do so. Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances. Even if a minimum penalty is prescribed, the authority competent to impose the penalty will be justified in refusing to impose penalty, when there is a technical or venial breach of the provisions of the Act or where the breach flows from a bona fide belief that the offender is not liable to act in the manner prescribed by the statute.

Standards of proof

In general, the standard of proof in a case of imposition of monetary penalty or disciplinary action is proof on the balance of probabilities (i.e., preponderance of probabilities), whereas in cases of criminal or quasi-criminal proceedings, the standard of proof required is higher. Courts have recognised the importance of using circumstantial evidence in regulatory actions. While recognising that direct evidence is a more certain basis to come to a conclusion, yet, in the absence thereof, it was held that Courts cannot be helpless, and it is the judicial duty to take note of the immediate and proximate facts and circumstances surrounding the events on which the charges/allegations are founded and to reach what would appear to the Court to be a reasonable conclusion therefrom. Further, it was held that the test would always be what inferential process that a reasonable/prudent man would adopt to arrive at a conclusion. However, in a recent judgement of the Supreme Court in Balram Garg v. SEBI, it has been held that the earlier judgements on circumstantial evidence are distinguishable on the facts of the case and held that in the case of violations of the SEBI (Prohibition of Insider Trading) Regulations, 2015, foundational facts must be established before a presumption is made. The apex court has indicated a high bar for standards of proof by differentiating insider trading cases from fraudulent/manipulative trade practices cases. This means the standards of proof which a regulator is required to collect while adjudicating and enforcing its regulations may vary depending upon the violation and nature of action contemplated.

The IBBI is empowered under regulation 13 of the Investigation Regulations to issue warning; order of suspension or cancellation of authorisation for assignment of an IP; order of suspension or cancellation of registration of its regulated persons, impose monetary penalty; order restitution or disgorgement; institute criminal prosecution under section 236 of IBC; or any other action or direction as may be considered appropriate, including
undergoing of training or internship. It therefore seems there is a mix of both civil and criminal penalties under the scheme of IBC.

There are many instances of acts which are punishable by imprisonment or fine or both which have been described as quasi-criminal. The Supreme Court has held that burden and standard of proof in proceedings, which are quasi-criminal in nature, is the standard of proof required in criminal proceedings. Thus, in respect proceedings which are quasi-criminal in nature, charges have to be proved beyond reasonable doubt and the alleged contravener becomes entitled to the benefit of doubt. Another related issue is the requirement of proving mens rea in cases which are criminal or quasi criminal in nature.

The logical question here is what acts under IBC constitutes civil proceedings in order to determine the standard of proof. Except for the proceedings under section 236 of IBC, powers such as suspension/cancellation of registration/assignment, imposition of monetary penalty and restitution/disgorgement etc. may fall within the ambit of civil proceedings. In Chairman, SEBI v. Shriram Mutual Fund, the Supreme Court held that it is settled law that when a penalty is imposed by an adjudicating officer, it is done so in adjudicatory proceedings and not by way of fine as a result of prosecution of an accused for commission of an offence in a criminal proceeding. Further, the Court held that mens rea is not an essential element for imposing penalty for breach of civil obligations. The Courts have differentiated offences under general penal law from the breach of a duty provided in a special legislation, which creates absolute or strict liability without proof of any mens rea.

Therefore, mere usage of the word ‘penalty’ will not be determinative to conclude the nature of proceedings being criminal or quasi-criminal. If the scheme, object and words used in the statute, provides that the proceedings for imposition of the penalty are adjudicatory in nature, in contradistinction to criminal or quasi-criminal proceedings, the determination is of the breach of the civil obligation by the offender. Courts have consistently ruled that breaches of provisions of the SEBI Act and Regulations are civil in nature, and mens rea is not essential.

Thus, regulators have to be mindful of the fact that in general and more particularly when their actions are quasi-criminal in nature, it is safer to err on the side of caution by ensuring that they have adequate evidence on hand rather than relying on circumstances and presumptions, before initiating enforcement actions or prosecutions.

**Powers of disgorgement and restitution**

Under IBC, the IBBI has the powers to direct any person who has made unlawful gain or averted loss by indulging in any activity in contravention of IBC, or the rules or regulations made thereunder, to disgorge an amount equivalent to such unlawful gain or aversion of loss. The IBBI may also provide restitution to the person who suffered loss on account of any contravention from the amount so disgorged, if the person who suffered such loss is identifiable and the loss so suffered is directly attributable to such person. Both disgorgement and restitution powers are rooted in equity and are designed to prevent
a contravener from unjustly enriching herself as a result of illegal conduct and also to compensate victims for their loss.

The Securities Appellate Tribunal (SAT) in Ram Kishori Gupta v. SEBI held that the basic idea behind disgorgement is restitution. It also held that as an investor protection measure, the investor needs to be compensated, since disgorgement without restitution does not serve any purpose. The question as to whether disgorgement is a monetary equitable remedy, or a penal measure has been engaging several Court’s attention across the globe. The United States Supreme Court in the case of Kokesh v. Securities and Exchange Commission (SEC) held that disgorgement as it is applied in SEC proceedings operates as a penalty. However, the Indian view seems to be that disgorgement is treated as an equitable remedy and not as a penal provision. Therefore, one could always argue that the disgorgement amount cannot exceed the unlawful gain or loss avoided.

**Delays in enforcement**

Section 219 of IBC provides that the IBBI may, upon completion of an inspection or investigation under section 218, issue a show cause notice to such IPA, IP or IU, and carry out inspection in such manner, giving such time for giving reply, as may be specified by Regulations. Regulation 13 of the Investigation Regulations require that the DC after providing an opportunity of being heard to the noticee, shall dispose of the show-cause notice by a reasoned order, and it shall endeavour to dispose of the show-cause notice within a period of 35 days of the date of the issuance of the show-cause notice. The IBC does not provide for any strict or mandatory timelines in respect of the enforcement powers of the IBBI, and the law generally provides the regulator with discretion in this regard. The Supreme Court in Government of India v. Citedal Fine Pharmaceuticals, Madras, held that in the absence of any period of limitation, the authority is required to exercise its powers within a reasonable period. In the case of Adjudicating Officer, SEBI v. Bhavesh Pabar it was held by the Apex Court that what would be reasonable time, would depend upon the facts and circumstances of the case, nature of the default/statute, prejudice caused, whether the third-party rights have been created etc.

The SAT is observed to have quashed the orders of the adjudication orders on the ground that there has been an inordinate delay in issuance of show cause notice and enforcement actions. The SAT further opined that old and stale disputes should not be raised and levied costs in some cases on the regulator. It is therefore important for regulators to bring timely action against the errant persons as inordinate delay adversely affects the ability of errant persons to defend themselves. Also, timely enforcement actions ensure better compliance culture.

**Disclosure of investigation material**

In terms of regulation 6 of the Investigation Regulations, the IA shall send a copy of the draft inspection report to the service provider requiring comments of the service provider within 15 days from receipt of the draft inspection report. The IA is also required to submit
a copy of the draft inspection report to the IBBI. It is also open to the IBBI to direct further inspection. Further, regulation 9 requires that the investigation report shall be submitted to the IBBI. There is no provision for providing the investigation report to the regulated persons. However, in terms of regulation 12, the show-cause notice to be issued by the IBBI shall contain the details of the alleged facts, the details of the evidence in support of the alleged facts, and the provisions violated.

In this context, the level of disclosure required during enforcement actions is another area which is heavily subjected to judicial review. In the case of T. Takano v. SEBI\(^{37}\) the question which arose before the Supreme Court was whether the investigation report under regulation 9 of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003 is required be disclosed to the person to whom a notice to show-cause was issued. The SEBI argued that the quasi-judicial proceedings that are initiated by the SEBI proceeds on the basis of the allegations that are mentioned in the show-cause notice and the documents that are annexed to it, and regulation 9 requires the IA to submit the report, after completion of the investigation, to the appointing authority, i.e., the regulator concerned. It is interesting to note that similar to the said SEBI Regulations, even the Investigation Regulations of the IBBI requires the furnishing of the investigation report to the IBBI. The SEBI argued that the report is only in the nature of an inter-departmental communication between officers investigating the matter and the authority who decides if any enforcement action is to be taken. The Supreme Court, however, concluded in that case that the accused person has a right to disclosure of the material relevant to the proceedings initiated against him. The Supreme Court further clarified that it is sufficient to disclose the materials relied on if it is for the purpose of issuing a show-cause notice for deciding whether to initiate an inquiry, but all information that is relevant to the proceedings must be disclosed in adjudication proceedings. This stage-wise distinction is an important lesson for all regulators. While recognising the right to disclosure, the Court also held that the right to disclosure is not absolute where the disclosure of information may affect other third-party interests and the stability and orderly functioning of the regulated market. It is for the regulator concerned to \textit{prima facie} establish that the disclosure of the report would affect third-party rights and the stability and orderly functioning of the regulated market, and the onus then shifts to the seeker/noticee to prove that the information is necessary to defend his case appropriately.

In a recent case of Reliance Industries Ltd. v. SEBI\(^{38}\), the issue of disclosure of material relating to enforcement actions was again examined by the Supreme Court. In this case the appellant had sought for all material collected by the regulator including certain internal reports and other reports from external experts in connection with a prosecution initiated against the appellant. Since the request for the information was denied, appeal was filed before the Supreme Court. The Court held that a regulator has a duty to act fairly, while conducting proceedings or initiating any action against the parties, and that the role of a regulator is to deal with complaints and parties in a fair manner. While allowing the appeal seeking disclosure, Court held that a regulator while enforcing the provisions of the law is bound by the principles of natural justice, wherein a party cannot be condemned without having been given an adequate opportunity to defend itself.
Privileged communication with legal advisers

It is possible for regulators to obtain opinion from external counsels or other experts before deciding on its enforcement actions. In this connection, section 129 of the Evidence Act, 1872 provides that no one shall be compelled to disclose to the Court any confidential communication which has taken place between him and his legal professional adviser, unless he offers himself as a witness, in which case he may be compelled to disclose any such communications as may appear to the Court necessary to be known in order to explain any evidence which he has given, but no others. In such cases, whether the regulator has a disclosure obligation of such privileged communications towards the purported contravener/noticee. In this regard, the Supreme Court in the Reliance case\(^\text{39}\) devised a simple test, whether the regulator has launched the prosecution on the basis of its investigation report or whether further scrutiny of the transactions by experts was called for. If the prosecution or enforcement is based on such expert opinion, from whomsoever it may be, they are only an extension of the investigation to help the regulator to ascertain the facts and reach conclusions for prosecution or otherwise, which are nothing, but a continuation of the fact-finding exercise undertaken by the regulator to determine culpability, and therefore cannot be covered by ‘legal privilege’.

Legal representation

Another question which has been subjected to several interpretations across the globe is whether the ‘legal representation’ is a part of the fair hearing process. The proponents in favour of right to legal representation argue that it is a part of the fair hearing based on the principles of natural justice. The argument against legal representation is that if it were to be allowed as of right, the delay and complications that this would cause would largely frustrate the objective to conduct the proceedings expeditiously and with complete fairness. The English Courts have not been consistent in this regard. Lord Denning as a part of the United Kingdom’s Court of Appeal in Pett v. Greyhound Racing Association Ltd.\(^\text{40}\) opined that the dictum of excluding legal representation may be correct when it involves minor matters but does not apply to tribunals dealing with matters which affect a man’s reputation or livelihood or any matters of serious import, and the natural justice then requires that he can be defended, if he wishes, by counsel or solicitor. However, in some other cases,\(^\text{41}\) the English Courts have upheld the law precluding legal representation.

In the United States of America, Title 5, section 555 of the US Code\(^\text{42}\) provides that a person compelled to appear in person before an agency or representative thereof is entitled to be accompanied, represented, and advised by counsel or, if permitted by the agency, by another qualified representative. It also provides that a party is entitled to appear in person or by or with counsel or other duly qualified representative in an agency proceeding.

In SBI v. Jah Developers (P) Ltd.\(^\text{43}\), the Supreme Court analysed several judicial precedents on right of legal representation and came to the conclusion that there is no right to be represented by a lawyer in the context of in-house proceedings of banks for identification of wilful defaulters.\(^\text{44}\) Further, in Crescent Dyes and Chemicals Ltd. v. Ram Naresh Tripathi,\(^\text{45}\)
the Supreme Court of India held that the right to be represented through counsel or agent can be restricted, controlled or regulated by statute, rules, regulations or standing orders and a delinquent has no right to be represented through counsel or agent unless the law specifically confers such a right. The Apex Court has been holding the aforesaid view consistently in case of departmental enquiries, and recently in the case of *Rajasthan Marudhara Gramin Bank v. Ramesh Chandra Meena*, held that as per settled proposition of law, the only requirement is that delinquent officer must be given fair opportunity to represent his case and that there is no absolute right in his favour to be represented through the agent of his choice. However, the Court also held at the same time that if the charge is severe and of complex nature, then request to be represented through a counsel can be considered keeping in mind the regulations concerned. The above principles could apply to the administrative and enforcement actions of regulators, including the IBBI.

In case of IBBI’s enforcement powers, there is no prohibition on legal representation. The position of the regulators on the issue of permitting legal representation during their administrative or enforcement proceedings seem to be varying. The antitrust regulator, i.e., the Competition Commission of India (CCI) had appealed before the division bench of Delhi High Court in *CCI v. Oriental Rubber Industries Private Limited*, challenging the order of single judge of Delhi High Court in allowing the legal representation in the proceedings before the Director General of the CCI. The division bench of the High Court held that when the consequences of an enquiry or investigation are severe and drastic, the right of a person to be accompanied or represented by an advocate cannot be extinguished, stands to reason and cannot be faulted with. The Court, however, qualified that the CCI shall ensure that the counsel does not sit in front of the witness; but is some distance away and the witness should be not able to confer or consult her or him.

In view of the above, one can safely conclude that although the right to legal representation is not an absolute right, in cases where the civil consequences could be severe or drastic, or the proceedings could be mired with legal complexity, providing the opportunity to be represented by a legal counsel, if requested, may strengthen the integrity and fairness of the process.

**CONCLUSION**

The Apex Court observed that it is of utmost importance that in a country grounded in the rule of law, institutions ought to adopt procedures that further the democratic principles of transparency and accountability, and principles of fairness and transparency of adjudicatory proceedings are the cornerstone of the principles of open justice. A quasi-judicial function is termed to be one which stands midway a judicial and an administrative function. The IBBI may, therefore, continue to further its adjudicatory role grounded on fairness, transparency, accountability, and accuracy.
1. About IBBI, IBBI website.
2. Section 196, IBC.
3. Section 218(1), IBC. The Board has formulated Insolvency and Bankruptcy Board of India (Inspection and Investigation) Regulations, 2017 for this purpose.
4. Section 218(3), IBC.
5. Section 218(4), IBC.
6. Section 220(3), IBC.
7. (1722) 1 Strange 557; 93 E.R. 698.
14. The Supreme Court in the case of U.P State Road Transport Corpn. v. Mohd. Ismail (1991) 3 SCC 239 observed that even a court cannot dictate the decision of the statutory authority that ought to be made in the exercise of discretion in a given case. It can at best command the statutory authority by a writ of mandamus to perform its duty by exercising the discretion according to law.
23. Black’s Law Dictionary defines ‘Mens rea’ as ‘guilty mind’; a state of mind that the prosecution, to secure a conviction, must prove that an accused had when committing a crime, criminal intention or recklessness.
24. Section 236, IBC – Trial of offences by Special Court.
28. Section 220(4), IBC.
29. Section 220(5), IBC.
38. 2022 SCC OnLine SC 979.
42. Section 555, Title 5, The US Code.
44. RBI’s Master Circular on Wilful Defaults, July 1, 2015.
46. (2022) 3 SCC 44.
47. 2018 SCC OnLine Del 9192 7.
49. 2022 SCC OnLine SC 979.
Part III
Institutions and Interdependencies
‘Regulators are in the best position to regulate when they are intimately knowledgeable about the activities they are regulating’

John Thain

As per regulatory design principles, while rendering public service, the regulators have to be focused on (a) stakeholders protection, (b) development of markets in which they perform, and (c) frame regulations in an unbiased manner with arm’s length distance from all the stakeholders. However, having myopic view on defined domain is criticised on grounds of (a) not being part of the larger vision, (b) fusion of absolute power can distort objectivity, (c) financial autonomy, by and large remains a myth, (d) democratic deficit due to undefined accountability, and (e) ‘regulatory capture by the vested interest groups’, which is the subject matter of this study.

With time the politico-economy has become more complex and the need for nuanced governance is felt across domains. The law makers have to account for a lot of known and unknown factors while legislating to address the issues emerging from market failures emerging due to information asymmetry, externalities, dominant market power or nature of public good. For this they rely on agencies of the legislature – the Government organised as Ministries/Departments to provide adequate and relevant information for decision making. Governments have felt the need for specialised supervisory agencies or regulators not only to act as an extended arm in enforcement but also to source and analyse the information required by the legislature. Such specialised agencies have become the mainstay of market regulation in capitalist, free market economies and have not been any different for post-1991 India. The Indian economy today is essentially governed through the regulators, and this has been in response to the better quality and standard of governance that these specialised regulators are able to bring forth given their focused areas of governance and their limited mandates.

Though a broad classification of regulators in India is possible in line with their primary mandate or the sector in which they function, such classification is not comprehensive. Regulators play more than any one role alone and have mandates for promotion, development, implementation, enforcement and monitoring in their respective domains. The powers delegated to regulators are also varied depending on the statute they are derived from and the larger objective set for them. The Insolvency and Bankruptcy Code,
2016 (IBC/Code) provided a comprehensive legislative intervention for addressing the issues of insolvency and bankruptcy. It also created a regulator, the Insolvency and Bankruptcy Board of India (IBBI) on October 1, 2016. The IBBI is considered a unique regulator as it is a - (a) Regulator of profession, (b) Regulator of frontline regulators, (c) Regulator of institutions (Information Utility), (d) Regulator of processes, and (e) acts as Authority under the Companies (Registered Valuers and Valuation) Rules, 2017.

Given the gamut of activities which the IBBI performs, it has been described as a ‘mini-State, having a mix of quasi-legislative, executive, and quasi-judicial functions’ and as a novel experiment, never done before anywhere in the world.

The objective of this article is to explore and understand the regulatory ecosystem in the insolvency space in India in the context of regulatory capture. It first details the structure of the regulatory ecosystem under the Code. It presents in brief the concept of regulatory capture and its identification and thereafter lays out the elements in the ecosystem that can help identify the possibility of capture of insolvency policy making. The article makes no attempt either to prove the existence or absence of capture or to assess whether any influence, that may exist as being good or bad for insolvency policy outcomes at large.

**STRUCTURE OF THE INSOLVENCY REGULATORY SPACE**

Economic theory conventionally studies the issue of regulation with an agency approach in the public interest paradigm. More simply, the construct involves a ‘principal’ usually the legislature (read Parliament), which sets the mandate with an objective of social welfare and decides on the rewards and punishments for achieving the objective or otherwise; an ‘agency’ usually the Government (Ministry/Department) and its extended arm, a specialised institution in the domain (Regulator) are mandated to work towards the set objective; the ‘firm’ which is the regulated; and the targeted outcome of regulation is the price or rate of return of the firm and how it affects the ‘consumer group’.

Drawing out a parallel of the regulatory structure for the insolvency space in India on the above theoretic frame, shows that the institutions are structured in a more complex way both in law and operation. It is also noticed that these institutions interact with each other in complex ways and that emerges from the nature of these institutions and the varied mandates set for them under the Code and the subordinate legislations (Figure 1).

The Parliament at the apex and the target company that is being resolved contain between them four layers of institutions. The process of governance is shared between these layers with each institution having a set of delegated powers and responsibilities flowing from the top to the bottom derived from the Code. Accountability from every layer leads up to the Parliament and flow of information about performance and achievement of the objective starts from the bottom and is channelled upwards through the intermediary layers. The instruments of regulation made and used for enforcement by these layers are unique to each. Figure 1 clearly shows the complex governance arrangement in the ecosystem. There are reasons for the same and have been deliberated by the Bankruptcy Law Reforms.
Committee (BLRC) which designed the Code. One understands the reasoning behind such design and can see the checks and balances attempted to be incorporated by such arrangement. Being aware of evolving nature of economic law, the BLRC recommended that\(^2\) -

The Committee recognises that it is not possible, at present, to fully design every last procedural detail about the working of the bankruptcy process. Further, the changing institutional environment in India will imply that many procedural details will need to rapidly evolve in the future. Hence, the Committee has taken the strategy of establishing a regulator to be called the Insolvency and Bankruptcy Board which will be given clear regulation-making powers about certain elements of procedural detail. The Code will be careful to not engage in excessive delegation of legislative power.

**CONCEPT OF REGULATORY CAPTURE**

The idea of ‘regulatory capture’, though not known by this name, is as old as regulation itself. The notion that private interests influence public policy making is one that has stayed along ever since the time of monarchies and is a reality in any political and economic system existing today. It has been largely studied in the context of corruption and as a part of political science or public administration. It has been identified as simply no other older theme in the western legal and political tradition than the one highlighted by capture and though heralded as a distinct contemporary theory, it is more old wine in new bottles.\(^3\) Capture has been predominantly understood as the social phenomenon of interest groups and lobbying.

Conventional economic theory identifies a more tangible idea of the ‘rent’ as the amount that exceeds what was economically or socially necessary and the behaviour behind it as
’rent seeking’. Such behaviour is harmful to others or the society at large and the rent seeker is not concerned about it. This concept embodies what is called corruption in the political realm. Economics has studied rent seeking behaviour since the days of the classical school but was christened as regulatory capture in the 1950s. More rigorous study of regulatory capture as an economic phenomenon was popularised after publication of George Stigler’s seminal work, ‘The Economic Theory of Regulation’ in 1971 but the seeds can also be traced back to Marx who laid out that large businesses control public institutions and use public policy in ways favourable to them ignoring the larger public good. Since 1970’s, capture has been studied as an economic phenomenon using varied approaches that attempt to study its occurrence, the cause-effect relation between capture and regulatory failure, attempts to measure capture and to build institutions and regulation in ways that prevents or minimises the possibility of capture. The field of economic regulation has largely benefitted from this and principles of economic regulation have taken into account the insights from studying capture as an economic factor and are being used in designing governance institutions. Failure of economic regulation became the centre point of discussion after the 2008 global financial crisis and one contributing factor was that the regulated industry was able to capture the regulator.

Capture is subjective as it based on an individual’s or group’s perception of bias. Perception itself depends on what definition the perceiver has in mind, the value choices she makes and her past experience. It is also generally confused with lobbying but is different because lobbying is observable but the influence behind capture is not observable. It exists when public policy outcomes exhibit a general bias in favour of one segment of society and such bias is consistent (Coglianese, 2016). Another difficulty with capture is that different people see different things from their point of view or the political ideology one prescribes to. There have been attempts to categorise the idea of capture based on the final consequence (Carpenter and Moss, 2014) – lax laws or enforcement is corrosive capture and strict laws burdening business as anti-competitive capture. One would have to arrive at the conclusion that crystallising the idea of capture in a clear comprehensive definition may not be tenable. Capture is more felt than defined.

Identifying capture

Given the elusiveness of the abstract notion of capture, studies have identified the least common factors that capture exhibits. Carpenter (2014) defines capture as the result or process by which regulation is, at least partially by intent and action of the industry regulated, consistently or repeatedly directed away from a defeasible model of the public interest and toward the interests of the regulated industry. On almost similar lines, Coglianese (2016) indicates that three components implicit to capture are that industry players influence policymaking leading to industry getting private benefits at the cost of overall public interest.

Research has used differing standards to identify existence of capture and there is considerable academic disagreement on this. However, when policy outcomes are a failure
then regulatory capture is brought up for discussions. Similarly, when the policy outcome is bad for the society then capture of policy making is highlighted. However, one has to accept that capture alone cannot be the reason for failure of policy outcomes and the existence of the former does not necessarily lead to the latter. The association is strenuous and causation hard to prove.

If identifying capture is difficult then measuring it is more so. Studies have attempted to identify factors that can be used to assess capture in policy making. The size of special interests (Stigler 1971; Posner 1974); mobilisation efforts (Braun 2015); cohesiveness of the group, diversity in constituents and intra-group dynamics (Pelzman 1976) and potential gains to be had if the policy outcome becomes favourable (Olson 1965). Some factors have a direct relationship and some indirect. Evidence regarding the nature of association, causation or correlation between factors and capture are numerous and inconclusive given the subjective nature of capture and the specificity of results to the context and situation.

This brings to the fore the difficulty with empirical evidence to prove capture. Empirical testing is very demanding, and questions remain about the level and nature of proof that is needed (Braun 2016). These are just one side of the story. Institutions of policy making are also aware of the possibility of regulatory capture and regulation making is expected to be actively monitored for capture. Factors associated with the organisation and structure of governance also determine whether capture occurred. The method of policy making adopted, interactions with stakeholders, evidence used in decision making, accountability policies and evaluation of outcomes are factors that determine the possibility of capture.

**Possibility of capture in the insolvency ecosystem**

The Parliament laid down the Code. In the insolvency regulatory space in India policy making for operationalising and enforcement has been delegated to the Ministry and to the IBBI. The Ministry is authorised to prescribe details which is done through the rules and to operationalise certain elements through notifications. The Code requires that detailing of matters be specified by the IBBI and is done through regulations and operational matters done through Circulars, Guidelines and Facilitation Notes. The IBBI takes on the mantle as the specialised agency for the domain of insolvency and acts as the extended arm of the Parliament and its accountability ensured to Parliament through the Ministry. The Insolvency Professional Agency (IPA) as the frontline regulator is closest to the regulated and has a mandate of promotion and development of the profession and capacity building of the professionals alongwith the supervisory functions it shares. The number of words in each of these instruments in a manner reflect the involvement of these institutions in hands-on enforcement. The Code has 70,470 words, rules add another 42,627 words and regulations add 1,82,116 words.

The stakeholder groups, which are affected by the policy outcomes in insolvency include a wide range of individuals and groups. These stakeholders are varied in terms of the stakes held in the resolution process, the ability to organise, group cohesiveness etc. The businesses that are insolvent and those undergoing insolvency resolution are the target group on which the Code operates and yet this group is the most disparate, unorganised
and has a limited number of common forums such as industry chambers and associations to use in order to approach policy makers. Companies in the larger and key sectors of the economy like mining, steel, cement, construction, electronics, automobiles etc., are better organised and have more resources in comparison with smaller sectors like consumer goods, toys, small-scale industries, handicraft-based industries etc., or those business segments that are predominantly micro, small and medium enterprises.

The creditor groups involved in the process include the financial creditors (FCs) – banks and financial institution; and the operational creditors (OCs) – employees, workmen, government agencies, vendors/suppliers to the insolvent companies. Banks and FCs have high stakes in the process as a larger share of the debt of the insolvent company is owed to them. These are mostly institutions – public and private sector banks, insurance companies, asset reconstruction companies, corporate financiers etc with the means and methods to organise themselves. As one stakeholder group they are most crucial for two reasons, one, the law itself puts them in the driver’s seat as the ‘committee of creditors’ (CoC), through the CoC enabled them to make decisions for all other creditors and the company and sanctified its decision making as ‘commercial wisdom’ protected from judicial scrutiny except on limited grounds and two, they form the largest component of the financial sector in the economy, which is one of the most organised and influential by its very nature.

One other means by which FCs can influence policy making is through the ‘revolving-door phenomenon’, where the regulator uses services of the interest group (Ayres et al., 1991;14 Boehm 200715), as they have the experience and expertise in dealing with insolvency situations as a part of their mandates as well. In terms of group cohesiveness, they would outweigh every other stakeholder group as collective action is easy here as they are few in number but with large stakes (Olson 1965). In contrast to the financial creditors the other creditor groups are almost voiceless.

The OCs whose debts are unsecured, are an amorphous group so much so that organising is a step that can be taken only if they are identifiable as a group in respect of any one company that is being resolved. Organising ability of employees and workmen, where they are in large numbers in any one company may be significant however, their ability to raise resources for representing and influencing policy making for the category as a whole may not be strong, therefore provisions of waterfall adequately prioritise the payment towards workmen dues. Government agencies on the other, are placed in a unique position though different arms of the same policy-making edifice the law limits their influence by according them a lower priority but their ability to influence decision-making depends on a host of factors that determine the internal workings of the administration and bureaucracy.

The Insolvency Professional (IP) who is at the centre of the resolution process is the agent independent (apparently, though one of the above stakeholders appoint them) of these stakeholders, functioning as an officer of the Court under the Court’s oversight and supervised by the IBBI. As an actor in the field, the IPs are uniquely placed as both, the cutting-edge level for operationalising the law and as the source of information that provides feedback on policy outcomes. They are organised as one profession and the law, in a way, has enabled their organisation through the IPAs as well. They have direct access
to the IBBI and form the single largest source of information that forms evidence for policy making. The IPs form the largest stakeholder group represented in any consultation held by the IBBI and rightly so, as the process regulations are operationalised by them. They are the constituency of the IBBI’s direct monitoring and supervision. The process regulations attempt to direct market behaviour and behaviour of other stakeholders indirectly through the IPs and the manner of conducting the process. This is essential as the IBBI does not have jurisdiction or instruments of regulation directed at the other stakeholders.

The IPAs as regulatory intermediaries (Abbott et al., 2016) play a diverse role in the policy cycle. They help in interpreting regulations, translate them into practical and usable forms for the IPs, provide capacity building, monitor compliance of IPs, address grievance and are empowered to take disciplinary action on the IPs for contraventions of the regulations. Given the central position of the IPA between the IBBI and the IPs and their development of profession mandate they have the flexibility of aligning with the stance of the IBBI or to take a stance that is favourable for their constituents. From the context of influencing policy-making these regulatory intermediaries are closest to the IBBI, having direct access to the IBBI and the IPs providing direct feedback from the field. They would be easily accessible and less costly route to seek in order to influence policy.

Real-estate allottees are at present an important stakeholder group in insolvency ecosystem. Their entry as a class of creditors with a seat at the decision-making table as FCs came through judicial intervention and subsequent amendment to the Code and enabling regulations. They continue to occupy a prominent place in discussions as their concerns are continuing despite facilitation in law. Developments that lead to the present is a good lesson in influencing policy-making. Their numbers as a group and the size of the problem was a cause of concern for the Courts and the Parliament. The media space provided on this issue alone warrants mention, as the matter got the attention it required through the ‘going public’ route, which has been accepted as an established means of influencing policy-making (Goldstein 1999; Hood 2010). Similar is the case where the governance machinery was required to take special attention in the insolvency resolution of the 12 large accounts.

**CONCLUSION**

The preceding discussions show that influencing policy-making is very much within a realm of possibility in the insolvency domain just like it is in any other. There are learnings above that can help in more transparent and robust policy-making process for the IBBI and the Government. The participatory approach to regulation making, as laid down in the regulations for regulation making, has been a part of the IBBI’s functioning extends the needed checks and balances and should continue to do so preferably with a more broad based approach. The IBBI as the largest provider of information regarding insolvency to the Parliament and the economy, should also diversify the sources from which information is collected. More points of observation need to be created in the resolution process cycle for the purpose of observation and learning. With around 6000 companies being admitted
into the resolution process, it is time that the IBBI initiated measures to systematically evaluate the impact of its regulations. The IBBI should also expand the use of empirics in strengthening evidence-based policy approach. There is now space for design and use of field experiments and randomised control trials to evaluate regulatory outcomes to understand the direct outcomes of regulations and to move from macro-level evaluations alone. These will enable the inclusion of behavioural and cognitive inputs into the policy making cycle. There are several technological tools that can be used not only for collection, collation and analysis of information but also for designing regulatory interventions and this is the era of technocratic regulatory interventions. Using tools like the pe-regulatory impact assessment will be useful to ensure better regulation making with inputs from stakeholders likely to be impacted.

2 Report of the Bankruptcy Law Reforms Committee, November, 2015, section 3.4.3.
4 Government of UK, Department of Business Innovation and Skills, “Principles for Economic Regulation”, April, 2011.
The rise of independent regulatory agencies (IRAs), as an instrument of the State, has been a remarkably noteworthy administrative reform of the late 20th century. Market liberalization policies of the 1980s and 90s led to creation of such authorities with relative autonomous regulatory powers, often referred to as the rise of the ‘Regulatory State’.

RISE OF THE ‘REGULATORY STATE’

The notion of the ‘Regulatory State’ is found to have originated, noticeably, in 1962, in the title of a book by James Anderson: ‘The Emergence of the Modern Regulatory State’, which dwelt upon the setting up of specialised independent agencies in the US. The ‘Washington Consensus’, a standard prescription of economic reforms for crisis hit developing countries in the 1980s, which encompassed free-market promoting policies, among other things, suggested that the State ‘roll itself back’ and privatise, deregulate and liberalise national economies.

This marked a paradigm shift at a policy level, and consequently for the institutional set up in the economies. In constructing this Regulatory State; regulators, monitoring agencies, commissions, special courts etc. were set up to develop, monitor, and enforce market rules and also provide policy guidance. Regulators came to occupy a centre stage in the institutional edifice of nations. They carried out governance on behalf of the State, in accordance with a statutory contract. These regulatory agencies were mostly designed to have the authority to deal with intricate issues; provide non-discriminatory access to essential services and guarantee ‘fair and transparent’ regulations.

Indian context

Starting in the 1980s, India too witnessed establishment of several IRAs across a range of sectors. Amongst the financial sector regulators fall the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority, and the Pension Fund Regulatory and Development Authority. Recent entrants in this area of regulation include the Insolvency and Bankruptcy Board of India (IBBI), and International Financial Services Centres Authority. Some examples of infrastructure regulators in the country include the Telecom Regulatory Authority of India, Petroleum and Natural Gas Regulatory Board, and Central Electricity Regulatory Commission. Some regulators of
professions are Institute of Chartered Accountants of India, Institute of Cost Accountants of India, Institute of Company Secretaries of India, Bar Council of India, and National Financial Reporting Authority. At the State level, regulators include the State Pollution Control Board, State Electricity Boards, State Electricity Regulatory Commissions, Bureau of Industrial Promotion, etc. Most recent entrant in the regulatory space is the National Medical Commission constituted in September, 2020 superseding the Medical Council of India. This is not an exhaustive list of regulators in the country.

The motivation for this change was, as for around the globe, to have arms-length decision making process, insulated from political pressures and with greater involvement of subject experts. Further, the considerations for setting up IRAs in the Indian context have been the need for economic regulation to evolve and change in line with emerging market realities. Though government departments have been discharging ‘regulatory’ responsibilities and continue to do so, over the last two decades the way this has evolved in India is creation of an IRA and fusing the powers of two or all three organs of the State, namely the legislative, executive and judiciary, in that authority for that specific domain. This not only renders the IRA very powerful, but also requires it to develop the capabilities required to discharge these onerous functions in domains that require specialised and continuously updated knowledge.

GOVERNANCE OF REGULATORS IN INDIA

The edifice of ‘Regulatory State’ rests on the principles of independence of regulators from the interference by the Government in its day-to-day activities while providing them with the overall statutory mandate under which they should operate. Some ways in which this independence is ensured include appointments to key positions for fixed tenure and immunity from removal, except in the case of incompetence and moral turpitude; greater financial autonomy including the power to raise own resources for some regulators; delegated powers and functions laid down in the statute etc. There have been differing experiments with composition of the board of the regulator, qualifications, age and expertise of the members, relation between the government and the regulator, powers and finances of the regulator, scrutiny of its quasi-legislative and quasi-judicial actions, and so on.

While Governments have hived off a number of functions to the regulators, they remain accountable for their actions. Since regulators are but extended arms of the State, acting on their behalf, they are accountable for the delivery of policy outcomes. For example, the regulators are required to report their actions to the administering Ministry/ legislature on a regular basis; these actions could be examined by committees and there is Parliamentary supervision in the form of requirements of submission of annual reports on the working of the regulator and audited financial statements. Other forms of oversight include through questions raised in the Parliament on various aspects of the functioning of regulators and deposition before Parliamentary Committees. Members of Parliament can individually raise issues about the functioning of a regulator with the Minister concerned and regulators are also required to have clear laid down mechanisms to address public grievances. However,
this Parliamentary oversight leaves much to be desired in terms of frequency of meetings and in-depth discussions on issues around independent regulators (Sanyal, 2016).³

With all its merits, the concept of IRAs has significant concerns as well. The fusion of legislative, executive, and judicial powers in one entity carries the danger of concentration of power and of potential misuse. It suffers from democratic deficit as it is not directly accountable to people or their representatives. Government continues to remain accountable for the governance carried out through the regulator, which is a classic example of the principal-agent problem. The role of regulators is generally under continuous scrutiny, especially heightened during times of crisis or when issues arise that create public concern. In case of exigencies, the Government is called upon to explain and carry out rescue operations. The challenge is to minimise the trade-off between the advantages of governance through the regulator and the apparent threat to democratic accountability. Given the complex agency and accountability issues posed by regulators as new mechanisms of governance, their design must be an integral part of a larger vision and unifying goal of public interest. Further, a continuous evaluation of their actions and manner of functioning can serve as a means to ensure accountability and transparency.

**EVALUATION FRAMEWORKS**

Regulators generally tread on a thin rope, performing the balancing act between a number of facets of regulation making, which is their main function. In normal times, regulators are criticised for ‘over-regulation’, calling for a hands-off approach. In unusual times, they are questioned for under-regulation, alleging them to be sleeping on the wheel. There is a tendency to use one untoward event to evaluate the performance of a regulator, ignoring several such events possibly prevented by it over the years. For want of a statutory requirement of an evaluation, which can factor in both achievements and failures, event specific evaluations have become the norm. Such evaluations do more harm than good, as they are overwhelmed by blame game and knee jerk reactions, often yielding band-aid solutions.

Thus, an objective, formal and periodic performance evaluation of regulators has been engaging the attention of the reformers. Periodic and consistent performance evaluations can assist in meeting the objectives of a good regulatory system viz, to produce a flow of good regulatory decisions; minimise the number of poor or mistaken decisions; speedily correct errors; avoid repetition of mistakes and identify lessons from good regulatory practices in other sectors and countries.⁴

**International frameworks**

Internationally, several frameworks are available for such performance evaluation. The most prominent among them are the World Bank’s Handbook for evaluating infrastructure regulatory systems, 2006 and OECD’s ‘Best Practices for governance of regulators’, 2014.⁵ Both OECD and World Bank argue that it is useful to subject regulators with ongoing and
periodic reviews to ensure that they are functioning in accordance with their statutory mandate.

Some jurisdictions have tailor-made evaluation frameworks such as UK’s ‘Performance Measurement by Regulators’ and Australia’s ‘Regulator Performance Framework’. A few jurisdictions, including US and South Africa have statutory obligations on the regulators to undertake performance evaluation. Further, an analysis across jurisdictions suggests that there is often a statutory obligation to undertake performance evaluation, which are mostly sectoral and thematic i.e., they seek to evaluate certain pre-determined aspects such as responsiveness, consultation process or transparency in decision making etc. For example, in Australia, the Public Service Act, 1999, Auditor-General Act, 1997, and Australian National Audit Office Standards, Public Governance, Performance and Accountability Act, 2013, make the Auditor-General under the Australian National Audit Office in-charge of audit of regulators. Under these Acts, the Auditor-General, *inter alia*, reviews a sample of orders and examines the stakeholder consultation process.

**Indian context**

The Second Administrative Reforms Commission (2009), in its 13th Report had recommended that a body of reputed outside experts should propose guidelines for periodic evaluation of independent regulators based on which Government, in consultation with departmentally related Standing Committee of the Parliament, should lay down the principles on which the regulators should be evaluated. It further went on to recommend that each statute creating a regulator should include a provision for a periodic impact assessment by an external agency. The Financial Sector Legislative Reforms Commission (2013)\(^6\) noted that there is need to require regulators to adhere to a comprehensive system of measuring their performance in the interest of greater transparency and accountability. The Commission recommended a formal mechanism to evaluate a regulator’s compliance systems through a review committee comprising of only non-executive members of the regulator’s governing board. The Damodaran Committee on Reforming the Regulatory Environment for Doing Business in India (2013)\(^7\) recommended that each regulator should undertake self-evaluation once in three years, and place its conclusions in the public domain for informed discussion and debate. This has been adopted in the Annual Report Rules relating to the IBBI. The Rules require the IBBI to carry out an assessment of its effectiveness and efficiency in terms of its objectives and mandate, keeping in view its resources, duties and powers, and an assessment of performance of its Governing Board (GB). The IBBI makes these self-assessments and publishes them in its annual reports.

**SUGGESTED EVALUATION FRAMEWORK**

In keeping with recommendations of various Committees, it is suggested that the respective statutes of regulators should provide for their annual, internal and external evaluation of performance, in relation to its objectives, resources, powers, and duties, and the nature of market it is responsible for. Given that it is difficult to envisage a standard framework...
for evaluation for every regulator since statutory design of every regulator and the nature of the market it supervises are unique, the authors suggest that a typical evaluation may factor in three sets of parameters, namely, governance, processes, and outcomes.

**Governance**

Good regulatory management and governance practices enhance regulatory outcomes. Additionally, strengthening the internal governance of regulators assists in maintaining the trust of regulated entities and other stakeholders. In evaluating this aspect of a regulator, it is important to bear in mind that IRAs perform their functions in ways that are distinct from government departments in more ways than one. Firstly, the regulators contain within them legislative (regulation making), executive (monitoring and supervision) and judicial (issuing orders) powers as opposed to a government department which typically exercises only executive powers. This regulatory structure potentially violates the principle of separation of powers. Secondly, the frequency and volume of regulation making is significantly higher due to the responsibility of regulators to react to dynamic market requirement. Thirdly, there is an independent and specialised appellate mechanism against the regulatory actions of most regulators.8

Thus, evaluating the governance aspect of a regulator would need to cover elements of quality of governance such as organisation design to address concerns arising from integration of quasi-legislative, executive and quasi-judicial powers with the regulator; compliance with statutory provisions in exercise of powers; transparency and responsiveness in discharge of its responsibilities etc. These indicators can be grouped into the following heads:

**Conduct of the Board:** Under this head, the evaluation may examine how the GB of a regulator transacts its business, comprising the institutional mechanism of ensuring transparency and accountability. Specific indictors for assessment could be: what are the mechanisms to ensure separation of quasi-legislative, executive and quasi-judicial powers; what are the systems in place for internal and external performance evaluation; how sound are the mechanisms to assist the GB with general financial and risk management and internal and external financial review mechanisms; how transparent is the conduct of the meetings of the GB; and does it have a laid out framework for conduct of its business.

**Responsiveness:** It is important to evaluate how the regulator engages with its stakeholders and responds to their legitimate concerns proactively and in a time bound manner, especially as regards exercise of its legislative powers. Responsiveness aspect of the regulator also includes aspects such as whether the regulator publishes an annual regulatory agenda in advance; does it have mechanisms for obtaining continuous feedback from its stakeholders and is it adequately disseminated on the regulator’s website and further is this feedback considered by the regulator in the right earnest; are regular awareness programmes organised for the information of relevant market players etc.
Processes

In order to fulfil its mandate as laid down in the establishing legislation, a regulator would need to develop appropriate processes and procedures. To assess its working in this aspect, a second set of parameters may include appropriateness and strength of processes followed in carrying out regulatory functions, such as quality of public consultation while making regulations; adherence to principles of natural justice in adjudication; extent of business disturbance while conducting inspections and investigations; systems for monitoring compliances, processing times for regulatory approvals or enforcement actions, etc.

Outcomes and impact

Outcomes of the actions of a regulator are discernible in the form of certain numbers, such as number of service providers registered and monitored; number of disciplinary actions taken; number of regulations notified and the number which withstood legal scrutiny etc. Impact of these actions are visible in the form of the regulator’s ability to meet its laid down objectives in an effective, efficient and efficacious manner. It can be said to be effective if the objectives are met as envisaged by the statute putting in place the regulator. Efficiency is the measure of the extent to which the objectives are met with minimum use of available resources, i.e., the relationship between inputs and output. The regulator’s actions can be said to be efficacious if the outcomes contribute to the larger ecosystem of the regulator and high-level system like the legal, economic and financial systems.

Thus, a third set of parameters to evaluate the functioning of the regulators could cover aspects of its regulatory outcome, including quality of regulation, regulatory impact assessment, adjudication orders, and services of regulated entities; market efficiency and integrity; cost of transactions; effectiveness of grievance redressal mechanism, and cost of regulations. The parameters to measure the performance of a regulator on the efficiency fronts could include aspects such as what are the outcomes of the judicial scrutiny of its regulations, i.e. whether they are able to withstand judicial challenge; how proactively have the regulations been amended to meet emerging needs of the markets; are the regulations and changes in the same disseminated widely; are there standardised internal procedures for drafting regulations etc. Efficiency measures could be timeliness of processes and regulation compliance costs imposed by the regulations on the service providers of the ecosystem etc.

Further, it is imperative that any performance evaluation of a regulator takes into consideration the feedback of its stakeholders, those who are impacted by its actions. Regular perception surveys are a means of achieving two-way communication between the regulator and its stakeholders, and serves as a means of giving an opportunity to the stakeholders to have a say in the extent and manner of their regulation by the regulator. Such surveys are conducted in a number of OECD countries.9 A comparison with peer regulators, nationally and internationally, would also be useful.
CONCLUSION

Mandating regular self and third-party assessment will perhaps be a far-reaching reform that would require greater stakeholder consultations and discussions. It will be important to engage with the IRAs to take forward this reform and further facilitate such evaluation. In the interest of transparency, the results of such an evaluation exercise should be placed in public domain.

One such move has been made by the IBBI. Its first third party assessment report is now available on its website for perusal by all stakeholders. This is a welcome step for other regulators to emulate.

However, such an assessment is not to substitute extant accountability arrangements such as response to Parliamentary questions, deposition before Parliamentary Committees, submission of annual reports, audit of accounts, etc. A self-assessment and third-party assessment of regulators can additionally aid evaluation and bolster the accountability mechanism.

*Views are personal.

2 *The Washington Consensus* refers to a set of free-market economic policies supported by prominent financial institutions such as the International Monetary Fund, the World Bank, and the U.S. Treasury. The term was coined by British economist John Williamson, in 1989. In brief, The Washington Consensus recommended structural reforms that increased the role of market forces in exchange for immediate financial help.
7 Damodaran Committee on Reforming the Regulatory Environment for Doing Business in India (2013), Ministry of Corporate Affairs, Government of India.
Certain amendments to various legislations were made effective with the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/Code), one being the Companies Act, 2013 (Companies Act). Section 255 read with schedule 11 of the IBC has amended the Companies Act on some selected areas. ‘Inability to pay debt’ as a ground of winding up by the Tribunal was omitted from the Companies Act. The voluntary winding up was omitted from the Companies Act and it was incorporated as voluntary liquidation under section 59 of the IBC. Similarly, the chapters on Revival of Sick companies was omitted from the Companies Act. There were both legislative changes as well as jurisdictional changes due to the enactment of IBC and notification of NCLT provisions parallelly. Under the IBC, the Adjudicating Authority (AA) is National Company Law Tribunal (NCLT) and the NCLT provisions were notified in establishing the unified jurisdiction under the Companies Act. The Companies (Transfer of Pending Proceedings) Rules, 2016 (Pending Proceedings Rules) was notified to transfer the pending proceedings from various jurisdictions to the NCLT. Rules 3-6 of the Pending Proceeding Rules prescribes the transfer of pending proceedings in various jurisdictions under the Companies Act. Rule 5 of the said Rules specifically deals with the transfer of pending winding up proceedings in various High Courts, on the ground of ‘inability to pay the debt’ under the Companies Act to NCLT under sections 7 or 9 of the IBC. It also mentions about the transfer of pending proceedings in Board for Industrial and Financial Reconstruction (BIFR) under the provisions of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) to NCLT except the proceedings where the BIFR has made recommendation for winding up under section 20 of the SICA. Both the legislative and jurisdictional changes with the establishment of NCLT as a unified jurisdiction under the Companies Act and the AA for corporate insolvency resolution process (CIRP) and liquidation process for corporate persons under the provisions of the IBC started a new era in corporate law and practice in India. In this article, attempt has been made to analyse the jurisdictional issues raised in relation to IBC and NCLT and to see if there exists any legislative gap?

ADJUDICATING AUTHORITIES FOR CORPORATE ENTITIES UNDER IBC: AN OVERVIEW

Sections 60 to 67A of the IBC deal with the AAs for corporate persons for insolvency resolution and liquidation. Section 60 of the IBC provides the provision for territorial jurisdiction with
the NCLT for matters related to insolvency resolution and liquidation for corporate persons including corporate debtors and personal guarantors thereof. During pendency of CIRP and liquidation proceeding of a corporate debtor (CD), the application for insolvency resolution or liquidation or bankruptcy of the corporate guarantor or personal guarantor, as the case may be, of the same CD shall be filed before the NCLT. The pending CIRP or liquidation or bankruptcy proceeding of corporate guarantor or personal guarantor, as the case may be, of the CD shall be transferred to the NCLT dealing with the CIRP or liquidation proceeding of the CD. The NCLTs have all the powers of the Debt Recovery Tribunal (DRT) as vested in Part III of the IBC. The NCLT has the jurisdiction to dispose of any application by or against the CD, any claim by or against the CD including the subsidiaries and any questions related to law or fact in the CIRP and liquidation proceeding of the CD under the IBC. Section 60(6) says that the period of moratorium against the CD shall be excluded to consider the period of limitation to file any suit or application by or against the CD. The Civil Court has no jurisdiction in the matters where the NCLT and the National Company Law Appellate Tribunal (NCLAT) have jurisdiction under the IBC. The appellate jurisdiction against the order of NCLT is vested with NCLAT and Supreme Court has the appellate jurisdiction against the order of NCLAT. The Code provides an expeditious disposal procedure. The Code also forbids any order of injunction by any court or tribunal or authority in respect of any action where the power is vested with the NCLT and NCLAT. The NCLT and NCLAT have power to impose penalty on any person who initiates CIRP or voluntary liquidation or pre-packaged insolvency resolution process (PPIRP) with malicious intention. The NCLT may pass an order imposing penalty (₹ 1 lakh to ₹ 1 crore) if any officer of the CD manages the affairs of the CD to defraud the creditors or for any fraudulent purposes after the commencement of the PPIRP.

Further, proviso to section 434(1)(c) of the Companies Act (w.e.f. June 6, 2018) provides scope to the parties to file application for transfer of proceedings related to winding up from the company court to the NCLT and the court can transfer those proceedings to the NCLT by an order. Those transferred cases shall be treated as an application for initiation of CIRP under the IBC. In Forech India Ltd. v. Edelweiss Assets Reconstruction Co. Ltd, the Supreme Court granted liberty to the appellant to apply under the proviso to section 434 of the Companies Act to the High Court of Delhi for transfer of the winding up proceeding to the NCLT Delhi, which will be treated as a proceeding under section 9 of the IBC.

**TERRITORIAL JURISDICTION**

Section 60 of the IBC says about the territorial jurisdiction of the NCLT. Few issues have been raised related to the determination of the territorial jurisdiction with the questions whether the territorial jurisdiction is of the NCLT having the jurisdiction over the place of registered office of the CD or creditors or personal guarantor? In Spectrum Voyages Pvt. Ltd. v. Fortis Healthcare Ltd, the issue was related to the appropriate jurisdiction to file a petition under the IBC. The principal bench, New Delhi held that jurisdiction for filing the application would be the NCLT having the territorial jurisdiction over the place where the registered office of the CD is situated. In this case the registered office of the CD was
situated in Gurgaon, Haryana. So, the NCLT, Chandigarh has the jurisdiction. The appeal was filed by the operational creditor (OC) against the order of the principal bench. The OC argued that section 60(1) says the jurisdiction of the NCLT over the corporate person’s registered office has the jurisdiction. Since, the OC’s registered office is located in Delhi, the NCLT bench of Delhi has the jurisdiction.

However, the NCLAT held that section 60(1) says that the AA for CIRP and liquidation of corporate persons including CD and personal guarantor shall be the NCLT having territorial jurisdiction over the place where the registered office of the corporate person is located. In this case the NCLT having the jurisdiction over CD’s registered office shall have the jurisdiction. It is the CD against whom the application for resolution is filed.

In Anil Kumar Malhotra v. M/s Mahindra & Mahindra Financial Services Ltd., an appeal was made to the NCLAT against the order of the principal bench, New Delhi. According to the appellant, the admission of an application under section 7 of the IBC is not appropriate in this case because the jurisdiction mentioned in the facility agreement is the court of Bombay. So, the main contention is about the jurisdiction of NCLT vs Court of Mumbai, which is mentioned in the clause 24.12 of the facility agreement. In this case, the territorial jurisdiction of NCLT in section 60(1) read with section 238 of the IBC was analysed. The jurisdiction under IBC in relation to any insolvency resolution is always the NCLT having territorial jurisdiction over the registered office of the CD. Section 60(1) read with section 238 of the IBC shall have overriding effect on the jurisdiction mentioned in the facility agreement. The NCLAT held that there is no error by the NCLT in admitting an application under section 7 of the IBC despite of the clause of the facility agreement.

**TRANSFER OF PENDING PROCEEDINGS**

Rule 5 of the Pending Proceedings Rules stipulates the stage of the various proceedings for transfer to NCLT. In the matters of pending proceedings in the High Courts, the rule specifies that if the notice under rule 26 and 27 of the Companies Court Rules, 1959 has been served on the respondent then those cases shall continue in the High Courts under the provisions of the Companies Act and in the proceedings, where the notice under rule 26 and 27 are not served shall be transferred to the NCLT and be treated as applications under sections 7 or 9 of the IBC. In case of the proceedings in BIFR, the cases will continue in the High Courts if the opinion has been forwarded by the BIFR under section 20 of the SICA to the High court for winding up of the company. The cases were transferred accordingly and applications under sections 7 or 9 of the IBC were filed depending upon the nature of the creditors, since the parallel proceedings of winding up in the High Courts and the proceedings under the IBC in the NCLT against the same corporate entity do not fulfil the objects of the code. Section 434 of the Companies Act was amended with the insertion of a proviso. The proviso to section 434(1) says that any party to a winding up proceedings pending before High court may file an application for the transfer of the proceeding to the Tribunal and such proceedings shall be dealt with by the Tribunal as an application for initiation of the CIRP.
In *Forech India Ltd. v. Edelweiss Assets Reconstruction Co. Ltd* a winding up petition was filed in the High Court of Delhi under section 433(e) of the Companies Act, 1956 i.e., ‘inability to pay the debt’ ground. The notice was served on the respondent in 2014. Another reference was made to BIFR under the provisions of the SICA, which was abated in 2016. Another OC i.e., SKF India Ltd. had filed an application under section 9 of the IBC, which was allowed for withdrawal. Meanwhile Edelweiss Assets Reconstruction Co. Ltd. moved to NCLT under section 7 of the IBC as a financial creditor (FC). The application was admitted by the NCLT. Forech India Ltd. had filed an appeal to the NCLAT against the order of the NCLT. The appeal was dismissed by the NCLAT referring to section 11 of the IBC. The Supreme Court held that the proceeding by the FC is an independent proceeding and must be decided as per the provisions of the IBC while considering the section 11 as irrelevant to the matter. However, the Supreme Court had emphasised on the effort of the Government in adding the proviso to section 434(1) of the Companies Act providing an opportunity to the party/parties to apply to the High Court to transfer the proceeding to the Tribunal. The Supreme Court granted the liberty to the appellant to apply to the High Court of Delhi under the proviso to section 434(1) to transfer the pending winding up proceeding to the NCLT, which can be treated as an application for CIRP under the IBC.

In *C.V. Shailandhran v. Union of India*, the Pending Proceedings Rules and the Companies (Removal of Difficulties) Fourth Order, 2016 were challenged in a writ petition made under Article 226 of the Constitution of India to the High Court of Madras and prayer was made to declare them as *ultra vires* of sections 434 and 465 of the Companies Act and violation of Article 14, 19 and 21 of the Constitution of India. According to the petitioner, section 434 contemplates about the transfer of the pending proceedings from the court to the Tribunal. Section 434 does not contemplate the transfer of the proceeding from one law to another law. The substantive right under one law i.e., company legislation cannot be taken by the application of the rule. As per the Pending Proceedings Rules, the pending proceedings under section 433(e) of the Companies Act, 1956 shall be transferred to the NCLT and the applications will be filed under the provisions of the IBC. According to the petitioner, all the pending cases under the Companies Act should be retained in the High Court. The Court held that as per the rules the cases where the notice has not been served under rules 26 and 27 of the Companies Court Rules, 1959, will be transferred to the NCLT. The Court stated that this stage of serving of notice under rules 26 and 27 are pre-admission stage and the decision of the Supreme court in *Forech India Ltd.* was referred to and the writ was disposed of.

**RESIDUARY POWER OF THE AAs/NCLT**

There has been a serious question about the power of NCLT to invoke residuary powers. Section 60(5)(c) of the IBC says that the NCLT shall have the power to adjudicate any questions in priorities or any question of fact or law arising out of the CIRP or liquidation process under the IBC. During the process of CIRP and liquidation under the IBC, many a times other issues related to contractual disputes, property disputes etc. have been raised. The question is that whether NCLT can interfere in all the matters during CIRP or liquidation
or not? What is the jurisdictional scope of the NCLT to entertain the matters outside the purview of the IBC? In *Tata Consultancy Services Ltd v. Vishal Ghisulal Jain, Resolution Professional*, the issue was that whether the NCLT can invoke the residuary power under section 60(5) of the IBC where a patent lack of jurisdiction exists. The IBC does not permit the overriding effect on all the contracts entered with the CD. In *Gujarat Urja Vikas Nigam Limited v. Mr. Amit Gupta & Ors.*, the Supreme Court held that ‘The residuary jurisdiction of the NCLT under Section 60(5)(c) of the IBC provides it a wide discretion to adjudicate the questions of law or fact arising from or in relation to the insolvency resolution proceedings’. The Apex Court held that the NCLT/NCLAT correctly stayed the termination of the PPA, because allowing the termination of the PPA would have resulted in corporate death.

Even the court has said that the NCLT and NCLAT should examine the jurisdictional scope while examining the prayers for interim relief. As per the Supreme Court judgments, the NCLT and NCLAT have the jurisdiction in all the matters under the IBC and not beyond the IBC.

**JUDICIAL INTERFERENCE BY NCLT AND NCLAT IN THE FRAMEWORK OF IBC**

Many a times the courts emphasise on the judicial intervention of the NCLT and NCLAT in the legal framework of the IBC. The courts have stated that the commercial wisdom of committee of creditors (CoC) to be given paramount consideration while dealing with the insolvency resolution of CD within a time bound resolution process, which is the legislative intention behind the enactment of the IBC. In *Vallal RCK v. M/s Siva Industries and Holdings Limited and Ors.*, the Supreme Court set aside the order of NCLAT and held that if 90% of the creditors find that permitting the settlement plan and withdrawal of CIRP is in the interest of all stakeholders, then paramount consideration should be given to the decision of the CoC. In this case the CoC approved the settlement plan filed by the promoter and withdrawal of the CIRP. Originally, an application for CIRP was filed in the NCLT under section 7 of the IBC and was admitted by the NCLT. The resolution plan did not receive the required number of voting by the CoC. So, an application was made by the Resolution Professional (RP) seeking liquidation process of the CD. Meanwhile the promoter of the CD filed a settlement plan as one time settlement, which was approved by the CoC with more than 90% voting. Subsequently the RP filed the application under section 12A of the IBC for withdrawal of the CIRP. The AA rejected the said application for withdrawal. The Supreme Court while setting aside the order of the NCLT and NCLAT stated that paramount consideration to be given to the wisdom of the CoC and emphasised minimal judicial interference of NCLT and NCLAT in the framework of the IBC.

**CONCLUSION**

In the matters of territorial jurisdiction under section 60(1) of the IBC, the ambiguity may be removed by removing the words corporate persons and retaining the words CD and personal guarantor only. The NCLT and NCLAT are the AA and Appellate Authority,
respectively under the IBC, and they have the statutory jurisdiction under the Companies Act. So, the NCLT and NCLAT may focus on the legislative intention behind the enactment of the IBC. In *New Delhi Municipal Council v. Minosha India Ltd.*, the Supreme Court answered a question related to impact of section 60(6) of the IBC and whether the CD can take advantage of section 14 of the IBC to compute the limitation period. The conflicting issues related to determination of limitation period under section 60(6) and application under section 11(6) of the Arbitration and Conciliation Act, 1996 and the Limitation Act, 1963 were discussed. It was not solely related to jurisdiction but a new interpretational approach to section 60(6) of the IBC was analysed. The Supreme Court very rightly stated that the moratorium period should be excluded while computing the limitation period. The Supreme Court has also highlighted the requirement of minimal judicial intervention in the cases of IBC. The Supreme court’s judgements on residuary jurisdiction of NCLT and NCLAT under section 60(5)(c) are also guiding principles. Sometimes the statutory boundaries and commercial wisdom may be the issue for the NCLT and NCLAT. The matters related to contractual disputes unrelated to the insolvency resolution must not be entertained by the NCLT. However, if the unrelated matters have any impact on the financial status of the CD or have impact on the CIRP or liquidation proceedings, then they may be considered in the interest of the corporate person and all the stakeholders. As the Supreme Court stated in *Gujarat Urja* case that, the NCLT and NCLAT can intervene in a contractual dispute only if it is central to the success of the CIRP. Without highlighting any legislative gap, Supreme Court very actively had settled such unexpressed legal and jurisdictional positions from time to time. It’s not new, beginning of any new legislation raises the question related to jurisdiction. The NCLT and NCLAT may follow the underlined principle of IBC related to time bound resolution and value maximisation and balancing of interest of all stakeholders and the guiding principles of Supreme Court related to minimal judicial intervention in IBC issues.

1. Section 60(2), IBC.
2. Section 60(3), IBC.
3. Section 67A, IBC.
The Insolvency and Bankruptcy Code, 2016 (IBC/Code) is a landmark legislation that has now been in force for the past five years and that seeks to achieve the twin objectives of revival of distressed entities and providing a time bound and efficient mechanism to exit a business through liquidation of assets.

The Code envisages a creditor-in-possession model by virtue of which the duty to run the corporate debtor (CD) as a going concern is laid down on the Resolution Professional (RP) who in turn works collaboratively with the committee of creditors (CoC) to seek a resolution plan for the CD. The Code envisages a mechanism wherein the day-to-day operations of the CD are managed by the RP and the key decisions regarding the corporate insolvency resolution process (CIRP) are undertaken with the approval of the CoC. This ensures that the process is run smoothly.

The Code has created an ecosystem where multiple stakeholders are involved, mainly as the financial creditors (FCs), operational creditors (OCs), workmen and employees, Government, the directors of the CD and prospective resolution applicants. As the ecosystem is maturing, there is a need for certain confidence building measures for each of the stakeholders that would enable them to support such an ecosystem more meaningfully and constructively.

As John F. Kennedy said, ‘the time to repair the roof is when the sun is shining’, the five years of the Code have pressed for a need to remove any remaining perceived stigmas related to insolvency and introduce confidence building measures to encourage participation from stakeholders and ensure a robust mechanism for keeping the process efficient and trustworthy.

This article presents the potential concerns of various stakeholders under the Code along with possible solutions/steps that can help generate confidence amongst such stakeholders. The ultimate success of the Code can be achieved only when the issues being faced by each stakeholder of the process are adequately addressed collectively for the benefit of the CD and of all stakeholders.
FINANCIAL CREDITORS

Under the Code, a CoC is generally composed of the FCs of the CD. Such a CoC is empowered to take key decisions including decisions on haircuts for creditors that is binding on all stakeholders, including the dissenting members and other stakeholders such as OCs who do not have much say in the CoC. The supremacy of commercial wisdom of CoC has been time and again reaffirmed by the Supreme Court in various cases including *K. Sashidhar*, *Essar Steel*, *Maharashtra Seamless* etc. However, in high-profile cases, as it often attracts the attention of media, CoC members are pressurised not to approve resolution plan ‘with a large haircut’ irrespective of however financially reasonable it may be, given the facts of the case. *Ghotaringa Minerals and Orchid Healthcare*, *Siva Industries and Holdings*, *Videocon Industries Limited* are some among the cases which have come under greater public scrutiny due to the perception of an unduly large haircut and subsequent withdrawal of the approvals.

At present, the term ‘haircut’ has not been defined in the Code. This has resulted in ‘haircut’ being used by the media to simplistically mean the percentage of the total claims that have been extinguished. While the interpretation is not flawed *per se*, in the context of stressed companies, it does not consider the following aspects:

(a) A company which enters the IBC is stressed and other means of resolving such stress have not been successful.

(b) The composition of the total claims by FCs that includes not only the principal and interest, but other penalties and charges being levied to the extent possible to increase the total amount of claim.

(c) Enterprise value or liquidation value of the CD at the time of referral into IBC (especially considering the stress faced by the CD which impacts its ability to meet obligations and maintain going concern).

(d) Potential upside for creditors through equity holding post-resolution.

(e) Potential realisation through reversal of avoidance transactions.

(f) Potential recovery from guarantors in a parallel proceeding.

(g) Greater economic activity generated by resolution of the stress in the CD and the multiplier effect it has on stakeholders and on the wider economy.

**Measures to support FCs**

It is submitted that one particular reason for this misinformation about resolution plans and ‘haircuts’ is the lack of or inadequate prominence being given to relevant information in the public domain. This results in selective dissemination of (mis)information.

It is therefore suggested that the CoC should make more detailed disclosures on the approval of resolution plan by CoC, providing for the liquidation value and resolution plan value, reasons as to why the ‘haircut’ has been accepted along with understanding
of why there has been value erosion, percentage of liquidation value being realised, and evaluation of resolution plans by CoC against the evaluation matrix published in the request for resolution plans (RFRP). Such disclosures would then be made accessible to other stakeholders to ensure adequate dissemination of more relevant information in relation to the resolution plan and its approval.

Examples of such disclosures would be:

(a) Rationale and reasons for approval of the selected resolution plan and for rejecting the other resolution plans to be detailed in the minutes of the CoC meeting approving the plan.

(b) Details of liquidation value, resolution plan value, percentage of liquidation value being realised, and evaluation of resolution plans by CoC against the evaluation matrix published in the RFRP to form part of the filings by the RP with the Adjudicating Authority (AA) when seeking approval of the plan.

(c) Disclosures to the stock exchanges by the RP (in case the CD is a publicly listed entity) on approval to include the resolution plan value and percentage of liquidation value being realised.

(d) Disclosure should include details of payments proposed to be made to each class of creditors as per the resolution plan, the payment mechanism to be adopted, the expected dates when payments would be made, the amount to be paid against each creditor listed in the list of claims, etc.

Though admittedly a counterintuitive move to a FC who are normally discrete and guarded in making any public disclosures, such a measure of sharing more relevant information should help in building the confidence of FCs in taking decisions as to ‘haircut’ and not being portrayed in a bad light.

Another reason for the misperception of ‘haircuts’ is because the CIRP is still primarily seen as a recovery mechanism in certain quarters. FCs are seen to seek maximum recovery against their claims rather than prioritising the successful reorganisation of the CD. Again, if the key benefits of the resolution plan in the successful rehabilitation of the CD are highlighted and prioritised in communications, the focus of the CIRP would be better understood and implemented. All stakeholders in the ecosystem must appreciate that the CIRP is a resolution process through which recovery happens; it is not the other way around.⁴

**OPERATIONAL CREDITORS**

The goods provided and services rendered by OCs also play a significant role in running any business in an economy, apart from the financial resources provided by FCs. OCs also play a significant role in the revival of a company under CIRP by providing goods and services which facilitate the running of the company as a going concern. Thus, it is important to build the confidence of OCs in the CIRP for successful implementation of IBC.
The need to build confidence amongst such OCs increases because while they are key stakeholders, they are not part of the decision-making agency in the process and have to rely upon the CoC for the protection of their interests.

The National Company Law Appellate Tribunal (NCLAT), in the case of *Binani Industries Limited v. Bank of Baroda and Anr.*, very clearly set out certain principles when dealing with the claims of OCs and the need to balance the interests of all creditors. The Court held that:

> Both kinds of credits need to be on a level playing field. ‘Operational Creditors’ need to provide goods and services. If they are not treated well or discriminated, they will not provide goods and services on credit. The objective of promoting availability of credit will be defeated... The ‘Financial Creditors can modify the terms of existing liabilities, while other creditors cannot take risk of postponing payment for better future prospectus. That is, ‘Financial Creditors’ can take haircut and can take their dues in future, while ‘Operational Creditors’ need to be paid immediately.... If one type of credit is given preferential treatment, the other type of credit will disappear from market. This will be against the objective of promoting availability of credit.... Therefore, the dues of creditors of ‘Operational Creditors’ must get at least similar treatment as compared to the due of ‘Financial Creditors’.... If the ‘Operational Creditors’ are ignored and provided with ‘liquidation value’ on the basis of misplaced notion and misreading of Section 30(2)(b) of the ‘I&B Code’, then in such case no creditor will supply the goods or render services on credit to any ‘Corporate Debtor’. All those who will supply goods and provide services, will ask for advance payment for such supply of goods or to render services which will be against the basic principle of the ‘I&B Code’ and will also affect the Indian economy. Therefore, it is necessary to balance the ‘Financial Creditors’ and the ‘Operational Creditors’ while emphasizing on maximization of the assets of the ‘Corporate Debtor’.

Though IBC provides for minimum payments to OCs in a resolution plan, which is not less than the amount to be paid to them in the event of liquidation of the CD, the OCs end up in receiving a negligible amount or nil amount, as in most cases, the liquidation value is insufficient to cover even the debt of FCs who are to be paid in priority in the event of liquidation. This along with the exclusion of OCs’ from the CoC, reduces their confidence in the CIRP. This is also seen anecdotally, where OCs are keen for their claims to be recognised as a claim by an FC.

**Measures to support OCs**

It is for further consideration whether it is now time for more detailed guidelines to be stipulated with respect to repayments made to OCs in settlement of their claims in a resolution plan. It could provide for a correlation between the payment made to secured and unsecured FCs and to various defined classes of OCs in line with the minimum amount to be paid to an OC under section 30 of the IBC.

Such classes of OCs could include:

(a) OCs in the MSME sector;
(b) OCs providing labour services to the CD (such as security, canteen services, packaging etc. which are normally contracted out) so that such OCs are also treated to the extent possible on par with other workmen and employees of the CD;

(c) Government agencies dealing with workmen and employee rights and dues (example provident fund authorities);

(d) OCs providing essential goods and services to the CD (such as electricity, water, telecommunication services, information technology services etc.); and

(e) OCs who are on the verge of insolvency proceedings (case filed and awaiting to be admitted) or are already undergoing insolvency proceedings under the Code.

If an unsecured FC is paid a certain percentage, then the argument should extend that OCs (and particularly the classes listed above) are also similarly treated. This would also go a large way to ensure that the mandate provided under section 30 of the IBC and regulation 38(1A) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) to demonstrate a fair and equitable distribution are followed in spirit.

Secondly, on approval of the resolution plan by the AA, adequate disclosures of the payments to be made against each creditor should be made on the same websites where the list of claims are regularly published, this disclosure should include details of payments proposed to be made to each class of creditors as per the resolution plan, the payment mechanism to be adopted, the expected dates when payments would be made, the amount to be paid against each creditor listed in the list of claims, etc. This would also keep the OC updated of his claim, and his payment. It is submitted that greater is the transparency of such information, higher would be the level of confidence of stakeholders in the fairness and equity of the process and of the distribution.

Employees

Section 23 read with section 20(1) of the Code vests the duty on RP to manage the affairs and operations of CD as a going concern, and the employees are one of the most important stakeholders whose cooperation make a significant impact in the conduct of the CIRP. The UNCITRAL Legislative guide on Insolvency Law also provides that the duties of an ‘Insolvency Representative’ includes protection of interests of employees. Thus, it is important for the RP to gain the trust and confidence of the employees within a short period of time because they are involved in day-to-day operations, have knowledge of underlying assets of the CD, and have relevant information required by the RP for maintaining the CD as a going concern during the CIRP.

It has been observed in several cases that promoters and employees do not cooperate and actively support the RP. Under such circumstances RP has no option but to resort to section 19(2) and seek relief from the AA for cooperation from employees of the CD. It becomes practically impossible for the RP to maintain the CD as a going concern and approach the Court each time there is non-cooperation. As the CIRP is a timebound process, such non-
cooperation becomes one of the major reasons for delay in the CIRP. The reasons for such non-cooperation from employees may include:

(a) Allegiance towards the erstwhile promoters or management of CD;
(b) Unpaid dues of the employees before the insolvency commencement date (ICD);
(c) Stigma attached to the insolvency proceedings and fear of losing their jobs; and
(d) Lack of knowledge, understanding and trust in the IBC process.

The RP has to work with such employees, resolve their issues and gain their confidence by communicating the objectives of the IBC, the intended benefits of the CIRP and that as a professional, he is bound by a code of conduct and to ensure that the process is run in a collaborative, fair and transparent manner. The following measures may be taken by the RP to instill confidence in the CIRP amongst the employees:

(a) Conduct meetings with the key/senior employees on the CIRP.
(b) Be willing to listen and enable senior employees/key managerial persons (KMPs) to share their perspectives on critical operating parameters, current challenges and possible solutions, the organisational and human resource structure, daily operations, and underlying assets of the CD for better understanding of the CD.
(c) Ensuring prioritised payment of salaries of employees who are working at the CD during the period of CIRP by making it as part of cost of keeping CD a going concern. In cases where there are no or limited operations, to ensure going concern, the RP needs to proactively mobilise interim finance or funding of CIRP costs from the FCs in the CoC. Timely payment of salaries instills self confidence in employees and also helps in mitigating the risk of key employees leaving the organisation during the CIRP period which can adversely impact the operations of the CD.
(d) Communicating to the employees about the treatment and prioritisation of any unpaid employee salaries accruing during CIRP as CIRP costs under the Code and requesting for filing of their claims for the period prior to ICD to ensure inclusion in the resolution plan. The RP may also actively support the employees in filing their claims as per the due process laid down in the Code.

Such measures for building confidence among employees can help the RP to efficiently use the resources of the CD and run the process smoothly.

It can be observed that the RP is not only required to comply with the provisions of the Code but is also expected to exercise skills including people management and organisational management to deal with such situations. The Insolvency and Bankruptcy Board of India (IBBI) as well the Insolvency Professional Agencies (IPAs) may also consider encouraging these skills in the RPs by:

(a) Webinars and seminars for training of RPs in people management, organisational management, and special situation trainings; with continuous professional education (CPE)
hours credit. Such sessions could include practical learnings obtained by other RPs from handling complex cases.

(b) Include subjects in the limited insolvency examination which can test the knowledge of RP to deal with such situations.

(c) Sharing best practices collated from successful resolutions within the ecosystem.

**Government**

The Government and its agencies are one of the most important stakeholders in every stage of the IBC process. The Code under various provisions provides for measures to ensure cooperation of Government authorities including ensuring non-termination of licenses, prohibition on discontinuation of essential goods and services, restriction on any action against property of CD, and implementation of the moratorium. In recent years, the Hon’ble Courts in a plethora of cases have upheld the primacy of the Code and have addressed the issues faced by RPs while dealing with Government authorities including freezing of accounts, attachment of properties of the CD under CIRP or liquidation or even after approval of resolution plan.

Further, in some cases, Government authorities have initiated action against the resolution applicants for payment of dues outside the resolution plan after approval of the resolution plan. The Code treats the Central Government, State Government or local authorities as OCs to whom statutory dues are owed by the CD which are classified as operational debts under section 5(20) of the Code. In a landmark judgment, the apex court in *Ghanshyam Mishra and Sons Pvt. Ltd. v. Edelweiss Asset Reconstruction Company Limited* has held that ‘The central government, any state government or any authority would be bound by the resolution plan, once it is approved by the Adjudicating Authority’.

The judgment ensures that a resolution under IBC gives the resolution applicant a fresh slate and protects it from recovery of any claim outside the resolution application.

Such issues with the Government authorities have been the cause of delays, litigations, and constraints for the RP to maintain the CD as a going concern as well as for the resolution applicant to execute the resolution plan and revive the CD in a viable and feasible manner. Thus, it is pertinent to understand the importance of having the confidence, cooperation and understanding of the Government authorities or agencies in the resolution process under the Code which could be built through:

(a) Awareness campaigns for Government authorities by the sectoral regulators, and IPAs about the process and the provisions of the Code;

(b) Communications by RP during the process - Relevant Government authorities must be communicated at the earliest for their cooperation and for filing their claims under the Code; and

(c) Facilitating more joint training and awareness sessions between IBBI and other Government agencies (similar to the various sessions held with the direct and indirect tax
authorities) to enable alignment of thought and understanding of the primacy of the IBC. The prioritisation of such sessions may be with the Government authorities where litigation is seen to be more prevalent. For example, currently by the Employee Provident Fund and Customs Authorities.

Government authorities can play a major role in facilitating the smooth conduct of the CIRP, maximisation of assets, timely resolution of CD and implementation of resolution plans. On the flip side, if such authorities are not aligned in action on the primacy of the Code, they can play a very negative part in the action implementation of the Code. After all, it is not for nothing that it has been said that the Government is the most active litigant in our judicial system. Therefore, such active measures can only help to ensure active participation and adherence of Government authorities to the primacy and to the provisions of the Code.

**BOARD OF DIRECTORS**

A corporate entity is governed by a Board of Directors that are responsible for the running of the company. The Board is responsible for protecting shareholders’ interests, establishing policies for management, oversight of the corporation or organisation, and making decisions about important issues that a company or organisation faces. This is supplemented by secretarial and support staff that are required for performing the mandatory compliances as prescribed under the Companies Act, 2013.

The admission order passed by the AA is a deemed notice of suspension of powers of the Board of Directors of a company. The powers of the Board are only suspended during the CIRP period and vests with the RP. The directors continue to be required to assist the RP in running the CD as a going concern. Such support becomes extremely crucial since the RP is an outsider to the company and their cooperation becomes necessary to achieve quicker resolution.

Section 17(1)(c) of the Code provides that ‘...the officers and managers of the corporate debtor shall report to the interim resolution professional and provide access to such documents and records of the corporate debtor as may be required by the interim resolution professional...’.

Further, section 18(1)(a) of the Code provides that the Interim Resolution Professional (IRP) shall ‘collect all information relating to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor’.

Often the supply and transfer of financial information from the management to the IRP/RP is irregular and the response apprehensive. The directors are not fully aware of the process and initially also look at the IRP/RP with suspicion. Sometimes, the information is shared in only a piece-meal manner and the preparation of the information memorandum is impacted.

The stated relief available to the IRP/RP on account of non-cooperation is section 19 of the Code by virtue of which the AA can direct the directors to cooperate in the process. Section 19 of the Code is an enabling provision which might lead to more conflict with the officers of the CD leading to further delays.
The IBBI most recently through its discussion paper dated April 13, 2022 proposes to introduce ‘Regulation 4C’ in the CIRP Regulations by which it proposes to enlist the information to be made available to the IRP/RP by the management in a time bound manner.

The support of the management is essential for running the company even during CIRP and the RP must consult the management and seek their support in managing the affairs of the CD, by including them in the process and not being averse to their inputs. The preferred option is to maintain open lines of communication with KMPs, encouraging them to cooperate. Encouraging employees to act as a team and to work with the RP is also a positive approach to run the process. Regular mediation, instead of confrontation can help to foster an atmosphere of cooperation with the management.

**Measures to enhance cooperation from Board of Directors**

(a) The directors are entitled to attend meetings of the CoC, and every document related to the meeting needs to be circulated with the directors as well. The RP and members of the CoC should seek inputs from the directors on operational matters or on matters where there is prior background and context and on the resolution plans as well. This would enable a more constructive and meaningful discussion. The Hon'ble Supreme Court in the case of *Vijay Kumar Jain v. Standard Chartered Bank and others* has held that the statutory scheme makes it clear that though the erstwhile Board of Directors are not members of the CoC, yet, they have a right to participate in CoC meetings, and also have a right to discuss along with members of the CoC resolution plans that are presented at such meetings.

(b) The directors would be involved in the day-to-day functioning of the CD and a mechanism of regular interactions with the RP and the RP team by which relevant information may be exchanged to ensure the going concern status is a constructive measure. The existing management and employees may be included in all key decisions with respect to operations as well as in the day-to-day operations. Such an inclusive move will dissuade the management from vexatious litigation and help run the process smoothly.

(c) The directors may also have been involved in the marketing strategy of the CD and the RP with the support of the directors can better identify potential resolution applicants and also reach out to competitors/interested parties who had tried to acquire the CD previously.

(d) The RP is also encouraged to assist the management in secretarial compliances in terms of the Companies Act, 2013 during the CIRP period to prevent any shortcomings during the CIRP. Joint ownership of issues and problems, more often than not, enables a more effective resolution.

(e) The organisational structure of the CD during CIRP may be updated to identify the more efficient employees who can constructively help run operations and the CIRP in a smoother way. This can be done with the help of the directors who would be more aware of the roles played by the KMP and employees.
RESOLUTION APPLICANTS

The Code provides for a market-based mechanism for timely resolution of distress. The India Investment Grid (IIG) is a step in that direction and provides a market for stressed assets. IIG is an initiative of the Department for Promotion of Industry & Internal Trade, Ministry of Commerce, Government of India and Invest India, the National Investment Promotion and Facilitation Agency as a platform for investment in assets under the National Infrastructure Pipeline. The IIG places itself as a market for assets inviting investments from across the globe for assets listed on the marketplace.

The projects include a dedicated portal for stressed assets that are currently in need of rescue through the IBC mechanism and even for assets that are currently in need of investment and likely to default in the near future. The portal is a one-stop solution bringing investors and the projects at one place for ease of acquisition and investment and presents a market for stressed assets in the country.

While a clear demarcation and bifurcation has been introduced through legislative interventions as far as distribution amongst creditors is concerned, there is still a dire need to bring about certainty in the resolution process. Further, the Code still needs to plug the administrative delays that dissuade a prospective resolution applicant from submitting a resolution plan. Some of the challenges faced by resolution applicants at present are:

(a) Negotiations and delays at the hands of the lenders/banks for approval/final decision.
(b) Delay at the stage of approval of resolution plan by the AA.
(c) Litigation by erstwhile promoters under various guises which delays.
(d) Litigation by statutory authorities for actions taken by the erstwhile management.
(e) Criminal action/investigation by the sectoral regulators and investigation agencies of the Government.

(f) The Venus Recruiters judgment of the Hon’ble Delhi High Court states that the law is not clear as to who shall pursue the applications for avoidance transactions once a resolution plan is approved by the AA as the RP becomes functus officio. Further, it is not clear whether the proceeds of avoidance transactions will go to the creditors of the CD or the successful resolution applicant.

This delays the closure of the CIRP, erodes the value of the CD and dis-incentivises the potential resolution applicants from participating in the process.

Most recently in the case of Ebix Singapore, the Hon’ble Supreme Court noted that ‘the NCLT and the NCLAT should endeavour, on a best effort basis, to strictly adhere to the timelines stipulated under the IBC and clear pending resolution plans forthwith’. In this case, the successful resolution applicant sought to withdraw its plan on account of inordinate delay by the AA in approving the resolution plan.
The Ministry of Corporate Affairs recently proposed that the Code should provide a fixed time period for approval or rejection of a resolution plan by the AA. Consequently, the Code may be amended to provide the AA with a time-period of 30 days for approving or rejecting a resolution plan under section 31.¹³

In a landmark judgment, the Hon'ble Supreme Court¹⁴ has reiterated the ‘clean slate theory’ and held that after a successful conclusion of CIRP under IBC and acquisition of the CD by a successful resolution applicant, the dues of all creditors, whether part of the resolution plan or not stand extinguished being bound by the treatment meted out to them under the resolution plan. This paves a way forward for the new management to come at the helm of affairs of the CD and revive its business without being saddled with fresh/undecided claims/proceedings.

In view of the above, some of the measures that can instill confidence among the resolution applicants are as follows:

(a) It is for consideration whether a specific timeline within which the FCs/banks/lenders need to give their approval/disapproval to a resolution plan should be stipulated. For example, within seven days of the RP placing all plans to vote. Further, the banks recording their vote must also be directed to give their reasons for assenting or dissenting to a resolution plan.

(b) As stated earlier, a time frame may be provided for the AA say, a period of 30 days for approving or rejecting a resolution plan under section 31. This will bring certainty to the process and avoid issues of contravention of a resolution plan.

(c) Closure of action by the Government and statutory authorities upon approval of a resolution plan - The AA while approving a resolution plan should specifically state that the order is a deemed notice of closure of all pending investigations/assessments against the CD.

(d) Presently, section 31(4) of the Code grants a resolution applicant a period of one year to seek approvals from the sectoral regulators in respect of a resolution plan. While it is appreciable that green channel approvals have been enabled for the resolution applicants, section 31(4) may be suitably amended to provide that the order under section 31 shall be a deemed approval of the sectoral regulator and be made applicable from the date of the order while also empowering the resolution applicant to formally file for an approval from the sectoral regulator. The approval by the AA may be temporary but would be a great enabler for handover and implementation of any resolution plan.

(e) Lastly, the law needs to settle on the current ambiguity on who is entitled to and who shall pursue the avoidance applications once a resolution plan is approved by the AA. For a resolution applicant, such an exercise can act as an incentive to pursue the avoidance applications if the proceeds of avoidance transactions benefit the successful resolution applicant/CD.
CONCLUSION

IBC has brought in a shift in the stressed asset recovery legislations and has proven itself as an effective way for resolution, maximisation of value of assets and balancing interest of stakeholders. The process under the Code not only requires the RP to carry out his duties but also requires the participation and cooperation of all the stakeholders involved at different stages. Therefore, the burden also lies on key stakeholders to contribute towards the success of IBC.

Even though the Code is still in its early phases, it is fair to state that fostering trust and building confidence by incorporating confidence building measures among the key stakeholders would encourage their pro-active participation in IBC process. Two of the key stakeholders in the process are the FCs and OCs whose confidence building is primary to the CIRP. Enhancing disclosure mechanisms and formulating guiding principles may be put in place to build the confidence of FCs and OCs.

A strong ecosystem needs to be nurtured not only within the Code but also outside of it by way of creating awareness among various stakeholders about their roles, rights, and duties under the Code. Further, the RPs need to enhance their capabilities and provided practical trainings to imbibe skills such as people and organisational management, handling of special situations, dealing with employees etc. All such measures will empower the RP with the practical skillsets needed to carry out his responsibilities smoothly and effectively with the cooperation of stakeholders.

Lastly, other participants in the ecosystem must recognise that the market today requires a paradigm shift which regards insolvency and bankruptcy as a tool, rather than a stigma. Such shift could encourage the evolution of insolvency resolution practices in the country and attract more participants to the insolvency resolution ecosystem.

Looking at the big picture, the development of a robust insolvency ecosystem where all the key stakeholders communicate, collaborate, and contribute effectively towards the growth of IBC would positively impact the development of a strong corporate debt market in India.

The Code is not adversarial. Collective action is core to the spirit and fundamental to the operational aspects of an insolvency regime. The intent is that all stakeholders should deal with each other with mutual reverence and aim to build confidence in each other. This would enable more effective collaboration and help achieve a common outcome.

‘If you want to go fast, go alone. If you want to go far, go together’

-African Proverb
*The authors would also like to recognise and acknowledge the assistance of the students of the Graduate Insolvency Programme (2021-2023) viz. Asman Joshi, Rahul Adlakha and Alleena Jose for their extended efforts and support on this article.

14. Supra Note 7.
Businesses and individuals, even governments, often depend on borrowings and debt to meet their transaction needs. They do fail to return the funds borrowed on due dates, resulting in default by them. The defaults could be because of temporary mismatch of cash flows or because of deeper failure of businesses, mismanagement etc. Creditors initiate insolvency/bankruptcy proceedings against the debtors to recover their dues. Many a time creditors end up recovering only a part of the dues, sometimes even close to nothing. Debtors also go through difficult situations post insolvency/bankruptcy proceedings, including relating to their reputation. Besides, there are consequences leading economic destruction value created by the businesses, whereby society at large is impacted negatively, in terms of employment, value creation and asset quality. Jurisdictions around the world have recognised these larger issues and have, over the years, put in place robust insolvency/bankruptcy framework to limit the damages on all stakeholders, including the economy and society.

India had its own insolvency legal framework in place right from 1800. The general refrain had long been to give relief to debtors from the actions of creditors whose dues he is unable to pay. In some ways, the insolvency regime was not balanced between competing interests of creditors and debtors and was tilted in favour of the debtors. This had its own unintended consequences, especially in the cases of business insolvencies/bankruptcies.

**BANKRUPTCY LAW REFORMS COMMITTEE**

The Bankruptcy Law Reforms Committee (BLRC) in their Report of November, 2015 observed:

The limited liability company is a contract between equity and debt. As long as debt obligations are met, equity owners have complete control, and creditors have no say in how the business is run. When default takes place, control is supposed to transfer to the creditors; equity owners have no say. This is not how companies in India work today. For many decades, creditors have had low power when faced with default. Promoters stay in control of the company even after default.

The BLRC also noted that as a consequence, the creditors in India have heavily tilted towards secured lending and lending based on analysis of business prospects was ‘shriveled’. The BLRC recognised that a comprehensive and consistent treatment of bankruptcy and insolvency for all these is an essential ingredient of India’s rise into a mature market economy.
Accordingly, it recommended a clean modern law which is a simple, coherent, and effective answer to the problems under Indian conditions. Based on their recommendations, a new Insolvency and Bankruptcy Code was enacted in 2016 (IBC/ Code) and the Insolvency and Bankruptcy Board of India (IBBI) was also formed under the Code as the regulator for this sector.

**INFORMATION UTILITY - DESIGN**

One of the inherent risks identified by the BLRC was the risk of delay due to atrophy and failure, leading to value destruction. It concluded that speed is the essence of a modern insolvency regime. It set about identifying and addressing the sources of delay.

Before an insolvency resolution process (IRP) can commence, the BLRC averred that all parties need an accurate and undisputed set of facts about existing credit, collateral that has been pledged, veracity about default etc. Considerable time can be lost before all parties obtain this information. Disputes about these facts can take up years to resolve in court. The objective of an IRP that is completed in more than 180 days can be lost owing to these problems. Hence, the BLRC envisioned a competitive industry of ‘Information Utilities’ (IUs) which should be charged with the task of holding an array of information about all debtors at all times.

The BLRC defined categories of information to be held in IUs as follows:

(a) Reliable and readily accessible records of liabilities of a solvent entity.

(b) Clear evidence of the instance of default.

(c) Records of assets that are pledged as collateral against secured credit contracts.

(d) Reliable and readily accessible records that comprise the balance sheet and cash-flow statements of the entity

To sub-serve the objective of speed in the whole process, the BLRC visualised the IUs as taking full advantage of computer technology in maintaining a centralised database of information, accepting and providing financial information, evidence of default etc. all in electronic format. They expected that when the IRP commences, within less than a day, undisputed and complete information would become available to all persons involved in the IRP and thus address one of the basic sources of delay.

**INFORMATION UTILITY UNDER IBC**

The IBC provided for registration of IUs under section 210 of the Code. The IUs have been tasked to undertake ‘core services’ which have been defined under section 3(9) of the Code as follows:

“core services” means services rendered by an information utility for –

(a) accepting electronic submission of financial information in such form and manner as may be specified;
(b) safe and accurate recording of financial information;
(c) authenticating and verifying the financial information submitted by a person; and
(d) providing access to information stored with the information utility to persons as may be specified.

Section 3(13) of the Code defines ‘financial information’ as:

“financial information”, in relation to a person, means one or more of the following categories of information, namely: -

(a) records of the debt of the person;
(b) records of liabilities when the person is solvent;
(c) records of assets of person over which security interest has been created;
(d) records, if any, of instances of default by the person against any debt;
(e) records of the balance sheet and cash-flow statements of the person; and
(f) such other information as may be specified.

The operations of the IU are being governed by the IBBI (Information Utilities) Regulations, 2017 (IU Regulations) as amended from time to time.

INFORMATION UTILITY – CURRENT STATUS

As on date, only one IU, viz., National E-Governance Services Ltd. (NeSL) has been registered with the IBBI. NeSL has been functioning from 2016.

NeSL renders the ‘core services’ – accepting electronic submission of financial information, safe and accurate recording / storage of financial information, obtaining verification and authentication of information from the counterparty to the debt, and providing access to information to persons permitted in the Code.

All financial creditors (FCs) have been mandated to submit financial information on all loans/advances, to an IU. Operational creditors (OCs) have been enabled to report their claims to the IU. The financial information as collected by the IU currently relates to information on records of the debt/claims of a person, records of liabilities when a person is a solvent, and records of instances of default.

There are provisions for the debtors to authenticate or question the information submitted by the FCs and OCs to the IU. Further, the authenticated information held by an IU serves as legal evidence in IRP and helps in meeting the timelines, for insolvency resolution, provided under the Code.
INFORMATION UTILITY – PERFORMANCE SO FAR

As a part of undertaking the core services of an IU, as of August, 2022, NeSL has been receiving financial information about solvent debtors from 720 FCs.

Table 1: FCs submitting financial information to NeSL – as of August, 2022

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Type</th>
<th>No. of entities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Public sector banks</td>
<td>13</td>
</tr>
<tr>
<td>2.</td>
<td>Private sector banks</td>
<td>69</td>
</tr>
<tr>
<td>3.</td>
<td>Non-banking finance companies (NBFCs)</td>
<td>239</td>
</tr>
<tr>
<td>4.</td>
<td>Housing finance companies</td>
<td>28</td>
</tr>
<tr>
<td>5.</td>
<td>All India public financial institutions</td>
<td>4</td>
</tr>
<tr>
<td>6.</td>
<td>Debenture trustees</td>
<td>8</td>
</tr>
<tr>
<td>7.</td>
<td>Alternate investment funds</td>
<td>2</td>
</tr>
<tr>
<td>8.</td>
<td>Other private creditors</td>
<td>357</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>720</strong></td>
</tr>
</tbody>
</table>

NeSL has also been receiving financial information from 779 OCs as well. The record of its performance in this regard, so far is given in Table 2.

Table 2: Performance of NeSL - Status as on March, 2022

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>Number</th>
<th>Amount (₹ in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Number of entities entered into agreement with NeSL</td>
<td>347</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Number of FCs submitting records on NeSL</td>
<td>692</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Number of OCs submitting records on NeSL</td>
<td>779</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Number of loan records received by NeSL from FCs</td>
<td>1,40,39,325</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>Number of records received by NeSL from OCs</td>
<td>1,85,166</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>Number of user registrations by debtors (FCs)</td>
<td>2,40,998</td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Number of user registrations by debtors (OCs)</td>
<td>7,79,926</td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Number of records verified by debtors (financial credit)</td>
<td>5,14,457</td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td>Number of records verified by debtors (operational credit)</td>
<td>4,75,564</td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Amount of loans/debt from FCs</td>
<td>1,45,39,538</td>
<td></td>
</tr>
<tr>
<td>11.</td>
<td>Amount of loans/debt from OCs</td>
<td>42,894</td>
<td></td>
</tr>
<tr>
<td>12.</td>
<td>No. of record of default certificates issued by NeSL (FCs + OCs)</td>
<td>67,617</td>
<td></td>
</tr>
</tbody>
</table>
Another major function of an IU is to issue ‘record of default’ (RoD). Table 3 gives information relating to the efficacy of RoDs as on August 31, 2022.

**Table 3: Record of default**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>FCs</th>
<th>OCs</th>
<th>CDs</th>
<th>Total number of CIRP cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of CIRP cases initiated after January 1, 2019</td>
<td>1854</td>
<td>2240</td>
<td>164</td>
<td>4258</td>
</tr>
<tr>
<td>Out of the above cases, number of cases where RoDs have been issued by NeSL</td>
<td>975</td>
<td>638</td>
<td>52</td>
<td>1665</td>
</tr>
</tbody>
</table>

*(CIRP: Corporate insolvency resolution process)*

**INFORMATION UTILITY – PERFORMANCE ASSESSMENT**

The fundamental objective of an IU is to maintain a centralised database of full set of liabilities of all entities that are serviced into by financial firms. Starting point for this is to get all financial firms report financial information to the IU. Table 1 and 2 above indicate that by and large this objective has been fulfilled. However, considering the number of scheduled banks, urban co-operative banks (UCBs) and registered NBFCs undertaking credit functions at 136, 1534, and 9652 respectively, the task is not yet done completely. Comforting factor is that all commercial banks, major cooperative banks and major systemically important NBFCs have been reporting to NeSL periodically. Further, when we note that the outstanding loans and advances of commercial banks at ₹ 120.16 lakh crore of NBFCs at ₹ 28.5 lakh crore and of UCBs at ₹ 3.12 lakh crore as at end of March, 2022, ₹ 145.39 lakh crore of loans and advances reported to NeSL indicates very substantial coverage of the targeted financial information by the NeSL.

As regards receiving information from the OCs, the coverage by NeSL as at end of March, 2022 is nominal. However, it should be noted that it is only voluntary for OCs to report.

A critical requirement for the CIRP is that the information available at IU should be undisputed. To ensure this, the IU Regulations require that the financial information submitted by the creditors is authenticated by the debtors. In this respect, as indicated in Table 2 above, the number of records that have been authenticated by the debtors forms less than 5% of the total records at NeSL. This is though unsatisfactory, considering the position that it is not mandatory for the debtors to confirm, the effectiveness of IU in this regard is bound to be muted.

The second objective of an IU is to provide clear evidence of the instance of default. Table 3 above indicates that NeSL had issued RoDs in 39% of the cases of CIRPs initiated after it commenced issuing RoD. The RoDs issued to FCs, OCs and the CDs accounted to 52.5%, 28.5%, and 31.5% of the CIRPs initiated by them respectively.
The very purpose of the RoD is to serve as an authenticated, undisputed, legal evidence of default so that the CIRP can commence without loss of time in establishing this fact. However, under the Code, it is not mandatory for the Adjudicating Authority to go by RoD alone.

**INFORMATION UTILITY – FUTURE PROSPECTS (IU VER 2.0)**

We can fairly say that the concept of IU has taken off successfully. We need to deliberate on what additional measures we can take to take full advantage of the special and unique infrastructure of an IU for the benefit of a modern and robust IBC process. This deliberation should cover both how to make the current arrangement work better and also what additional functionalities that can be gainfully assigned to the IU.

As noted in previous paragraphs, the current coverage of registered IU i.e., NeSL, both in terms of number of reporting entities and outstanding amount, has been very substantial. However, for complete coverage, several measures may be taken. For one thing, the IU will have to go about awareness creation and marketing campaign. Secondly, respective regulators can effectively play a catalytic role, while supervising the regulated entities, to see that all the regulated financial firms do report to IU as required. Thirdly, OCs should be incentivised to report their claims to the IU such as incentive of higher rank in the waterfall for the IU reported claims over the unreported claims. Further, the use of IU records may be made mandatory in phases based on the size of the debt by amending section 9(2) and section 9(3) of the Code, so that the OCs above a threshold are mandatorily required to use the IU records for making an application.

Currently the debtor authenticated records of IU form hardly 5%. To make the IU records as ‘the undisputed’ record for the purpose of IBC process, we need to build both incentives and disincentives for the debtors to authenticate the IU records soon after the creditors have reported the financial information.

As mentioned earlier, the BLRC originally defined four categories of information to be housed in an IU. Of these, currently NeSL caters to the first two viz., records of liabilities and record of defaults. As regards the other two ideas relating to record of collateralised assets and record of financial statements to be housed in IU, it must be noted that there are already two institutional arrangements in India for the same. The Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) is a Government of India company. The object of the company is to maintain and operate a registration system for the purpose of registration of transactions of securitisation, asset reconstruction of financial assets and creation of security interest over property, as contemplated under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. Similarly, the MCA-21 project of the Ministry of Corporate Affairs acts as the platform for housing the financial statements (balance sheets, profit & loss statements, cash flow statements etc.) of corporate entities. Hence it will be duplication of avoidable expenses and efforts to house these statements in an IU. However, for the purposes of effective and informed IBC processes, the stakeholders will need these records. It will be
a good idea to legally enable the IU to freely access the records from CERSAI and MCA-21 and provide a wholesome position about the debtors to the required stakeholders. A way of enabling will be that the IBBI recognises CERSAI and MCA-21 as limited purpose IUs, by way of suitable amendments to the Code or IU Regulations and frame regulations/standards/protocols for inter-IU exchange of records.

Similar extension of the usefulness of IU as a single window for IBC process can be thought of with reference to credit records and operational flow records of invoices in commercial transactions. The Reserve Bank of India is building a centralised ‘public credit registry’ (PCR). The Goods and Services Tax Network (GSTN) has built ‘indirect taxation platform’ to help taxpayers in India, among others, to file invoices and returns electronically. These records can play very useful role as legally evidenced claims for processes under the Code. The suggested arrangements for CERSAI and MCA-21 can equally apply for the proposed PCR and GSTN as well.

**CONCLUSION**

The IU is a very unique institution, not just for India, but for the whole world. There is no parallel institution in any other jurisdiction. NeSL is functional in India for the past six years. It has achieved its primary fairly well. There are ample opportunities to expand the role of IU to make it as the single window for the IBC process.
The Bankruptcy Law Reforms Committee (BLRC), which conceptualised the Insolvency and Bankruptcy Code, 2016 (IBC/Code), in its report discussed the issue of information asymmetry in the Indian credit markets. The BLRC recognised that, in India, the debtor has more information about its assets than its creditors and to that extent there is information asymmetry. This information asymmetry could be a significant barrier to fair negotiations between the debtor and its creditors. It could also lead to delays in the process of stress resolution. The BLRC recommended the creation of a regulated information utility (IU) that would make available all relevant information to all stakeholders and facilitate in resolving insolvency and bankruptcy.

While some parts of the Code have their origin in insolvency laws in advanced jurisdictions like the UK, the IU as a concept is unique to India. National E-Governance Services Limited (NeSL) was registered as India’s first IU in 2017. It had to traverse uncharted territory and has now evolved into an institution which can make an impact on the credit ecosystem of the country.

The IU addresses the issue of information asymmetry in the following ways:

(a) A creditor registered on the IU platform can access the details of the borrowings of a corporate debtor (CD) from all its institutional creditors, with the consent of the CD. These details are available in the credit facility report (CFR) provided free of cost to all creditors who are users of the IU services. A creditor can download, on an ongoing basis the CFR and see if any creditor has reduced its exposure. This could be based on information which is not available to other creditors. Other creditors will come to know of this on scrutiny of the CFR, accordingly, they can make further enquiries and decide to limit their own exposure and take remedial measures, if required. Further, all creditors who are users on the platform can come to know of the CD’s dues to suppliers, if the supplier has submitted the information to the IU. Since all creditors on the IU platform have access to the same information in respect of the debt, default, credit history, security provided to the creditors, etc., there is no information asymmetry.

(b) The biggest advantage for all users of the IU is the facility of default broadcast provided by the IU. When a creditor submits information of default in respect of a debtor, the IU does the process of authentication and verification as provided in the IBBI (Information Utility) Regulations, 2017 (IU Regulations). On completion of the process of authentication
and verification, the IU communicates the information of default to all creditors of the
debtor along with status of authentication. At this stage all creditors become aware of
incipient stress in the debtor which has resulted in the default to a creditor. If it is a supplier
or operational creditor (OC), it can insist on a credit enhancement by way of a letter of
credit, advance payment etc. If it’s an institutional creditor like a bank or non-banking
financial company (NBFC), it could negotiate with the borrower to de-risk the exposure
by exercising various options like additional equity from promoters or strategic investors,
additional collateral securities etc. Sometimes information of default is submitted by
creditors on account of disputes or disagreement between the two parties, especially in
respect of suppliers. Along with other details, the record of default (RoD) from the IU also
highlights the existence of such dispute along with the reasons for the same. Disputes are
settled outside the IU and on settlement, the debtor can insist on the creditor to submit
fresh information to the IU and accordingly, the credit history of the debtor gets updated.

**BENEFITS TO STAKEHOLDERS IN THE CREDIT ECOSYSTEM**

Besides addressing the issue of information asymmetry, the IU can be of use to stakeholders
in the credit ecosystem in the following ways:

(a) **A tool for early detection and resolution of stress:**

The definition of default as provided in the Code is non-payment of debt when whole
or part of the same or any part or the instalment of debt has become due and payable
and has not been paid. In the Indian banking system, delay in repayment of a loan by a
month leads to classification of a debt as a special mention account (SMA), while delay in
payment by more than 90 days leads to classification of a debt as a non-performing asset
(NPA). In an NPA account, the creditor does not earn interest income and has to even
make provisions for the debt in its balance sheet. As default or non-repayment of debt
has a certain amount of stigma and can also lead to drying of informal and formal credit
channels, banks and other creditors do not often take coercive action against the borrower
in the initial period, in the hope that the stress is temporary and can be resolved through
alternate means. Its only when an account becomes SMA that it comes into the regulatory
scrutiny of the bank. The reporting of information of default to the IU can provide an
alternate method of stress resolution. When a default, which could mean delay in payment
by even one day, is reported to the IU, the IU presents the information to the debtor for
his authentication. At this stage the information is confidential and only two parties, the
concerned creditor and the debtor are aware of the same. If the debtor cures the default,
then the information of default remains confidential and is not even reflected in the credit
history of the debtor. Subsequently, the debtor is reminded three times and only after
completion of the process of authentication and verification of the information of default,
the information is transmitted to other creditors. The reporting of information of default
to the IU is therefore beneficial to the creditor as it can bring the debtor to the negotiating
table to resolve stress at an early stage when there is still value in the CD. The delay in
reporting and resolution of stress leads to progressive deterioration in the enterprise value
of the CD. It is also beneficial to the debtor because he can take steps to address the issue of default without affecting his credit history.

(b) A tool in credit appraisal:

A large CD usually has a consortium of banks or a multiple banking arrangement to meet its requirements of bank finance. The CD may seek to have a new bank in the consortium for a number of reasons. It could be that the existing banks or one bank may have observed some adverse features in the account and have decided to limit or reduce their exposure. Sometimes, the existing banks may also decide to cap their exposure as a prudent measure without there being any adverse features in the account. The incoming bank can request the debtor to obtain the CFR from the IU to ascertain if any bank was reducing its exposure to the CD, sometimes, this could be even without reducing its limits. The CFR can also reveal, especially in respect of multiple banking arrangement, whether any credit enhancement by way of security has been provided to any bank. Further, if there was any incidence of default it will be reflected in the credit history of the borrower. The CFR of the IU also provides credit exposures by way of debentures and related defaults.

The IU also has data for proprietorships firms and partnership firms. If a bank or even a private financial creditor (FC) desires to finance such entities, it can request the debtor for a CFR from the IU, which provides the details of the borrowings, security created, and charge created etc. If the borrower claims to have no borrowings, a simple Debt Query Report can be obtained from the IU to confirm the same.

(c) Recovery of OC dues:

It is not mandatory for an OC to submit information to the IU. However, it is beneficial for the OC in the many ways. Unlike institutional creditors like banks or NBFCs, OCs have little information about the credit worthiness of the debtor as they do not participate in the consortium meetings of banks and are not a part of the exchange of the information arrangement between banks. They also do not have security for their credit provided against their supplies of goods and services and the documentation is not as rigorous compared to banks. As a result, when insolvency commences, OCs often find it a challenge to establish their claims especially related to interest or penalty related to delay payment. This is compounded by the fact that in the corporate insolvency resolution process (CIRP), the OCs do not have representation in the committee of creditors (CoC), the institution which makes critical decisions. Moreover, the experience till date is that in the CIRP, OCs in general have shown very low levels of recovery compared to their dues, although this is due to other reasons as well. If the OC submits information to the IU, it gets access to the information submitted by the other creditors and can access the credit history of the debtor with its consent. He can then take an informed decision on whether to continue the relationship with the debtor.

Many small suppliers or OCs, especially in the micro, small, medium enterprises segment face a huge challenge of delayed payments especially from large corporates, even when
the latter are solvent. Many such suppliers have used the provisions of the Code to get payments from their buyers, sometimes the CIRP gets withdrawn subsequent to settlement or payment. It is widely acknowledged that there is a behavioural change in the approach of debtors to their creditors subsequent to implementation of the Code. However, there is a stigma associated with the information of insolvency proceedings coming in public domain affecting future business relationship between the supplier and the buyer. If instead, the information of default is submitted to the IU, the law provides that the IU has to present the information to the buyer for authentication and verification. At this stage the information is not public, the CD may settle with its supplier, and in such a scenario, its credit history and reputation remain intact. However, if the debtor still does not pay up, the IU conducts its process of authentication and verification of default as provided in the IU Regulations. Subsequent to the same, a RoD is issued by the IU, and at the same time a default broadcast is sent to all creditors of the debtor. As all creditors become aware of the default, it can persuade the CD to arrive at a settlement with its creditors. The CIRP often lead to promoters losing control over the CD, therefore even the threat of CIRP may force the CD to settle with its creditors.

(d) Support to the Adjudicating Authority:

The Code provides that the Adjudicating Authority (AA) shall ascertain the existence of default from the records of an IU. The record of default (RoD) from the IU can be submitted by the FC or OC along with its application for initiation of insolvency proceedings against the CD. The RoD has essential details required for the AA to decide whether the application can be admitted for initiation of insolvency proceedings. The date of default is a critical piece of information which the AA is looking for, to be reassured that the debt is not time barred. This has to be read with the acknowledgment obtained by the creditor. The RoD also has the information regarding the delivery of information to the debtor and the status of authentication. This is to ensure that the CD was given an opportunity to give his opinion on the information of default reported by the creditor to the IU.

The IU Regulations provide that the AA can also access the information in the IU if required, either to ascertain the authenticity of the RoD submitted by the creditor or to obtain an updated version of the same.

(e) The IP’s personal assistant:

One of the duties of the Insolvency Professional (IP) is to constitute the CoC. The IP puts out a public announcement and calls for claims. After verifying the claims, the IP constitutes the CoC with voting share of each FC being based on its share in the credit facilities. The law provides the IP, access to the information in the IU. The IU can support the IP as, after receipt of claims he can compare the data with that in the IU. If any creditor has not submitted his claims, he can take up with the creditor for submission of his claim. In case of any discrepancy, he can also take up with the creditor and ascertain the reasons for the same. This can reduce litigation in respect of claims which can lead to delays in conclusion.
of the CIRP. On a later date, when the law permits, the IP can even constitute the CoC based on the claims data with the IU. This should be acceptable as every debtor is given an opportunity to authenticate and verify his information in the IU. The information with the IU also records if any dispute has been reported by the CD in respect of an information submitted by a creditor, along with reasons for the same. This would give an alert to the IP and he can seek additional information to verify the claim. Finally, the IU also provides data storage services which facilitates compliance with the requirements of storage of all data related to the CIRP and liquidation processes as per the IU Regulations.

(f) Earning the trust of stakeholders:

One of the objectives of the Code is to maximise the value of the assets of the CD. Accordingly, while inviting resolution plans as part of the CIRP, marketing needs to be done to generate interest from a wide spectrum of resolution applicants. At the same time, the entire bid and auction process has to be done on an online platform which can inspire confidence of all stakeholders and participation without any geographical barriers. To facilitate the process, the Insolvency and Bankruptcy Board of India empanelled platform for distressed assets (PDA) service providers after calling for applications through a process of request for proposal. NeSL is one of the empanelled service providers offering PDA services. The PDA is an effort to further the objectives of the Code by providing for an electronic marketplace which would reduce cost, improve efficiencies and provide improved access to all market participants.

Besides the PDA services, NeSL also offers an end-to-end software platform for the CIRP. The advantage in this platform is that an IP can work from anywhere, whether, it is home, office or while travelling. He or she can authorise his team with appropriate rights to access files and also monitor remotely all that is going on. There is no need for any stand-alone storage of data and the attendant risks of cyber-attack, unauthorised access etc are mitigated. Besides other stakeholders like the registered valuers and members of the CoC have access to the PDA in a secure manner to the extent permitted under the provisions of the Code.

NeSL has an information security policy and a security framework compliant with ISO 27001:2013 requirements and also adheres to the Reserve Bank of India (RBI) guidelines on cyber security framework. Information security & privacy is ensured in all applications and processes. The data is stored in a tier-4 data centre with the primary and disaster recovery centres located in different seismic zones. The IU Regulations provide for an inspection of the IU17 and also an audit of the information technology framework, interface and data processing systems every year.18

CONCLUSION

The IU has the potential to be of enormous use to all stakeholders. While it is not a public credit repository, access to authorised persons is simple, fully online and based on a robust
process of verification of identity. However, the full potential can be realised if all users are cognisant of their responsibilities to the ecosystem. The Code provides that a FC shall submit financial information to the IU. The RBI has advised all its regulated entities to submit information in respect of all customer segments. The IU Regulations provide that the information shall be updated at monthly intervals within a week from the end of the month. Further, the information of default shall be submitted within seven days of its occurrence. Every stakeholder owes it to the ecosystem to comply with the above so that all can benefit from the information in the IU.

2. Regulation 21(4)(a), IU Regulations.
3. Regulation 21(3), IU Regulations.
4. Section 3(12), IBC.
7. Section 2(p), Section 2(ta), The Information Technology Act, 2000.
8. Regulation 21(4), IU Regulations.
9. Section 215(3), IBC.
10. Chapter II of the IBC.
11. Section 214(e), IBC.
12. Regulation 21, IBC.
13. Section 7(4), IBC.
14. Regulation 23(1)(e), IU Regulations.
15. Section 18(c) and Section 21(1), IBC.
16. Regulation 23(1)(d), IU Regulations.
17. Regulation 37, IU Regulations.
18. Regulation 34, IU Regulations.
19. Section 215(2), IBC.
21. Regulation 27(1), IU Regulations.
Part IV
Imprint, Impact and Insight
The cornerstone of economic reforms in India has been its reliance on market mechanisms to facilitate economic growth. In a liberalised and globalised economic setting, markets are meant to serve as an essential economic institution that would let competitive forces drive private initiatives towards public ends.\(^1\) However, the extent and intensity of competitive rivalry and dynamism in markets depend on several factors, including the ease of entry and exit of firms. Threat of entry is the market’s mechanism for disciplining market power, which is lessened in the presence of entry barriers. Consumer welfare suffers when high or insurmountable entry barriers create conditions conducive for abuse of market power by incumbent(s). Hurdles to exit, on the other hand, can contribute to resources staying longer in existing firms instead of being relocated for more efficient use. Increased misallocation is linked with reduced firm dynamics, where the least productive are able to remain in the market, hindering entry of more efficient firms.\(^2\) Thus, barriers to exit, like barriers to entry, weaken the market discipline mechanisms of the competitive process, which act to relocate resources from one market or firm to another according to changing conditions.\(^3\) Easy entry and exit possibilities are also important from the standpoint of their implications for the ease of doing business. When the entry and exit processes are *ex ante* known to be rapid and smooth, they create incentives for investment.

An effective insolvency and bankruptcy regime plays a critical role in facilitating the exit of non-viable firms and the restructuring of viable firms in a time-bound and orderly manner. Robust implementation of insolvency and bankruptcy laws, undergirded by a strong institutional framework, significantly improves the competitive process of exit and can thereby spur productivity growth. In India, the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/ Code) marked a watershed moment in the history of economic reforms and ushered in a new paradigm for market-led resolution of distressed assets. Within a short span, the Insolvency and Bankruptcy Board of India, put in place a proactive regime based on best practices, streamlined processes and anchoring the resolution ecosystem in market realities. That India’s ranking in resolving insolvency in the World Bank’s Ease of Doing Business improved remarkably from 136\(^{th}\) to 52\(^{nd}\) in just about three years bears testimony to the astounding strides made by the young regulatory body.

As markets take centre-stage in resource allocation, ensuring efficiency in market mechanisms through a combination of regulatory instruments and reforms would have far-reaching benefits for the economy. While speedy and efficient resolution/exit would
play its part, easy entry and fair and healthy competitive operating conditions in markets would also be critical.

Competition spurs productive efficiency which, in turn, propels economic growth, besides incentivising innovation that brings about dynamic efficiency and higher competitiveness. Several empirical studies have suggested that competition enhances productivity at the industry level, generates more employment, and lowers consumer prices. Despite its all-encompassing benefits, healthy competition may not emerge on its own. Even the most ardent votaries of a market economy recognise that liberalised markets cannot be presumed to be competitive and efficient. Without oversight and necessary intervention, we could witness a chaotic environment, where dominant firms misuse their market power to fence out competition, cartels drive up prices, or anti-competitive mergers weaken the competitive structure of markets, resulting in businesses being affected and consumers being deprived of value for money. Such distortions break the link between liberalised markets and the productivity and innovation gains they are believed to yield. Therefore, the need for regulatory oversight cannot be overemphasised.\(^4\)

Against this background, the Competition Act, 2002 (the Act) was enacted as a modern legislation to provide a regulatory framework to deal with competition issues. The Act provides the legal framework for the promotion and preservation of competition in markets in India. The Act was enacted after repealing the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act). As we embarked on the path of reforms in the early nineties, the MRTP Act was acknowledged to have outlived its utility, and control of monopoly was no longer appropriate for a competitive market economy. The new competition law embodies the post-liberalisation philosophy of competition as the foundation of well-functioning markets. Thus, it aims to promote competition—a paradigmatic shift from MRTP’s mandate of curbing monopolies.

The Act aims to prevent practices having adverse effects on competition, promote and sustain competition in markets, protect consumer interests, and ensure freedom of trade carried on by other participants in markets in India. Provisions dealing with anti-competitive agreements and abuse of dominant position became operational in 2009, and provisions related to mergers and acquisitions were notified in June, 2011. The Competition Commission of India (CCI/Commission), established as the enforcer of competition law in India, devoted its formative years shaping the regime in accordance with evolving market realities while anchoring it in the economic development goals of the nation.\(^5\)

Since inception, it has been the Commission’s endeavour to develop a culture of competition in markets through effective enforcement of law and proactive advocacy outreach. The focal points of its actions and interventions have been to bring about swift market correction so that businesses can compete on merits irrespective of their size and, most importantly, ensure that consumers benefit from improved market outcomes. In correcting market-distorting practices, the Commission has used an effective mix of the twin instruments of enforcement and advocacy. The instrument of enforcement has been applied judiciously, with interventions made only in such cases where business conduct was found to seriously
undermine market processes and mute competition. For instance, the Commission has had an assertive enforcement agenda against cartels to free Indian markets from this pernicious economic offence and optimise deterrence. At the same time, it has incentivised self-reporting and offered businesses an opportunity to approach the Commission for lesser penalty by making vital disclosures on cartels. The idea has been to engage the industry not only for prompt detection and rectification of competition problems but also make them realise that everyone stands to gain from fair and competitive markets.  

The Commission is also responsible for undertaking competition scrutiny of big-ticket combinations (mergers, amalgamations, acquisitions) before they are consummated. Based on its assessment, the Commission can provide unconditional approval, approval with modifications, or disapprove proposed combinations. Advance mandatory notification requirement gives the Commission the ability to identify and remedy potentially problematic transactions, thereby benefitting consumers and competition. However, the Commission has been conscious of the fact that combinations are an essential means for businesses to achieve synergies; they facilitate the vital process of industrial evolution and restructuring by way of entry, expansion, and exit. Consequently, undue regulatory interventions against combinations are likely to be counterproductive to the overall economic policy objectives of the State. Yet, the experience across competition jurisdictions shows that combinations could also, in certain circumstances, change the market structure in a manner that adversely affects welfare. In the absence of regulating such transactions, a given sector may become concentrated over a period of time, resulting in unfair pricing, poor quality, and distortion of level playing field. These outcomes cannot be reversed by ex post unscrambling of the combined entities owing to high socio-economic cost. This has called for ex ante regulation of combinations under competition law across jurisdictions. Being the guardian and representative of consumer welfare in free market economies, the role of competition agencies assumes significance insofar as balancing the synergies and anti-competitive effects of inorganic business consolidations. Thus, they are entrusted with the mission of establishing a pro-market regulatory system that expeditiously facilitates synergetic transactions, and combinations that have anti-competitive potential alone are subject to detailed review.

The CCI, acknowledging the need and significance of inorganic growth for enterprises to attain size, scale, and efficiency, has focused on quick approval of mergers and acquisitions. The CCI has had occasions to examine merger filings in diverse sectors of the economy, ranging from financial markets, pharmaceuticals and healthcare, power, to digital markets. The average number of days taken for the disposal of combination cases over the last two years stands at 17 working days.

Over the years, the CCI has continued its efforts to streamline and amend its procedures and regulations to promote a trust-based system. A Green Channel system was introduced for automatic approval of combinations on August 15, 2019. This is a first-of-its-kind trust-based system in the world, where notifiable transactions having no overlaps, be it horizontal, vertical, or complementary, between the parties, are deemed approved upon filing. It is expected to promote speedy, transparent, and accountable merger review,
striking a balance between facilitation and enforcement. Overall, there were a significant number of transactions by first-time Private Equity firm investors in new sectors, resulting in no overlaps. These firms have been filing notifications through the Green Channel. A total of 54 Green Channel notices have been received since the inception of this fast-track dispensation. The Green Channel route has gained traction, with such filings constituting around 25% of the total combination filings, demonstrating stakeholders’ confidence.

Through a slew of other moves, the CCI has reduced compliance burden and improved ease of filing for industry. For instance, in recent amendments to the Merger Control Regulations, the requirement of providing information on non-compete arrangements in merger filings has been dispensed with. This has provided parties to the combination with the required flexibility to negotiate non-compete clauses and reduced information requirements at the time of notifying the combination. Further, revised guidance notes were issued, which provided the parties to the combination clarification notes on the information to be filed with the CCI. For facilitating filings, the CCI issued a practice direction, enabling parties to authenticate pleadings through any of their authorised representatives instead of filing them through directors as per the extant practice.

Procedural fairness and transparency are also accorded utmost priority in adjudicating antitrust cases. The CCI recently notified a revised confidentiality regime based on extensive stakeholder consultation on experience gained and difficulties faced, in line with global best practices. The objective of the exercise was to establish a robust information-sharing regime that allows parties to effectively present their cases in the interest of justice without compromising the sanctity of commercially sensitive information. The thrust of the new regime is on self-certification and self-declaration in a trust-based system with provisioning for penal action for deviations and aberrations.

The rise of the digital economy and the reliance of consumers and businesses on digital platforms accelerated considerably during the pandemic, multiplying the need for competition agencies to take a closer look at digital markets. It needs to be ensured that steps taken towards recovery do not irreversibly alter markets and that competition principles are respected along the way, especially by ‘gatekeeper’ firms that provide online intermediation services.

On the one hand, digital markets are bringing in innovation, but on the other, they are giving rise to various competition concerns. In recent times, there has been a steady rise in cases examined by the CCI emanating from new-age markets, which ranged from across the verticals, such as online marketplace platforms, app stores, payment gateways, online travel, food aggregators, and social networking. Such cases pertained to issues such as self-preferencing, deep discounting, and leveraging, which have a direct interface with competition law regime. In the context of e-commerce platforms, the concern is that, in light of the dual roles performed by them (i.e., role of marketplace as well as a competitor in the market), they may have the ability as well as the incentives to discriminate and leverage. From a competition law perspective, it is important that they remain neutral in their functioning.
Anti-competitive effects in new-age markets may be different from traditional price effects, and examining such conduct may require new theories of harm and new ways of assessing impact. Further, the traditional consumer welfare framework in antitrust that primarily looks at price and output may fail to capture forms of market power and effects on both/multi sides that should be relevant to antitrust. Thus, in digital markets, the theories of harm may need to be augmented to account for factors such as data, quality, choice, privacy, and innovation that shape the digital competition landscape, instead of focusing only on price effects. In other words, when dealing with digital markets, non-static harms have taken centre stage. The business models of firms operating in digital markets can be complex and multi-sided, and often involve reliance on data and may include zero-price markets. The nature of data, the difficulty in understanding the operation of algorithms, and other complexities require authorities to apply new tools and approaches to investigate and inquire into anti-competitive behaviour in digital markets. Increasingly, data is emerging as an important metric in the assessment of market power as well as examining conduct.

In its interventions in digital markets, the CCI has been focused on acting swiftly and crafting suitable remedies to address challenges arising out of new forms of business models. The CCI’s constant endeavour has been to strike a delicate balance while addressing market distortions without stunting efficiency and innovation. The implementation of advocacy as a non-intrusive measure has enabled and brought out an acceptable and inclusive competition compliance regime among all stakeholders. In this process, the CCI has complemented its enforcement efforts by conducting market studies. A market study on e-commerce was conducted to develop a better understanding of the novel competition issues emerging from the growing importance of digital platform-centric commerce. Market studies in the telecom and pharmaceutical sectors were also initiated, given their significance in the COVID-19-induced socio-economic milieu. While the telecom study was launched due to rapid advancements in technology and the fast-changing market dynamics in the sector, which became more pronounced due to the pandemic, the pharmaceutical study was initiated because of observable demand-side issues such as lack of effective consumer choice.

The market study on e-commerce revealed bargaining power imbalance and information asymmetry between platforms and their businesses as emerging issues in e-commerce. Under its advocacy mandate, the CCI urged e-commerce platforms to institute a set of self-regulatory measures over certain areas such as search ranking, collection/use/sharing of data, user review mechanisms, revision of contract terms, and discount policy.

The telecom study brought out new issues and challenges from the competition law perspective, with the market moving towards data-based applications and services and technology-led convergence across the value chain. Competition concerns arising out of data were flagged, and it was highlighted that the antitrust law framework is broad enough to address the exploitative and exclusionary behaviour arising out of privacy standards and entities commanding market power. The study accentuated the need for a harmonious regulatory environment, focusing on strengthening cooperation among sectoral regulators and the competition authority.
During the pandemic, the pivotal role of the pharmaceutical sector in the public health agenda came to the forefront. Quality, access, and affordability of medicines are key determinants in the overall quality of public health, which became more apparent during the pandemic. Achieving these outcomes is paramount, as pharmaceuticals contribute over 40% to the total out-of-pocket expenditure on health. Against this background, with the overarching objective of understanding the competition landscape in the pharmaceutical sector in India, the study focused on the specific realms of the distribution architecture for drugs (including the emergence of e-pharmacies), trade margins, prevalence of branded generic drugs in India, and its implications for competition. The study report was released in November 2021 and examined several factors that might influence price competition in the sector. It was observed that a prerequisite for price competition in generics is to dispel concerns about drug quality. Concerns surrounding drug quality discourages prescription by generic names and incentivises the proliferation of high-price, branded generics. This phenomenon was noted as diluting the price-reducing effect of generics in India. Accordingly, a multi-pronged and harmonised regulatory response to the issue of drug quality was recommended, and specifically, the establishment of a national Digital Drugs Databank was suggested.

Government policies and legislations, formulated with certain stated objectives, may inadvertently and unintendingly restrict competition, erect entry barriers, and distort level playing fields. *Ex ante* competition assessment of draft/proposed legislations/policies for identifying competition issues and recommending pro-competitive measures is thus a key area of engagement with the government as part of the advocacy mandate of the CCI. To take this agenda forward, the CCI had recently written to ministries and state governments to forward various draft policies, laws, and regulations relating to different sectors of the economy to the CCI in order for it to provide inputs from a competition law perspective. The CCI has been receiving references for such assessments and has been providing its comments in order to contribute to the nation’s larger agenda of improving ease of doing business and propelling economic growth.

The CCI also actively participated in the deliberations for drafting the national e-commerce policy of India, which were initiated by the Department for Promotion of Industry & Internal Trade, Ministry of Commerce and Industry, and provided inputs to ensure that the principles of fair competition are embedded in the policy.

In keeping with the reforms under ‘Ease of Doing Business’ and to meet the demands of the evolving markets, the CCI has been continuously streamlining its processes and also regularly updating its analytical tools to keep pace with emerging global and technological trends. Even at the peak of the pandemic, the CCI responded in a dynamic way, both on procedural and substantive implementation of law, to ensure that competition regulation moves unabated, and took various steps to contribute towards economic revival. A trust-based, business-friendly regulatory mechanism for regulating competition has been a constant endeavour of the CCI since its inception, both in policy and practice. However, the trust has to be necessarily mutual between the industry and regulator, and the fruits of such
a system cannot be realised if the approach to compliance is merely reactive or tactical. To make such trust-based regime sustainable, it is imperative that parties adopt proactive compliance as the guiding light of corporate governance strategy. Regulatory mechanisms are contemplated to nurture efficient practices that assure a healthy business culture for inclusive growth. Business could be more efficient and competitive by adopting proactive measures to appreciate regulatory philosophy, imbibe them in corporate governance and, accordingly, align their compliances. This would not only reduce non-conformance risks but also ensure advantage of the current structure of the Indian economy and emerging dynamics that provide a fertile ground for businesses to capitalise on the enduring opportunities at the global scale.

As the Indian economy recovers from the pandemic induced economic distress, it is crucial that markets work well. The government’s emphasis on infrastructure creation and the various bold reform measures taken in the recent months have buoyed optimism for a rapid recovery. Robust, nuanced, and targeted enforcement of regulatory instruments will ensure a competitive business environment that rewards legitimate business efforts, where every enterprise gets a fair chance to enter, compete, and succeed. As regulators continue to benchmark their efforts with the global best practices while giving careful consideration to the specificities of Indian markets, the industry also needs to adopt a proactive approach to compliance, which comports, in letter and spirit, with statutory requirements. Effective enforcement of regulations and healthy competitive strategies of businesses in conjunction can establish markets as an institution in India that supports the public policy goal of inclusive economic growth and higher consumer welfare.

3 OECD Secretariat (2019), Barriers to Exit – Background Note.
4 Gupta A. K. (2021), Keynote Address - Vision India@75 Series – Road to 2047, 20 September.
5 Ibid.
6 Vision India@75 Series – Road to 2047, 20 September, 2021.
7 Notification mandatory for combinations meeting the jurisdictional asset-turnover threshold.
8 Gupta A. K. (2021), Keynote Address - Inaugural Series of Webinar on Competition Law, Bangalore Chamber of Commerce, 8 April.
The large and complex structure of the global financial system is often defined by its interconnectedness with the other sectors of the economy as it not only helps to allocate capital and risk\(^1\) but also performs the role of intermediation between the personal sector of an economy and the corporate sector.\(^2\) Stability in the financial sector is, therefore, an international public good.\(^3\)

A major turnaround in the resolution regime of the financial sector came with the Global Financial Crisis of 2007-09, starting in the UK with the bank run on Northern Rock, 2007 and involving the bankruptcy of Lehman and a bailout of American International Group—both within a couple of days of each other in September, 2008. Professor Eidenmuller notes that, around that time, a worldwide near-consensus amongst policy makers and regulators emerged that the default, in particular, of a systemically important financial institution demands a special regime that kicks in earlier, is more flexible, and also much speedier than an ordinary bankruptcy proceeding,\(^4\) so as to avoid the destructive loss of value associated with a bank failure.\(^5\) Further, the Global financial crisis also led to certain instrumental transformations in the capital and liquidity requirements in the banking sector, in the form of Basel III norms, with a view to provide for stringent financial sector regulation.\(^6\)

In a bid to reduce the fear of the depositors and minimise the knock-on effects of failure of systemically important financial institutions while avoiding a taxpayer bail-out, UK was the first jurisdiction to pass the Banking Act of 2009, a modern bank resolution and recovery regime, followed by the US with Title II of the Dodd–Frank Wall Street Reform and Consumer Protection Act, 2010 and Germany with the Kreditinstitute-ReorganisationGesetz, 2010.\(^7\)

Further, in the wake of the Global financial crisis, as governments and central bankers were struggling to contain the turmoil, a group of 20 Finance Ministers and Central Bank Governors (G20) established a new entity, ‘the Financial Stability Board’ (FSB). The FSB’s core mission was to promote the regulatory standards that best ensure the stability and soundness of the financial system. The FSB not only laid down the key components to reduce the moral hazard faced by Globally Systemically Important Financial Institutions (G-SIFIs) but also established specific working groups and committees for developing ‘Key Attributes of Effective Resolution Regimes and Essential Elements of Effective Recovery and Resolution Plans for the financial sector’ (Key Attributes).\(^8\)
While most of the countries have tried to design an insolvency regime for their financial institutions closer to the key suggestions given by FSB, in India, the legislative vacuum persists.

This article offers an evaluation of the legislative efforts made by India in bringing a special resolution framework for the financial service providers (FSPs) through the Financial Resolution and Deposit insurance Bill, 2017 (FRDI Bill). Though the FRDI Bill did not see light of the day and was taken back due to public backlash, the article argues that it offered some good framework for the insolvency resolution of banks and other financial institutions. If the gaps in the FRDI Bill can be identified and reworked, there is a possibility to fill in the existing legislative vacuum for insolvency framework for FSPs. This article argues for reintroducing FRDI Bill with certain modifications.

DEVELOPMENTS IN INDIA

Around the period accompanying the global financial crisis, the Indian government, with a view to simplifying the complex and cumbersome legislations in the Indian financial sector and bring them in line with the international regulatory requirements, established the Financial Sector Legislative Reforms Commission (FSLRC) in March, 2011. After due discussions and deliberations, the FSLRC came out with the draft ‘Indian Financial Code’, meant to replace the bulk of the then existing financial law in India.

Amongst the nine components identified for review in the financial sector by the FSLRC, one of them pertained to addressing the issue of resolution of failed financial firms and protecting the interests of stakeholders involved. The FSLRC, while identifying a gap of a resolution regime in the Indian financial sector, recommended for a specialised resolution regime for a wide array of financial firms in India, proposing the establishment of a specialised ‘Resolution Corporation’ working in close coordination with the respective sectoral micro-prudential regulators, which will offer a viable alternative to the financial instability resulting from bankruptcy proceedings, or the fiscal and political consequences of taxpayer-funded bailouts. This Report by the FSLRC was useful for the ‘Committee to Draft Code on Resolution of Financial Firms’ to come out with the FRDI Bill.

Additionally, the Reserve Bank of India (RBI), in January, 2013, also constituted a high level Working Group (Working Group) to suggest extensive strengthening of the resolution regime, taking into consideration the structure of Indian financial institutions. It highlighted the various shortcomings in the present financial sector laws, like the presence of segmented sectoral statutes to deal with resolution of respective financial institutions instead of a unified law, limited existing powers to sectoral regulators and the absence of powers to resolve a financial institution’s holding company to and others. One of major problems highlighted by the Working Group was that of forced merger by the RBI, where an insolvent bank is forcibly merged with another bank.
In March, 2016, the then Finance Minister of India constituted a Committee to draft a Code for resolution of financial firms (the Committee). The Committee in its Report, while highlighting the shortcomings and limited abilities of the present sectoral regime to resolve institutions in the financial sector, noted that the power granted to the financial regulators to resolve the respective financial institutions prevents specialised resolution capabilities from getting developed, and impedes cross-sectoral learnings in the financial sector. Further, the principle of ownership neutrality or a level playing field for all types of private/public/foreign firms is totally absent as certain exemptions from resolution powers in the existing statutes have been granted to public sector firms. Recognising a systemic vacuum that exists with regard to bankruptcy situations in financial firms, a comprehensive Code on Resolution of Financial Firms, a separate legislative framework, in the form of FRDI Bill was introduced in the Indian Parliament to overcome the systemic vacuum that exists with regard to the bankruptcy of financial firms. The FRDI Bill received public backlash due to the controversial bail-in clause that allowed appropriation of debtor’s insured amount over and above the insured amount. Hence the Bill was referred to the Joint Committee for review, which presented its Report in August, 2018. After the conclusion of multiple meetings, the Joint Committee decided to withdraw the FRDI Bill. It is because of this reason that presently, in India, there is no defined and a separate resolution regime for resolving institutions in the financial sector.

As a stop gap arrangement, the Ministry of Corporate Affairs (MCA) has notified rules providing a framework for insolvency resolution of systemically important FSPs, excluding banks. These rules were issued under the power given to the Government under section 227 of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) and are only applicable for non-banking financial companies (NBFCs) (including housing finance companies (HFCs)) with asset size of ₹ 500 crore or more as per last audited balance sheet. The MCA noted that FSP rules were only an interim mechanism to deal with any exigency pending introduction of a full-fledged enactment to deal with financial resolution of banks and other systemically important FSPs. Therefore, it’s not unsafe to conclude that there is a complete regulatory vacuum for resolution of FSP’s in India.

**CHALLENGES IN THE FRDI BILL**

The Key Attributes as discussed above set out the core elements that the FSB considers to be necessary for an effective resolution regime. In the light of Key Attributes suggested by FSB, the paragraphs below identify the noncompliance of five key attributes namely (a) Scope, (b) Resolution Authority; (c) Resolution powers; (d) Set-off, netting, collateralisation, segregation of client assets; and (e) Safeguards.

*Inclusion of certain Systemically Important Institutions*

FSB Key Attribute 1 states that the resolution regime should be clear and transparent as to the financial institutions within its scope. Even though the provisions of the FRDI Bill apply to specified service providers, as listed down in schedule 2, the resolution of many financial
institutions, mentioned under that list, by the Resolution Corporation is contingent on them not being notified to be resolved under the provisions of section 227 of the IBC. Prima facie, this leads to ambiguity as to the scope of the financial institutions, which will be resolved by the Resolution Corporation under the provisions of FRDI Bill.

The issue of certain financial institutions being resolved under the provisions of general insolvency law is not without precedent. In the UK, even though the Banking Act, 2009 establishes a special resolution regime for resolution of banks and other financial institutions, those institutions will be resolved under the UK’s Insolvency Act, 1986, if there is no public interest involved and the respective institution is not holding any form of deposits or client assets. It is pertinent to note that there has to be a clear line of demarcation, even if certain financial institutions are to be resolved under the provisions of the Code, which is not the case with the Code, as section 227 empowers the Central Government to notify any FSP to be resolved under the Code, with certain modifications.

In paragraphs below, a case is made out for inclusion of four such systemically important institutions namely insurance institutions, pension funds, housing finance and insured service providers.

(a) Inclusion of Systemically Important Insurance Institutions within the scope

FSB Key Attribute 1 defines the scope of the resolution regime as extending to financial institutions that are systemically significant or critical in an economy. Explaining the ambit of this Key Attribute, in relation to the insurance sector, the FSB Key Attributes Assessment Methodology for the insurance sector states that there must be existing guidelines, criteria or procedures for assessing whether an insurer could be systemically significant or critical if it fails and that would enable the relevant authorities to apply the resolution powers to an insurer when necessary to meet the resolution objectives.19 However, the provisions of the FRDI Bill, under section 25(3), do not refer to specific indicators for the insurance sector to be designated as systemically important.

(b) Pension funds

The term specified service providers, to which the provisions of the FRDI Bill apply to, does not explicitly include pension funds, even though the Pension Fund Regulatory & Development Authority has been included as an organisation under the appropriate regulator, as per schedule 1 of the FRDI Bill and respective amendments have been carried out to the Pension Fund Regulatory and Development Authority Act, 2013 to accommodate the powers of the Resolution Corporation to resolve pension funds.

Pension funds must be resolved under the provisions of the Code, but if the pension funds start offering guaranteed pension schemes, in that case, the resolution of pension funds would be more properly accommodated under the FRDI Bill mechanism. This was also the reason discussed in the meetings of the Report on the FRDI Bill, 2016 to leave the pension funds out of the ambit of specified service providers but leave some leeway for it to be resolved if minimum guarantee schemes are implemented in India.20
It is also pertinent to note that the proposed Financial Sector Law Amendment Bill, 2018 in South Africa\(^{21}\) intends to bring the resolution of only designated systemically important pension funds under the ambit of a special regime for resolution of financial institutions. Further, in Australia, superannuation funds are not resolved under the special resolution regime for financial institutions, even though Australia's pension industry is the fourth largest in the world.

(c) HFCs

Presently, the term specified service providers in the FRDI Bill does not include HFCs under its ambit, even though respective amendments have been carried out to the National Housing Bank Act, 1987 to accommodate the powers of the Resolution Corporation to resolve National Housing Bank (NHB), which is a principal agency to promote the HFCs in India.\(^{22}\)

The Joint Committee in its Report had also emphasised the fact that the resolution of HFCs should be carried out under the provisions of FRDI Bill and hence, NHB should also be included as an appropriate regulator.

**Ensuring operational independence of the resolution authority**

According to FSB Key Attribute 2.5, the resolution authority must have ‘operational independence’ consistent with its statutory responsibilities, transparent processes, sound governance and adequate resources. It should have the expertise, resources and the operational capacity to, amongst other things, conduct resolution planning in preparation for the risk of possible future failure and to implement resolution measures with respect to large and complex firms.

The ‘Key Attributes Assessment Methodology for the Banking Sector’ elaborates that the requirement for resolution authority to be operationally independent does not mean it can have no functions other than resolution. An authority that carries out resolution functions may also carry out other functions, such as supervision or deposit insurance, provided that adequate governance arrangements are in place to manage any perceived or actual conflicts of interests that may arise from combining those functions within a single authority.\(^{23}\) Further, in EU and its member states as well as Hong Kong, this operational independence has resulted in the presence of separate staff/unit/department within the same authority for resolution functions.

In the FRDI Bill, the Resolution Corporation performs the functions of resolution as well as deposit insurance. However, there are no provisions in the FRDI Bill which point to either the presence of adequate governance arrangements or the presence of different staff and operational capacity within the Resolution Corporation to manage any perceived conflicts of interests arising from its functions of resolution and deposit insurance.
Risk assessment criteria for insurance firms

FSB Key Attribute 3.1 states that resolution should be initiated when a firm is no longer viable or likely to be no longer viable and has no reasonable prospect of becoming so. Further, the annex-2 to the Key Attributes, which provides guidance on the implementation of the Key Attributes, in relation to resolution regimes for insurers and insurance firms, states that the exercise of the resolution powers, in relation to insurers, must be exercised by the resolution authority only when the insurer is no longer viable or likely to be no longer viable and has no reasonable prospect of becoming so, before it is balance-sheet insolvent, the determination of which can be based on suitable indicators like the insurer being in breach of minimum capital, a strong likelihood that policyholders or creditors will not receive payments as they fall due, etc.

The provisions of the FRDI Bill do not specify the risk assessment criterion separately for the insurance sector. There is a need for defining the various categories of risk to viability, relevant to the insurance sector, as the parameters presently given in the FRDI Bill are broad in nature.

However, provision to clause 36(5) of the FRDI Bill provides certain leeway to the Resolution Corporation in specifying different criteria for risk assessment for different categories of specified service providers. Further, guidance can be taken from Singapore’s special resolution regime for financial institutions, where even though general risk assessment criteria exist for all forms of financial institutions, certain specific risk assessment criteria have been also provided for the insurance firms.24

Timely payout & transfer of insured deposits in liquidation

FSB Key Attribute 3.2(xii) states that the Resolution Corporation, while liquidating the whole or part of a failing firm, must ensure the timely payout or transfer of insured deposits and prompt (for example, within seven days) access to transaction accounts and to segregated client funds. Further, if timely pay-out is not possible, other circumstances, like depositors having access to a substantial proportion of their insured deposits within a timely period would be treated as largely complying with Key Attribute 3.2(xii).25

According to the International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Insurance Systems,26 as referred to in the FSB methodology, a timely payout is a payout made to the depositors within seven working days and if not, then a credible plan must be in place in the jurisdiction to reach this seven-day payout target within two years.

However, there are no provisions in the FRDI Bill which refer to prompt payout to depositors in the event of the liquidation of the firm. From the date of commencement of liquidation, a payout to the insured depositors is possible within a lengthy maximum period of seven months.27 Further, there is no presence of a credible plan, in the provisions of FRDI Bill, to ensure the seven day target payout within two years.
At this juncture, guidance can be taken from various countries like UK, where the Bank of England has the power to enable fast payout to depositors and quick access to accounts,\(^{28}\) within a period of seven days;\(^ {29}\) In Singapore, the Singapore Deposit Insurance Corporation plans to make payment within a total of seven working days as well.\(^ {30}\)

**Reversal of asset and liability transfers to bridge institution**

FSB Key Attribute 3.4.(iii) refers to the powers of the Resolution Corporation to reverse the asset and liability transfers to a bridge institution, which have not been prescribed as one of the resolution powers of the Resolution Corporation in the provisions of the FRDI Bill.

A statutory power for an administrative authority to establish and operate a bridge institution exists in 14 jurisdictions. In eight of those jurisdictions (six EU Member States, Japan, Singapore), the resolution authority has an explicit statutory power to transfer assets or liabilities back (‘reverse transfer power’) from a bridge bank to the bank in resolution, its estate or to another entity such as an asset management vehicle. In three other jurisdictions - Canada, Switzerland, US, however, reverse transfers are achieved through provision in the transfer instrument rather than by means of a statutory power. Canada, Korea and Mexico are countries, wherein like India, the bridge institution is owned completely by the resolution authority. In the UK, the bridge bank is a subsidiary of the Bank of England.

According to the World Bank guidebook on understanding bank recovery and resolution in the EU,\(^ {31}\) a reverse transfer can be provided for, and assets (and liabilities) moved back to the entity under resolution or to the bridge bank if, following the sale, additional details come to light on the quality of the transferred assets. This reverse transfer option will increase the entity’s salability and the chance of finding a private sector purchaser within a short(er) period of time. The resolution financing arrangements can include reverse transfer guarantees to the buyer in the sale contract. Thus, having the power to reverse such transfers allows for the ability to reach a resolution for the entirety of the business as opposed to just the ‘good’ part of the business that would have been transferred to the bridge institute, while allowing the bridge institute to properly manage and curb the erosion in value of the key businesses. This power would therefore afford more flexibility to the Resolution Corporation to resolve the beleaguered financial institution in the most efficient way possible in order to maximise value and minimise systemic damage to the fabric of the financial ecosystem.

**Bail-in as a resolution method**

The FRDI Bill provided for various tools to resolve a failing financial firm which include transferring its assets and liabilities, mergers or even liquidation. Bail-in provision was one of the methods of resolution provided in the Bill. This provision allowed for a financial firm on the verge of failure to be rescued by internally restructuring its debt. The provision received maximum criticism on account that it will cause systemic risk and put several depositors at risk. It was one the main reasons for withdrawing the FRDI Bill.
FSB Key Attribute 3.5 states the specifications for implementing a bail-in, as a resolution measure. Even though the eligible instruments for bail-in have not been identified in the FRDI Bill, discretion has been granted under section 52(5) to the Resolution Corporation to specify the kind of liabilities or instruments which may be subject to bail-in. Further, the Joint Committee in its Report had also stated that the respective stakeholders, including the public, had expressed apprehensions about the usage of bail-in for resolving a failed financial firm or specified service providers.

However, it is to be duly noted here that even though, as per FRDI Bill, insured deposits have been excluded from the application of bail-in, the coverage of insured deposits is presently very low in India i.e., ₹ 5 lakh which makes the exclusion per se insignificant. This coverage limit is abysmally low, compared to the coverage limit of insured deposits approx. ₹ 1.84 crore in US and ₹ 1.5 crore in Australia. India stands at the lowest, in terms of coverage limit of insured deposits, in G-20 jurisdictions. Even though such deposits are excluded from being bailed-in, the low coverage limit still makes the provision of bail-in objectionable or controversial for the general public, as a major chunk of their deposits will still be eligible for bail-in.

The effect of the bail-in is also to leave all creditors in no worse a position than would have prevailed in a case where the institution was liquidated under general insolvency law. Moreover, bail-in has emerged as an effective option in resolution regimes of financial institutions around the world, especially after the Global Financial Crisis of 2007-09 where lot of governments had to rely on state funding or bail-outs or usage of taxpayers’ money in a bid to cope up with the moral hazard or assumption about inevitable intervention by the state to rescue financial institutions. So, one way of avoiding the moral hazard problem is to convince market participants that the government will not provide liquidity support or bail outs, and instead the financial institution will be resolved despite its systemic importance.

An objection which is sometimes raised to bail-in capital is that because the pulling of the bail-in trigger and the quantum of the resulting write-down or conversion are in the discretion of the regulator, it is not possible for holders of bail-in eligible debt to make any meaningful pre-estimate of their risk of loss. This will make such debt difficult or impossible to price on the market. This was one of the major reasons why the introduction of the FRDI Bill in India was faced with such severe criticism and public backlash.

A bail-in regime does concentrate any loss (not absorbed by equity or subordinated debt) on a subset of senior creditors, whereas insolvency regimes spread losses across a wider group. Realistically, however, the increased losses resulting from a liquidation or the dismembering of an institution in a resolution are likely to outweigh these risks—in most cases investors in bail-in eligible debt are likely to be better off than under the alternatives of insolvency or the use of other resolution tools—and investors should in any event analyse their likely loss in resolution on a worst case outcome. Hence, it is pertinent to examine the bail-in provisions in special resolution regimes of some countries -
<table>
<thead>
<tr>
<th>Countries</th>
<th>UK⁴⁰</th>
<th>Singapore</th>
<th>Australia</th>
<th>South Africa</th>
<th>FRDI Bill (India)</th>
</tr>
</thead>
</table>
| Eligible instruments | Sequence justifies the eligibility of instruments for bail-in. | 1. Equity instrument (Additional Tier-1 capital)  
2. Any unsecured liability (Additional Tier 1 and 2 capital)  
3. Contractual bail-in instruments | Additional Tier-1 and Tier-2 capital instruments. | 1. First loss after capital (FLAC)⁴¹ instruments.  
2. Unsecured liabilities. | Eligible instruments to be specified in form of regulations by the Resolution Corporation. |
| Excluded instruments | 1. Protected deposits  
2. Secured debts  
3. Liabilities for holding client assets  
4. Liabilities of less than seven days maturity owed to financial entity  
5. Liabilities with remaining maturity of less than seven days owed to settlement systems.  
6. Salary liabilities owed to employee or former employee  
7. Pension scheme liabilities  
8. Critical operations’ liabilities  
9. Liabilities related to deposit insurance schemes (Further scope for exclusion) | 1. Derivatives contract  
2. Issuance before November 29, 2018 [enactment of the Monetary Authority of Singapore (MAS Act, 1970)]  
3. Secured portion of any liability  
4. Certain senior securities | No excluded liabilities | 1. Unsettled exchange traded transactions  
2. Certain derivatives instruments  
3. Deposits owed to the corporation for public deposits  
4. Unsecured transactions between certain settlement systems | 1. Liabilities to insured depositors  
2. Liabilities for holding client assets  
3. Liabilities of original maturity up to seven days.  
4. Liability owed to central counter party (CCP)  
5. Secured liability  
6. Liabilities owed to employee/workmen, including pension liabilities.  
7. Transaction pertaining to early termination rights. |
<table>
<thead>
<tr>
<th>Countries</th>
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<th>Australia</th>
<th>South Africa</th>
<th>UK</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sequence of write-down</strong></td>
<td>Sequence to be inferred after considering eligible and excluded liabilities.</td>
<td>Sequence to be derived from eligible instruments.</td>
<td>Sequence to be determined according to eligible and excluded liabilities.</td>
<td>Sequence to be derived from eligible instruments.</td>
<td>Sequence to be determined according to eligible and excluded liabilities.</td>
</tr>
<tr>
<td>2. Additional Tier-1 instruments</td>
<td>2. Unsecured liabilities</td>
<td>2. Constitutional principles for compensation may be made applicable.</td>
<td>2. Right to compensation if non-compliance of NCWO principle</td>
<td>2. Public interest to be seen</td>
<td>2. Public interest to be seen</td>
</tr>
<tr>
<td>3. Additional Tier-2 instruments</td>
<td>3. Right to compensation if non-compliance of NCWO principle</td>
<td>3. Principles for compensation may be made applicable.</td>
<td>3. Right to compensation if non-compliance of NCWO principle</td>
<td>3. Any widespread adverse impact on the financial system to be considered.</td>
<td>3. Any widespread adverse impact on the financial system to be considered.</td>
</tr>
<tr>
<td><strong>Safeguards</strong></td>
<td>Right to compensation if non-compliance of NCWO principle</td>
<td>Pari-passu and creditor hierarchy to be followed.</td>
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<td>Pari-passu and creditor hierarchy to be followed.</td>
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</tr>
</tbody>
</table>
In India, the provisions of the FRDI Bill permit the Resolution Corporation, in consultation with appropriate regulator, to carry out bail-in through a scheme or an instrument.\textsuperscript{42} It is pertinent to note here, just like UK, South Africa, Australia and Singapore, necessary safeguards like contractual recognition of bail-in in the instruments, creditor compensation rights if NCWO is not followed, respecting creditor hierarchy and \textit{pari-passu} principles have been embedded in the FRDI Bill with a view to avoid any abuse of powers by the Resolution Corporation. Even though the eligible instruments to be bailed-in will be specified by Resolution Corporation through regulations, certain liabilities like insured deposits (similar to UK), secured liabilities (similar to UK and Singapore), liabilities in form of salary owed to employees and pension scheme benefits (similar to UK), etc. have been excluded from this power, which is also not without any precedent.

The major reason for the public’s backlash towards the FRDI Bill was due to the lack of understanding and apprehension towards the misuse of insured deposits.\textsuperscript{43} As noted above, insured deposits are excluded from bail-in. The extant provisions of bail-in were not only supplemented with adequate safeguards but also, they are majorly in sync with the practices followed across best jurisdictions in this regard.

\textbf{Immunity to directors and officers of the failed firm}

FSB Key Attribute 5.3 reads that the directors and officers of the firm under resolution should be protected in law (for example, from lawsuits by shareholders or creditors) for actions taken when complying with decisions of the resolution authority.

The provisions of the FRDI Bill are silent on any such immunity being accorded to the directors and officers of the firm under resolution for complying with decisions of the resolution authority. On this front, guidance can be taken from UK,\textsuperscript{44} EU BRRD,\textsuperscript{45} Singapore,\textsuperscript{46} and Australia,\textsuperscript{47} where directors or management of the firm under resolution are protected from suits or granted immunity for actions, when complying with decisions of respective resolution authorities.

\textbf{Speedy resolution powers & availability of legal remedies & due process}

FSB Key Attribute 5.4 states that the resolution authority should have the capacity to exercise the resolution powers with the necessary speed and flexibility, subject to constitutionally protected legal remedies and due process. Under section 126, good faith actions are protected. However, under offences and penalties, section 107 punishes any person (includes a body corporate which includes the Resolution Corporation also) for contravening any provisions of the Act, which is further appealable.

Hence there is a lack of review or appeal mechanism for redressal of grievances of the affected parties in the context of classification of risk to viability of a financial firm, bail-in provisions, limited provisions with regard to foreign resolution action and barring the jurisdiction of courts on the process of Resolution Corporation’s decisions.
Redressal against resolution measures through compensation

FSB Key Attribute 5.5 states that the resolution regime should provide for redress against the resolution measure by awarding compensation, if justified. However, there is no provision in the FRDI Bill providing for the right to compensation. Except for the remedy of compensation pertaining to the NCWO safeguard, there is no provision in the FRDI Bill which provides any form of compensation to any aggrieved party on non-compliance of the duties by the resolution authorities.

CONCLUSION

In the light of above discussions, the paper clearly establishes the need for a separate framework for the resolution of financial service providers in India. Currently, NBFCs are governed by FSP rules formed under IBC, which provides for the general insolvency framework in India. We suggest that going forward the resolution of financial institutions should exclusively be done under a special resolution framework. For this, the FRDI Bill must be re-introduced, and its scope must be widened to include all types of financial entities including housing finance companies and pensions funds. In any case if the policy makers decide to adopt UK\textsuperscript{48} and the US\textsuperscript{49} style model & govern resolution of certain entities under section 227 of IBC, clear-cut thresholds as to applicability of general & special insolvency frameworks must be devised to avoid any confusion.

Further, the coverage limit of insured deposits in India presently stands at i.e., ₹ 5 lakh. This coverage limit is abysmally low when compared to the coverage limit of insured deposits of approx. ₹ 1.84 crore in the US and ₹ 1.5 crore in Australia. India stands at the lowest, in terms of coverage limit of insured deposits, in G-20 jurisdictions. Given the publish outlash on bail in provision it is strongly recommended to increase the coverage limit of insured deposits and bring it at par with international standards. Even though such deposits are excluded from the purview of bailed-in, the low coverage limit still makes the provision objectionable or controversial for the general public, as a major chunk of their deposits will be at risk as it will not be covered under the insured deposit.

Also, considering the international standards and IADI Principles, attempts must be made to payout to depositors within seven working days.\textsuperscript{50} In Singapore, the Singapore Deposit Insurance Corporation plans to make the payment within a total of seven working days. In South Africa, the reimbursement to depositors is currently envisaged to take place within 20 working days and reducing the payout period to seven working days once the deposit insurance system attains maturity. In Australia and the US, payout is achievable within seven working days.

Lastly, the FRDI Bill in its extant form does not provide for reverse transfer powers to bridge institutions as available in the best practices across the world. The resolution authorities, as per the law in UK, Singapore and EU, have reverse asset and liability transfer powers.
It is pertinent to provide for such a resolution method under the new framework. This would assist in resolving the entirety of the business as opposed to just the ‘good’ part of the business that would have been transferred to the bridge institute, while allowing the bridge institute to properly manage and curb the erosion in value of the key businesses. It would also afford more flexibility in resolving beleaguered financial institutions while minimising systemic damage to the fabric of the financial ecosystem.

It is submitted that there is an imminent need to fill this legislative vacuum and provide for a special resolution framework. India is already witnessing some big cases of insolvency of financial services such as IL&FS. More importantly, instead of redrafting a new Bill, the need is to reintroduce the FRDI Bill addressing some changes. Attempts should be made to harmonise the draft Bill with international best practices. Efforts should also then be made to advocate the strength of the law and ensure protection of all stakeholders.

3 Ibid.
5 Supra Note 2.
6 Ibid., Chapter 14 and 15.
7 Ibid.
10 The term used in the FSLRC’s Report, and the draft Indian Financial Code is ‘Covered Service Provider’, defined as an FSP, under section 2(76) read with section 2(75) of the Indian Financial Code, that has obtained insurance under section 262 of the Indian Financial Code. Essentially, it includes all forms of financial services, as defined under section 2(75) of the Indian Financial Code, like buying, selling or subscribing to a financial product, affecting contracts of insurance and others.
11 Ibid.
13 Sections 37 and 45, The Banking Regulation Act, 1949.
15 For instance, Life Insurance Corporation can only be liquidated under the Life Insurance Corporation Act, 1956, by an order of Central Government. The State Bank of India Act, 1955 exempts State Bank of India from the laws relating to the winding up of other banking companies i.e., the Banking Regulation Act, 1949 and the Companies Act, 1933.
19 Financial Stability Board, “Key Attributes Assessment Methodology for the Insurance Sector, Methodology for Assessing the Implementation of the Key Attributes of Effective Resolution Regimes for Financial Institutions in the Insurance Sector”, August, 2020, p.19, EN 1(c).
20 Supra Note 14, p.25.
21 Like India, South Africa is one of the emerging and developing economies that are a part of the BRICS.
22 Preamble to the National Housing Bank Act, 1987.
23 Financial Stability Board, “Key Attributes Assessment Methodology for the Banking Sector, Methodology for Assessing the Implementation of the Key Attributes of Effective Resolution Regimes for Financial Institutions in the Banking Sector”, October, 2016, p.21, EN 2(d).
25 Supra Note 19, p.32, EN 3(m).
26 IADI Core Principles for Effective Deposit Insurance Systems, Core Principle 15.
27 Clauses 72 and 73 of the FRDI Bill.
28 Section 99(2), the Banking Act, 2009.
30 SDIC Deposit Insurance Policyowners’ Protection, FAQs on Deposit Insurance Scheme, Q.24.
32 In India, the coverage limit of the insured deposits has now been increased to ₹ 5 lakh per depositor, as per the Budget 2020.
33 "Deposit Insurance: Background, Core Principles and System Overviews", Presentation to New Zealand Treasury and RBNZ Staff Wellington, 28th - 29th January, 2019.
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34 Supra Note 23, p. 33, EN 3(n).
39 Supra Note 38, 10.20.
40 Certain exceptions are there for building societies and banking groups. Bail-in cannot be done to liabilities of CCP.
41 FLAC is a new tranche of loss-absorbing instruments, being unsecured, subordinated, not subject to set-off, etc.
42 Clause 52, The FRDI Bill.
43 Supra Note 38.
45 Articles 40(12) and 42(13), EU BRRD.
46 Section 124, The Monetary Authority of Singapore Act, 2018.
47 In UK, the absence of ‘public interest in resolution’ and ‘no holding of public deposits/assets’ would lead to a financial institution being resolved under general insolvency law and not special insolvency law i.e., The Banking Act, 2009.
48 In US, all forms of financial companies, except insurance, Insured Depository institutions and brokers/dealers can be resolved under its general insolvency law i.e., US Bankruptcy Code, 1978, but if a systemic determination has been made for certain financial companies, then those systemically important institutions will be resolved under Title II of the Dodd Frank Act, 2010, which is akin to a special insolvency law for financial institutions.
49 Supra Note 26.
The COVID-19 pandemic has disrupted normal life and triggered a massive economic slowdown driving corporate failures around the world including in India. In such a scenario, it is important that a strong bankruptcy system can enable financially distressed companies to access the credit market and make them survive under these stressed scenarios. An efficient bankruptcy process that allows liquidity-constrained firms to reorganize and continue running their businesses, can help support the credit market by relaxing their financial constraints, and hence resulting in greater entrepreneurship and better access to debt markets. Amid lockdowns and economic shutdowns, we evaluate a recently introduced bankruptcy law, the Insolvency and Bankruptcy Code, 2016 (IBC/Code), in India in terms of its effectiveness in improving financial performance of distressed firms.

In this regard, our recent study provides novel evidence on the impact of the IBC reform, that balances the rights of both creditors and debtors, on the performance of financially distressed firms via exploring the credit flow channels. Using a panel of 33,845 non-financial Indian firms for the period 2008-2019 with a difference-in-differences (DID) analysis, we first study the impact of the IBC on the availability of debt financing and cost of credit, and then its subsequent effect on financial performance of distressed firms as compared to non-distressed firms.

THE IBC REFORM IN INDIA

In the context of India, there was no efficient bankruptcy reform until 2016 and corporate insolvency procedures were contained under different legislations such as the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA 1985), the Debt Recovery Tribunal Act, 1993 (DRT Act), the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). As resolving insolvency was a challenge in the Indian multi-layered legal framework, the Government of India introduced the IBC on May 28, 2016 as a unified mechanism for time-bound resolution of credit-linked disputes.

Similar to most emerging economies, India’s debt market is dominated by the state-owned banks, and domestic credit to private sector by banks (% of GDP) is 50% in 2019, compared to a world average of 90.5%. Recent statistics show the creditor rights index in India improved from 6 in 2014 to 9 in 2019, compared to the world average of 5.67 in 2019. Earlier in India, it used to take 4.3 years to resolve insolvency in 2014 which has declined to...
550 days on average under IBC proceedings; under the IBC, 5636 cases have been admitted into corporate insolvency resolution process (CIRP) as of June 30, 2022.\(^4\)

As per the Economic Survey 2020-21, the IBC has improved resolution processes compared to the earlier mechanisms. The RBI data shows that as a percentage of claims, the scheduled commercial banks have been able to recover 45.5% of the amount involved through IBC in 2019-20, which is the highest as compared to other modes and legislations. Also, IBC recoveries were more than the combined recoveries each year under Lok Adalats, Debt Recovery Tribunal, and the SARFAESI Act during 2016-17 and 2019-20. These outcomes suggest that, since the IBC is specifically designed for firms in financial distress, the law aims to prevent corporate failure and has helped in maintaining creditor rights to the creditor’s benefit while limiting hasty liquidation to the debtor’s benefit, resulting in increased efficiency in keeping viable firms alive.

**IBC AND CREDIT CHANNELS**

As firms closer to the point of financial distress are most likely to be supported by a bankruptcy law, Bose et al. (2021)\(^5\) conducts a DID analysis by constructing the treated and control groups based on firms’ status of being in financial distress. As the IBC helped to strengthen creditor rights in India, it is likely to affect both supply of and demand for credit by distressed firms. An efficient bankruptcy law tries to determine how to compensate creditors, while maximising the value of firms in financial distress before they file for bankruptcy. During this phase, managers of distressed firms have strong incentives to make risky investments so that if the project succeeds, bankruptcy can be avoided or delayed. Hence, there may not be a decline in long-term demand for debt or a decline in corporate risk taking. On the supply side, due to stronger creditor rights in the post-legislation period, there can be an improvement in bank credit supply, as the credit suppliers are more protected in the post-IBC era. Overall, the IBC can help in expanding credit availability without restricting credit demand, unlike the legislation of SARFAESI Act that protected the secured creditors which resulted in a decrease in credit demand.

Bose et al. (2021)\(^6\) is the first study to provide evidence on the impact of the IBC on the ‘credit channels’ of distressed firms. The notion ‘credit channels’ is referred to as the access to long-term and short-term financing, and cost of credit. We find that after the IBC reform, distressed firms were able to increase their access to long-term debt by 6.3%, short-term debt by 1.4%, and reduce their cost of financing by 0.8% as opposed to non-distressed firms due to better and faster debt recovery mechanisms under the IBC framework.

Moreover, we suggest that distressed firms that benefit from both increased access to debt and reduced cost of borrowing (as shown in Figure below) are further able to improve their performance resulting in higher growth opportunities, compared to their non-distressed counterparts. Furthermore, our evidence shows that the performance benefits stemming from the implementation of the IBC are more prominent for those financially distressed firms that are larger, younger and more collateralised.
Note: The above figure displays the real total debt (in ₹ millions), and cost of borrowing among distressed (treated) and non-distressed (control) firms.

CONCLUSION

We conclude that these results are relevant to the current academic and policy debates on safeguarding and preserving businesses, especially in the midst of the current COVID-19 crisis, which is driving many businesses into bankruptcies. Given the profound implications of this COVID-19 induced pandemic, a strong bankruptcy system can not only support financially distressed companies to benefit from a quick and long-lasting revival process, but it can also make lenders more confident to lend to firms under stressed scenarios.

2 The World Bank, World Development Indicators.
4 IBBI Quarterly Newsletter, April-June, 2022.
5 Supra Note 1.
6 Supra Note 1.
Impact of legal systems on financial markets is well debated in academic literature (Hail and Luez, 2006; Miller and Puthenpurackal, 2002). A credit ecosystem that effectively balances the rights of creditors and debtors lies at the heart of the development process of capital markets (Djankov et al., 2008) and enhances entrepreneurial activities (Francis et al., 2009). Bankruptcy procedures ensure rescue of viable businesses and the preservation of borrowers' repayment incentives (Hart, 1995; Rodano et al., 2016). Due to ineffective contract enforcement, banks issue more short-term debt where, lenders review their lending decisions more frequently and restrict borrower flexibility to increase the riskiness of assets (Diamond, 2004). Qian and Strahan (2007) find that stronger legal rights result in loans with longer maturities and lower spreads. While weak creditor rights and poor enforcement effect credit supply, banks charge higher interest rate spreads and ration some borrowers as risks increase, instead of increasing interest rates (Stiglitz and Weiss, 1981). Better enforceability of contracts increases loan size, lengthens loan maturity, and reduces loan spreads (Bae and Goyal 2009). The enactment and institutionalisation of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) is a paradigm shift in Indian financial system facilitating an effective legal mechanism of creditor protection rights and provides a framework for resolution of distress firms. In this context, the objective of this article is to analyse the post-IBC trends in credit markets in terms of loan volumes, interest rates, credit risk and reviews the institutional measures strengthening the ecosystem of credit markets. Finally, the article concludes by identifying issues to be addressed for strengthening the credit market ecosystem to gain the potential of the IBC institutional system.

POST-IBC CREDIT MARKET TRENDS

The two widely used parameters to assess the financial intermediation of an economy are Credit to Gross domestic product (GDP) ratio and Credit-Deposit ratio. Higher ratios indicate aggressive and effective intermediation of the banking sector in the real economy, while a lower ratio shows the need for supply of more formal credit.

At macro level the credit disbursals have marginally increased post IBC but declined in 2019-20, in year 2020-21 jumped to 55.3% which may be due to policy interventions of the Government to enhance the supply of credit, with a view to mitigate the adverse effects of pandemic. However, this supply declined in 2021-22, may be due to low demand and on setting of recession trends. On the overall, post-IBC financial intermediation is not very progressing.
Expanding and Strengthening Credit Markets: Post IBC

Bank credit to industry and services

Bank credit to industry and services (Table 1 and Figure 2) increased from ₹42717 billion to ₹55486 billion, a compound annual growth rate (CAGR) of just 5.37%. The services sector has shown an impressive growth of 11.29%, but credit to large industry is showing an abysmally lower growth rate of just 1.34%. Thus, bank’s lending to asset-based industries could be due to low investment demand.

Table 1: Banking sector credit to industry and services (₹ in billion)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro and small</td>
<td>3715</td>
<td>3697</td>
<td>3730</td>
<td>3755</td>
<td>3818</td>
<td>3839</td>
</tr>
<tr>
<td>Medium</td>
<td>1148</td>
<td>1048</td>
<td>1037</td>
<td>1064</td>
<td>1056</td>
<td>1361</td>
</tr>
<tr>
<td>Large</td>
<td>22444</td>
<td>22053</td>
<td>22226</td>
<td>24039</td>
<td>24177</td>
<td>23981</td>
</tr>
<tr>
<td>Services</td>
<td>15411</td>
<td>18022</td>
<td>20505</td>
<td>24156</td>
<td>25949</td>
<td>26306</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>42717</strong></td>
<td><strong>44821</strong></td>
<td><strong>47497</strong></td>
<td><strong>53014</strong></td>
<td><strong>55001</strong></td>
<td><strong>55486</strong></td>
</tr>
</tbody>
</table>

(Source: Handbook of Statistics on Indian Economy, RBI, 2021)

Overall credit flow to micro, small and medium enterprise (MSME) sector (Table 2) has increased from ₹12964 billion (2017-18) to ₹16136 billion (2019-20), thus post-IBC credit supply to MSMEs shows an annual growth rate of 7.57%. The subsequent year’s credit growth may be attributed to Government’s emergency credit line guarantee scheme (ECLGS), introduced to mitigate adverse effects of the pandemic.
Table 2: Credit flow to MSME sector

<table>
<thead>
<tr>
<th>Year</th>
<th>No of accounts (in million)</th>
<th>Amount outstanding (₹ in billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016-17</td>
<td>23.4</td>
<td>12964</td>
</tr>
<tr>
<td>2017-18</td>
<td>26.2</td>
<td>13242</td>
</tr>
<tr>
<td>2018-19</td>
<td>32.1</td>
<td>15107</td>
</tr>
<tr>
<td>2019-20</td>
<td>38.4</td>
<td>16136</td>
</tr>
<tr>
<td>2020-21</td>
<td>42.0</td>
<td>17839</td>
</tr>
<tr>
<td>2021-22</td>
<td>26.5*</td>
<td>20226</td>
</tr>
</tbody>
</table>

(Source: RBI Annual reports)

* There is a significant decrease in number of accounts due to mandatory registration on Udyam portal under new MSME definition.

Table 3 depicts that non-banking financial companies (NBFCs)' credit to industry increased by 6%, slightly higher than the credit supply of banks, of course NBFCs are largely lending to retail sector. The overall advances have increased by 15% which is almost twice the banks’ lending to industry.
Expanding and Strengthening Credit Markets: Post IBC

Table 3: NBFCs’ credit portfolio (₹ in billion)

<table>
<thead>
<tr>
<th>End of March</th>
<th>Industry</th>
<th>Services</th>
<th>Gross Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>8063</td>
<td>1865</td>
<td>13169</td>
</tr>
<tr>
<td>2017</td>
<td>8940</td>
<td>2224</td>
<td>14846</td>
</tr>
<tr>
<td>2018</td>
<td>11220</td>
<td>3214</td>
<td>19661</td>
</tr>
<tr>
<td>2019</td>
<td>9307</td>
<td>4108</td>
<td>22954</td>
</tr>
<tr>
<td>2020</td>
<td>9665</td>
<td>3566</td>
<td>24606</td>
</tr>
<tr>
<td>2021</td>
<td>10613</td>
<td>3293</td>
<td>26987</td>
</tr>
</tbody>
</table>

(Source: Trends and Progress in Banking, RBI)

Corporate bond market

The IBC treats public debt (debt mobilized by firms from the market) on par with private debt (bank loans) thus bond holders have equal rights with institutional lenders. The debenture trustee representing the bond holders can file for corporate insolvency resolution process (CIRP) if the debtor company fails to pay the promised interest and principal amount of bonds. Further, banks are advising the companies to approach the bond markets if the fund-based credit exposures exceed ₹10,000. However, the enhanced protection to bondholders by IBC has not resulted in firms raising of resources from bond markets. NBFCs and infrastructure firms raised substantial amount of debt through bond markets, while the debt mobilised by firms dealing with other businesses is insignificant (Table 4). Thus, post-IBC firm’s resource mobilisation from bond markets is insignificant.

Table 4: Primary issues of corporate bonds (₹ in billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Finance</th>
<th>Infrastructure</th>
<th>Manufacturing</th>
<th>Oil</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017-18</td>
<td>2522</td>
<td>2077</td>
<td>220</td>
<td>23</td>
<td>488</td>
<td>5331</td>
</tr>
<tr>
<td>2018-19</td>
<td>2348</td>
<td>1531</td>
<td>150</td>
<td>12</td>
<td>381</td>
<td>4420</td>
</tr>
<tr>
<td>2019-20</td>
<td>1106</td>
<td>960</td>
<td>56</td>
<td>4</td>
<td>219</td>
<td>2346</td>
</tr>
<tr>
<td>2020-21</td>
<td>2121</td>
<td>1688</td>
<td>348</td>
<td>7</td>
<td>192</td>
<td>4356</td>
</tr>
<tr>
<td>2021-22</td>
<td>2397</td>
<td>1159</td>
<td>129</td>
<td>55</td>
<td>106</td>
<td>3847</td>
</tr>
</tbody>
</table>

(Source: Rakshita, CCIL Newsletter March 2022)

Cost of credit

Bank’s loan pricing is largely determined by benchmark policy rate (repo rate); thus, banks’ lending rates are to be in tandem with the policy rate. The repo rate has reduced from 6.75% as of March, 2016 to 4.00% by the end of March, 2021; a reduction of 275 basis points, while the bank’s lending rate to large industry during the same period reduced from 12.36% to 8.53%, a decline of 383 basis points, indicating banks passed on the benefit of low interest rate to large industry firms (Figure 3). But the banks have reduced MSME lending rate only 248 basis points (Figure 3). The reduction in bank’s lending rates for large
firms well reflects in reduction in the cost of credit for listed companies (Figure 4) but not for unlisted companies (Figure 5). Thus, post-IBC benefit of reduction in cost of credit is due to reduction in market interest rates only but may not be due to reduction of credit risk premiums nor the enhancement of credit worthiness of firms. Strengthening of creditors interests has not resulted in substantial mobilization of debt by the firms in bond market.

**Figure 3: Repo rate and lending rates of banks**

Cost of credit is estimated as finance costs to total debt. All the variables are winsorized at 1% to avoid outliers.

**Figure 4: Cost of debt of listed firms**
Debt maturity: Long term Vs. Short term debt

The long-term debt structure of listed firms shows a smooth decreasing trend. However, this is not observed in the case of private firms as the ratio of long-term debt to total assets shows a peak in 2016 (Figure 6 and 7). It is observed that the trend of increase is seen from 2014 to 2016 and comes down in 2017 and 2018 and then smoothen out. The access to debt decreased by 1.96 times for listed firms unlike an increase observed (Bose, et al. 2021).

(Source: Computed by using Prowess data)
Secured Vs. Unsecured loans

Protection of creditor rights should make the banks and other creditors to enhance secured credit, post-IBC the ratio of secured debt to total assets has declined, indicating firms are more cautious about bankruptcy risk and reduced the secured debt (Figure 8). Vig, 2013 finds a reduction in the use of secured debt by firms and this was more pronounced in the case of firms with high levels of tangible assets.

![Figure 8: Secured Vs. Unsecured debt to total assets](image)

A comparison of distress and non-distress firms (Table 5) reveals that, no significant difference between the means of long-term debt, short term debt and cost of debt for distressed firms pre-IBC compared to post-IBC. Thus, in terms of debt maturity, cost of debt and collateral (secured) debt, the impact of IBC between distress and healthy firms is insignificant. The capital structure of the firms has not shown any change due to IBC. Table 5 presents the sample means with standard deviations in parentheses. Distress is a dummy that takes value 1 if a firm in a year has interest coverage ratio of less than one, [Earnings before interest, taxes, depreciation, and amortisation (EBITDA)/Interest $<=$ 1], and 0 otherwise. IBC is a dummy variable that equals 1 if the observation occurs in the post reform period of May, 2016 to March, 2021 and 0 otherwise.
Table 5: Descriptive statistics of distress and non-distress firms pre-and post-IBC period

<table>
<thead>
<tr>
<th>Particulars</th>
<th>IBC=0</th>
<th>IBC =1</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Distress =1</td>
<td>Distress =0</td>
<td>Distress=1</td>
<td>Distress=0</td>
</tr>
<tr>
<td>LTD/TA</td>
<td>0.44 (0.63)</td>
<td>0.18 (0.19)</td>
<td>0.43 (0.60)</td>
<td>0.18 (0.20)</td>
</tr>
<tr>
<td>STD/TA</td>
<td>0.27 (0.34)</td>
<td>0.19 (0.15)</td>
<td>0.30 (0.38)</td>
<td>0.17 (0.14)</td>
</tr>
<tr>
<td>Cost of Debt</td>
<td>0.13 (0.11)</td>
<td>0.15 (0.14)</td>
<td>0.14 (0.19)</td>
<td>0.15 (0.18)</td>
</tr>
<tr>
<td>ROA</td>
<td>-0.15 (0.24)</td>
<td>0.04 (0.05)</td>
<td>-0.15 (0.26)</td>
<td>0.04 (0.05)</td>
</tr>
<tr>
<td>Size</td>
<td>6.40 (2.29)</td>
<td>6.87 (1.82)</td>
<td>6.41 (2.44)</td>
<td>7.11 (1.89)</td>
</tr>
<tr>
<td>Liquidity</td>
<td>-0.08 (0.57)</td>
<td>0.15 (0.22)</td>
<td>-0.09 (0.61)</td>
<td>0.18 (0.23)</td>
</tr>
<tr>
<td>Age</td>
<td>0.82 (0.8)</td>
<td>0.95 (0.35)</td>
<td>0.97 (0.66)</td>
<td>1.08 (0.69)</td>
</tr>
<tr>
<td>Collateral</td>
<td>0.36 (0.29)</td>
<td>0.30 (0.23)</td>
<td>0.33 (0.29)</td>
<td>0.30 (0.23)</td>
</tr>
</tbody>
</table>

CREDIT RISK

This section reviews trends in credit risk of Indian firms from multiple dimensions.

Non-performing assets of banks

IBC is expected to reduce the credit risk of firms and reduction in banks’ non-performing assets (NPAs). Banking sector NPAs in 2015-16 increased from ₹6,119 billion to ₹10,397. By end of September, 2021 the NPAs reduced to 6.90% as can be observed from Figure 9. Thus, banks have quickly reduced the NPAs by filing for CIRP.

![Figure 9: Gross NPAs as percentage of advances of commercial banks](Source: Reserve Bank of India)
Low recovery and resolution of NPAs

In the very first year of commencement of IBC, banks have recovered 49.60% (Table 6) of bad loans through IBC mechanisms of either resolution or liquidation. But the average recovery rate is still very low compared to other countries like Singapore and Japan.

Table 6: Recovery rate under various legal channels

<table>
<thead>
<tr>
<th>Year</th>
<th>Lok Adalat</th>
<th>DRTs</th>
<th>SARFAESI</th>
<th>IBC</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016-17</td>
<td>6.30%</td>
<td>10.20%</td>
<td>18.30%</td>
<td>NA</td>
</tr>
<tr>
<td>2017-18</td>
<td>4.00%</td>
<td>5.40%</td>
<td>32.20%</td>
<td>49.60%</td>
</tr>
<tr>
<td>2018-19</td>
<td>5.10%</td>
<td>3.90%</td>
<td>15.00%</td>
<td>45.70%</td>
</tr>
<tr>
<td>2019-20</td>
<td>6.20%</td>
<td>4.90%</td>
<td>17.40%</td>
<td>46.30%</td>
</tr>
<tr>
<td>2020-21</td>
<td>4.00%</td>
<td>3.60%</td>
<td>41.00%</td>
<td>20.20%</td>
</tr>
</tbody>
</table>

(Source: Report on Trends and Progress in Banking, RBI)

Out of 480 cases resolved till March 31, 2022, with a total claim of ₹7,607 billion, financial creditors’ (FCs) claim is ₹6,849 billion, and recovery is just 33%. While the number of liquidated cases is 1,609, with a claim of ₹7,941 billion, thus the pains of realisations are very high, and lenders have foregone more than 95% in many cases. Due to various factors, resolutions took inordinate delays resulting to negligible recoveries for FCs. A few examples of large haircuts and low recoveries are - Videocon group companies (95.85%), Deccan Chronicle (95%), Lanco Infra (88%), Ushdev International (94%) Zion Steel (99%) and so on.

The fundamental issue in loan contracting is addressing information asymmetry, in addition to conventional credit appraisal, internal credit rating models, banks are also dependent on external credit ratings. The experience of CIRP has helped the banks to strengthen the credit appraisal and due diligence process. In facility rating, banks assign higher weight to fixed assets like land, but the experience in several cases indicates that the promoter, as an individual, hold rights on land while the building and plant are registered on entity, leading to low marketability of such assets. If an entity has leased properties as operating assets, any default on lease rental by the borrower is also a limiting factor in smooth resolution. Title disputes are a major factor for poor resolution process.

Multivariate analysis

Widely used credit risk measure to assess the default risk of a corporate firm is Altman’s Z-score, based on accounting ratios. A firm with a Z-score of 2.00 and above is considered that firm has low default risk, while below 2.0 is considered as firm with higher default risk. Post 2016, Indian corporate firms’ Z-score improved but on categorical basis not falling in the low-risk zone. Thus, post-IBC the corporate firm’s default risk has not reduced considerably based on financial accounting information.
Expanding and Strengthening Credit Markets: Post IBC

Table 7: Credit risk (Altman Z-scores) of Indian firms

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Firms</td>
<td>1217</td>
<td>1252</td>
<td>1242</td>
<td>1221</td>
<td>1220</td>
<td>1284</td>
<td>1353</td>
<td>1463</td>
<td>1511</td>
<td>1479</td>
</tr>
<tr>
<td>Mean (Continuous)</td>
<td>2.97</td>
<td>2.72</td>
<td>2.54</td>
<td>2.81</td>
<td>3.78</td>
<td>3.66</td>
<td>4.26</td>
<td>4.54</td>
<td>3.96</td>
<td>2.83</td>
</tr>
<tr>
<td>Maximum</td>
<td>30.86</td>
<td>76.34</td>
<td>97.84</td>
<td>88.00</td>
<td>137.73</td>
<td>115.62</td>
<td>111.43</td>
<td>114.99</td>
<td>94.06</td>
<td>91.98</td>
</tr>
<tr>
<td>Mean (Categorical)</td>
<td>0.86</td>
<td>0.76</td>
<td>0.73</td>
<td>0.78</td>
<td>0.92</td>
<td>0.97</td>
<td>1.07</td>
<td>1.14</td>
<td>1.07</td>
<td>0.84</td>
</tr>
</tbody>
</table>

(Source: Jayadev M and Aishwarya Krishna, draft Report on “Bankruptcy Prediction” submitted to the Ministry of Corporate Affairs, Government of India, 2022)

The authors have also used a logistic regression framework to estimate probability of default for listed firms. The time series of cross-sectional averages is shown below in Figure 10. The default probability has shown a decline post-IBC. It is an augmented form of Z-score converted into probability of default.

Figure 10: Probability of default derived from logistic regression

(Source: Jayadev M and Aishwarya Krishna, draft Report on “Bankruptcy Prediction” submitted to the Ministry of Corporate Affairs, Government of India, 2022)
Market based measures of credit risk

Downgrades to upgrades

Rating migrations capture quick way of firm’s credit risk. In the case of United States, the ratio of Moody’s Investors Service’s downgrades to upgrades, a forward-looking measure, explains the default rate two to three quarters later (Okashima and Fridson, 2000). Indian firms are having more downgrades for every single upgrade (Figure 11), the ratio of downgrades to upgrades declined in years 2017 to 2019, but there after jumped to 4.57 indicating substantial increase in downgrades. In year 2020, the credit rating of 2024 firms downgraded while only 443 firms shown improvement in credit rating. This may be attributed to economic adversities of the pandemic.

Figure 11: Ratio of downgrades to upgrades

(Source: Jayadev M and Aishwarya Krishna, draft Report on “Bankruptcy Prediction” submitted to the Ministry of Corporate Affairs, Government of India, 2022)
Credit spreads of corporate bonds

The corporate credit spreads show that post-IBC the spreads have increased and reduced only after 2020 for well rated bonds but not in other categories.

Table 8: Average credit spreads of corporate bonds (basis points)

<table>
<thead>
<tr>
<th>Year</th>
<th>AAA</th>
<th>AA</th>
<th>A1</th>
<th>A2</th>
<th>A</th>
<th>BBB</th>
<th>BB</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>P1</th>
<th>NA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-12</td>
<td>119</td>
<td>189</td>
<td>248</td>
<td>-</td>
<td>202</td>
<td>185</td>
<td>227</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>205</td>
</tr>
<tr>
<td>2012-13</td>
<td>98</td>
<td>161</td>
<td>231</td>
<td>-</td>
<td>220</td>
<td>308</td>
<td>262</td>
<td>182</td>
<td>-</td>
<td>-</td>
<td>193</td>
<td>181</td>
</tr>
<tr>
<td>2013-14</td>
<td>85</td>
<td>140</td>
<td>275</td>
<td>-</td>
<td>163</td>
<td>291</td>
<td>254</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>189</td>
<td>176</td>
</tr>
<tr>
<td>2014-15</td>
<td>46</td>
<td>123</td>
<td>179</td>
<td>141</td>
<td>149</td>
<td>351</td>
<td>83</td>
<td>138</td>
<td>566</td>
<td>-</td>
<td>-</td>
<td>148</td>
</tr>
<tr>
<td>2015-16</td>
<td>62</td>
<td>164</td>
<td>205</td>
<td>-</td>
<td>237</td>
<td>593</td>
<td>710</td>
<td>281</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>167</td>
</tr>
<tr>
<td>2016-17</td>
<td>73</td>
<td>221</td>
<td>240</td>
<td>-</td>
<td>343</td>
<td>720</td>
<td>1042</td>
<td>1699</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>170</td>
</tr>
<tr>
<td>2017-18</td>
<td>74</td>
<td>171</td>
<td>177</td>
<td>825</td>
<td>352</td>
<td>500</td>
<td>957</td>
<td>1052</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>135</td>
</tr>
<tr>
<td>2018-19</td>
<td>105</td>
<td>183</td>
<td>199</td>
<td>-</td>
<td>232</td>
<td>460</td>
<td>602</td>
<td>885</td>
<td>687</td>
<td>656</td>
<td>-</td>
<td>256</td>
</tr>
<tr>
<td>2019-20</td>
<td>114</td>
<td>282</td>
<td>-</td>
<td>-</td>
<td>391</td>
<td>1135</td>
<td>659</td>
<td>1185</td>
<td>781</td>
<td>807</td>
<td>-</td>
<td>220</td>
</tr>
<tr>
<td>2020-21</td>
<td>99</td>
<td>392</td>
<td>-</td>
<td>-</td>
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<td>1807</td>
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<td>1099</td>
</tr>
</tbody>
</table>

(Source: CCIL’s Newsletter Rakshita March, 2022)

Merton’s probability of default

Models based on accounting information and financial statements are on historical performance as opposed to the firm’s prospects, they are likely to be poor predictors of future default events. Accounting data is based on fundamental concept of conservatism embedded in accounting may lead to under-estimating assets and overstating of liabilities (Hillegeist et al. (2004)). Accounting based models such as Altman (1968)’s multivariate discriminant analysis assumes that the variables are jointly normal, and extremely crucial for the classification to be accurate. Market-based approaches overcome some of these limitations through their use of stock market information. Structural models based on option pricing theory considers asset volatility. The essence of structural models lies in the notion that default occurs when a firm’s assets reach a threshold level of debt. Merton, 1974 presented the first systematic study of debt valuation that built on the link between option pricing and capital structure. We have followed the variations proposed by Vassalou and Xing (2004) and Bharath and Shumway (2008). Cross sectional averages of Merton probability of default every month has been plotted in the Figure 12 below. The aggregate probability of default shows a considerable decline post-IBC, indicating as a forward-looking approach, the default risk of listed firm’s has declined.
Thus, there is no reduction of credit risk, quantified based on Z-scores but the market-based information measures, Merton’s probability of default shows, post-IBC, credit risk of listed firms shows declining trend. However above results are to be examined in a more robust empirical framework.

**INSTITUTIONAL MEASURES**

Post-IBC, some institutional mechanisms are being established, helpful to banks to take early steps in preventing corporate distress.

**Central repository for large corporate credits**

The RBI has established ‘central repository of information on large credits’ (CRILC) to collect, store and disseminate credit data to banks and financial institutions. Banks must furnish information on asset quality of borrowers with an exposure of ₹50 million and above. Banks are reporting special mention accounts (SMA) status of the firms to the CRILC.

SMA is an account which is exhibiting signs of incipient stress resulting in the borrower defaulting in timely servicing of debt obligations, although the account has not yet been classified as NPA as per the extant RBI guidelines. As early recognition of such accounts will enable banks to initiate timely remedial actions to prevent their potential slippages into NPAs. In case of multiple or consortium lending, borrowers may delay or default in debt service to one of the banks, the other consortium lenders can take this as an alert and strengthen credit monitoring.
Legal Entity Identifier code

The purpose of legal entity identifier (LEI) codes is to make it easier to identify a counterparty in financial transactions. The issuance of codes is regulated by the global umbrella organisation Global Legal Entity Identifier Foundation. The RBI recommended LEI code for large corporate borrowers having credit exposure of ₹500 million and above and a roadmap for other borrowers to obtain LEI code. Such identification is helpful in monitoring the borrowers to identify any early symptoms of distress.

Security and covenant monitoring using distributed ledger technology

Covent violations are common by firms and often creditors or bond holders may not know about such violations, which is a symptom of credit risk. The market regulator Securities and Exchange Board of India (SEBI) has notified the operational guidelines for distributed ledger technology (DLT) used for blockchains to monitor security and covenants of non-convertible bonds. The recording of asset details (and their verification), allotment, listing and payment of interest or redemption shall be available in the DLT system. The SEBI also prescribed process of security creation and monitoring of underlying security, asset coverage, and covenants of the non-convertible securities. Debenture trustees can know well in advance about the default risk of bonds and can take corrective action quickly to protect the interests of bond holders.

NARCL: Bank for asset reconstruction

Following the government’s policy announcement in February, 2021, National Asset Reconstruction Company Ltd. (NARCL) and India Debt Resolution Company Ltd. (IDRCL) have been set up by banks to aggregate and consolidate stressed assets for better resolution. NARCL acquires stressed assets by paying 15% cash and 85% through security receipts (SRs). Although, existing asset reconstruction companies (ARCs) have been helpful in resolution of stressed assets of smaller value loan, NARCL is an additional channel to address large NPAs with a backstop facility from the Government. Government provides a five year guarantee up to ₹ 30,600 crore for the SRs issued by NARCL. The condition precedent for invocation of guarantee would be resolution or liquidation. The guarantee shall cover the shortfall between the face value of the SRs and the actual realisation. The guarantee will also enhance liquidity of SRs, as SRs are tradable.

NARCL is popularly called as bad bank. Many countries have such a centralised bad bank offering benefits, freeing up banks’ resources for more important core operations, positive signalling to investors and customers, avoiding fire or distress sales, and complement the activities of the existing public and private ARCs. Resolutions ending with huge haircuts may reduce and creditors may realise better value. The ARC framework is designed to allow originators to focus on lending, by removing sticky stressed financial assets from their books. IDRCL is an operational entity which manages the asset and engage market professionals and turnaround experts to handle the resolution process under an exclusive arrangement.
The RBI’s Committee to review the working of the ARCs, popularly known as Sudarshan Sen Committee in its Report of November, 2021 made recommendations to make ARCs more effective and efficient, important among them are:

(a) In case of consortium/multiple banking arrangements, if 66% of lenders (by value) decide to accept an offer by an ARC, the same may be made binding on the remaining lenders and it must be implemented within 60 days of approval by majority of lenders.

(b) For better value realisation and enhancing the effectiveness of ARCs in recovery, even the borrower’s equity may be allowed to be sold to ARCs.

(c) ARCs may be allowed to participate under IBC as a resolution applicant either through their SR trust or through the Alternate Investment Fund (AIF) sponsored by them.

(d) To give impetus to listing and trading of SRs, the list of eligible qualified buyers may be expanded to include high net-worth individuals, corporates, NBFCs/ housing finance companies, trusts, family offices, pension funds and distressed asset funds with suitable safeguards.

Bad bank experiment is expected to benefit the public sector banks by releasing the capital locked up in NPAs, which would be helpful for extension of credit supply. Not only financial capital, even human capital of the bank may be utilised more productively.

Information Utility

The information utility (IU) constituted under IBC, National E-Governance Services Ltd. (NeSL), provides all financial information, title deeds of collaterals, and all other necessary information, both for creditors and debtors addressing information asymmetries. The IU has reduced bank’s dependency on debtor for information. It helps banks to improve credit appraisal and monitoring systems.

Amendments to Credit Information Companies (Regulation) Act, 2005

The Government has amended the Credit Information Companies (Regulation) Act, 2005 and included all entities engaged in processing information for the benefit of banks. With this, the RBI has notified banks that can access the information from insurance companies, rating agencies, brokers registered with the SEBI and trading members of commodity exchanges. This extended coverage of other information processing companies will be helpful for banks and credit institutions to monitor the borrowers and mitigate the risk.

Public credit registry

The RBI is working on establishment of a public credit registry (PCR). PCR is a repository and provides data on borrowings, repayments, covenants, and any modifications of credit
terms of all borrowers both corporate firms, non-corporate entities, and individuals. This will help banks to strengthen the monitoring processes and take all preventative steps to avoid slippages.

**ISSUES TO BE ADDRESSED**

**Strengthening accounting information system**

Banks rely heavily on accounting information of borrowers, both bank’s internal rating models and rating methodology followed by external ratings assign considerable weight to financial risk factors, quantified based on accounting information. Often the debt covenants are designed on financial statement variables. Thus, accounting, and financial reporting standards for unlisted and private limited companies needs to be strengthened. Evidence (Joanna Shuang Wu and Ivy Xiying Zhang, 2014) shows that adoption of International Accounting Standards has an impact on external credit ratings. Although listed companies follow Ind-AS, (converged with International Accounting Standards), Accounting information reporting practices of unlisted companies needs to be streamlined to make them as true and fair.

**Interim finance or finance during bankruptcy**

Bankruptcy process is taking considerable time to arrive at a logical conclusion, the average time is 15 months, some are exceeding two years also. Firms need to seek financing for continuing operations during the resolution period. Unfortunately, banks are unable to provide such finance. The existing credit policies and stringent government norms do not allow public sector banks to finance the operations of the distressed firm during bankruptcy. As the CIRP imposes moratorium, promoters are away and impossible to expect infusion of any equity or debt. Establishment of an institution or designing a policy is needed to provide interim finance for the potentially viable firms.

**Quick resolution of SME distress**

Government has taken multiple initiatives to enhance the supply of credit to SMEs, but in case of distress and bankruptcy, the resolution process is costly and time consuming, often the asset values deteriorates. Thus, SMEs require a time and cost-effective resolution process A separate legal mechanism may be introduced to address SME distress and bankruptcy. Japan has such a separate resolution process for small and medium enterprises.

**Banking strategy**

Last few years have seen growth of retail loan portfolio of almost all the banks. Digitisation and analytics have made retail loan processing very quick and cost effective. This has also worked as a hedging strategy to mitigate risk of large corporate lending. Recent bank mergers of have created large commercial banks in public sector, these banks with an
articulated strategy should focus on SMEs and large corporate lending, leaving the small ticket size and retail loans to other banks. Banks need to come out with focussed strategies for corporate lending against the current practice of lending to all the segments.

**Market for loan sales and securitization**

A dynamic secondary market for bank loans will also ensure proper pricing credit risk for each exposure. Such pricing will be useful for recognition of impending stress. A well-founded regulatory framework governing sale of bank loan exposures is needed to facilitate secondary market for bank loans.

**Investment demand**

Increase in number and size of service-oriented companies have reduced the demand for capital expenditure, further most of these companies are holding substantial cash balances and avoiding debt and associated financial risk (Summers, 2015). Suggestions on overcoming demand side secular stagnations are worth considering to boost investment demand. Corporate firms have to invest in research and development and innovation leading to more capital expenditure, which results in associated demand for working capital and employment generation, Such huge investment in capital and operating expenditure will push the demand for bank credit.

**Strengthening NCLTs**

On the operational side, a greater number of NCLT benches need to be established, especially in industrialised towns and cities to address larger number of cases quickly. Once committee of creditors (CoC) finalises the resolution plan by voting, further litigations should not be encouraged at NCLT or NCLAT or in any court. A framework for group insolvency is also to be developed to address cases like Videocon.

**Wilful defaulters**

Wilful defaulters are the NPAs with frauds and banks have filed cases with investigative agencies. The CIRP under IBC has resolved only one listed company out of the 106 wilful defaulters reported during 2016 to 2020. Currently, declaring a borrower as wilful defaulter takes not less than two years from the date of recognition of the respective loan as NPA. In this lengthy process, the collateral asset values will deteriorate, and banks will recover hardly any value out of collaterals. Access to bank credit is tighter for firms that are more frequently involved in bribery practices (Shusen Qi and Steven Ongena, 2019). The RBI should come out with improved processes in recognition of wilful defaulters and take stringent action against them.

**CONCLUSION**

To conclude, the IBC has improved loan recovery, reasonably quick resolution compared to earlier mechanisms, and reduced the distress risk of both listed and unlisted firms. The Code has had a significant impact on debt structure of listed firms. It has reduced the
leverage and proportion of secured credit of firms. However, reduction of cost of credit is marginal. To see significant improvement in credit supply and expansion of credit to various industries, demand side measures are to be better addressed given the supply side bottlenecks are largely addressed.

BIBLIOGRAPHY


The Insolvency and Bankruptcy Code, 2016 (IBC/Code) is the first of its kind holistic creditor-in-control bankruptcy regime in India. Unlike earlier bankruptcy regimes, such as the Board of Industrial and Financial Reconstruction (BIFR), the IBC is more efficient and effective in resolving sick firms. Hitherto, the initiation of bankruptcy proceedings was based on the accounting event of net worth turning negative, and the incumbent management continued to be in control during bankruptcy proceedings. There was no time limit on bankruptcy proceedings. The quasi-judicial board that adjudicated bankruptcy cases took five to eight years to dispose of a case. Most importantly, multiple laws dealing with creditor rights and corporations conflicted with the bankruptcy law creating room for confusion and litigation.

In contrast, the IBC ushered in a regime of creditor-in-control during bankruptcy; the incumbent management is dismissed immediately on the admission of a case. The trigger event under IBC is a default on loan; a significantly less discretionary measure than before. The law imposes time limits for the completion of bankruptcy proceedings. Any violation of set timelines automatically leads to liquidation. Finally, the IBC overrides other related laws in matters of bankruptcy, significantly reducing the scope for litigation. Therefore, the new law is more comprehensive and more creditor friendly. Not surprisingly, several studies have examined the implications of IBC on debt, capital structure, activities, and governance of firms in India and have documented positive effects of the IBC.

However, apart from the desirable ex-post effects of the stringent Code, it is crucial to investigate whether the IBC introduces any ex-ante disciplining effect on firms. As the Dutch philosopher, Desiderius Erasmus correctly points out, ‘Prevention is better than Cure’. Thus, the purpose of any stringent bankruptcy law should not be limited to the efficient resolution of a bankrupt firm but to deter firms from entering avoidable bankruptcy situations in the first place. Although not all bankruptcies are avoidable, there is evidence that firms default on loans by tunneling resources. Such cases of willful loan delinquency by borrowers are prominent in economies such as India, where the legal enforcement is weak.

The features of IBC can help discipline managers and improve the corporate governance of the firms. Specifically, the creditor-in-control nature of the Code poses a credible threat of loss of control for the promoters and managers of the firm. Given that most firms in
India have a high level of promoter holdings, it is reasonable to expect the firms’ owners to behave and avoid admission to bankruptcy courts. In this article, the authors provide evidence supporting the disciplining effect of IBC by showing that firms’ equity and investments increased post-IBC.

**EQUITY INFLOW**

In the event of bankruptcy, shareholders face a significant write-down in the value of their investments owing to residual claims for equity holders. Thus, we can expect the shareholders to invest fresh equity into the firm’s *ex-ante* to avoid admission to bankruptcy. Further, Indian companies usually have a significant shareholding by promoters or owners. Thus, the threat of loss of control is even higher in Indian companies, which can induce high capital inflows (Chakraborty *et al.* (2022)).

We investigate the impact of IBC on equity inflows by segregating firms into treated (highly affected) firms or control (less affected) firms based on the distance of the bank from the relevant National Company Law Tribunal (NCLT) court, which has jurisdiction over the firm. Note that the bank can file a bankruptcy case against a delinquent borrower only in the NCLT court, which has jurisdiction over the firm’s location. Thus, all else equal, the cost of filing and dealing with a bankruptcy case increases with the distance of the bank branch from the NCLT court. Using a sample of 45,762 firm-year observations from Prowess, we examine the average equity inflows for treated and control firms before and after the IBC was legislated. Figure 1 shows that, on average, a firm more affected by the bankruptcy law witnesses approximately ₹70 million increase in equity capital after the IBC was legislated. At the same time, less affected firms did not see an increase in equity capital after IBC came into effect.

![Average change in capital (₹ in million)](image)

**Figure 1: Change in equity capital post IBC**

This figure plots the average increase in equity capital for treated and control firms. The vertical axis represents the increase in equity capital in millions (rupees). The blue (orange) bar represents control (treatment) firms. The pre-period is from 2014 to 2016, whereas the post-period is from 2017 to 2019.
Next, the increase in equity capital is adjusted for share redemption to calculate the net equity inflow. As shown in figure 2, for the treated firms, the average net equity inflow in the post-period is much higher than the average net equity inflow in the pre-IBC period. However, the trend is the opposite for the control or less affected firms. The control firms witnessed a decrease in average annual net equity inflow after the IBC came into effect.

This figure plots the average increase in net-equity inflow for treated and control firms. The vertical axis represents the increase in equity capital in millions (rupees). The blue (orange) bar represents control (treatment) firms. The pre-period is from 2014 to 2016, whereas the post-period is from 2017 to 2019.

Finally, Figure 3 plots the time trend of change in net worth for the affected and unaffected group of firms around the IBC legislation. It shows that the annual increase in net worth of control firms was higher than treated firms during the years preceding the IBC. However, the trend reversed after the IBC was implemented. That is, firms that are more exposed to the IBC see a higher increase in net worth in the post-IBC period.

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**Figure 2: Change in net equity inflow post IBC**

**Figure 3: Change in Net Worth post IBC**
compared to firms that are less affected by the IBC. Thus, the equity inflow for affected firms is persistent across all the years during the post-IBC period, from 2017 to 2019.

This figure plots the average annual increase in net equity inflow for treated and control firms. The vertical axis represents the increase in equity capital in millions (rupees). The blue (orange) line represents control (treatment) firms.

OUTSIDE EQUITY INFLOW

The older bankruptcy regime allowed significant leeway to insiders or promoters to ‘time’ bankruptcy and ‘tunnel’ resources while the bankruptcy proceedings were ongoing. Tunneling is a practice where the controlling shareholders indulge in diverting the firm’s resources for their private benefits at the expense of minority shareholders and creditors. This expropriation of minority shareholders’ claims leads to agency-agency frictions or type-II frictions between the two types of shareholders. Such type II frictions are common in emerging economies and are at the heart of corporate governance problems in firms in India.

However, under the new regime, the increased power of the creditors can put brakes on the tendency of inside shareholders to tunnel resources from the firm: creditors can now threaten liquidation or reorganisation. Thus, the agency frictions between outside and inside investors can abate, improving the firm’s corporate governance. Subsequently, equity inflows from outside or non-controlling shareholders can increase after the implementation of the IBC.

In Figure 4, we compare the average annual increase in holdings by outside investors in the pre-IBC and post-IBC periods for treated firms with those of control firms. As expected, the firms more affected by the IBC experience a significant increase in additional shareholdings by outsiders, but the firms less affected by the IBC witness a decrease.

This figure plots the average annual increase in additional holdings by outsiders for treated and control firms. The vertical axis represents the increase in additional holdings in millions of shares. The blue (orange) bar represents control (treatment) firms.

Figure 4: Change in holdings by outside investors post IBC
REDUCTION IN TUNNELING ACTIVITIES

Tunneling refers to excessive extraction of resources by insiders from the firm over and above their fair share. Tunneling makes a firm more vulnerable to loan defaults, which is the trigger event for a bankruptcy case under IBC and can lead to the removal of incumbent management. Thus, IBC curbs the tendency of insiders to tunnel resources and improves the governance of the firms.

To measure the extent of tunneling activities by firms, we estimate the related-party transactions (RPT) of firms reported in the audited annual reports. A difference-in-differences analysis shows that the average yearly RPT expenses or outflows for treated firms decline significantly. In contrast, the RPT income or inflow does not change statistically. Figure 5 below plots the annual changes in the RPT expenses for the treated and control firms. As shown in this figure, there was little difference in RPT expenses between the treated and control firms in the pre-IBC period. By contrast, during the post-IBC period, the RPT expenses of affected firms were much lower than the RPT expenses of unaffected firms. This difference in RPT behavior of the two sets of firms indicates that the IBC had a disciplining effect on the firms, which plausibly explains the inflow of equity capital from outsiders.

\[ \text{Figure 5: Change in RPT expenses post IBC} \]

This figure plots the trend of average annual RPT expense of treated and control firms around the IBC implementation. The vertical axis represents the average RPT expense in millions (rupees). The blue (orange) line represents control (treatment) firms.

THE REAL IMPACT

The additional capital inflow via an improved governance channel can also induce higher investment activities. Figure 6 plots the net investment cash outflow of the two categories of firms around the IBC implementation period. As shown, the difference in the level of investment activities between the affected and the unaffected groups of firms...
was high in the pre-IBC period, with the affected firms having low investment before the IBC implementation. However, after the IBC was implemented, the gap has reduced considerably over the years. That is, the affected firms are now at par with the unaffected firms in terms of investments. Using a difference-in-differences design, the incremental investments made by treated firms after IBC, compared to the investments made by control firms, is a significant ₹48 million. Hence, the IBC led equity inflows has spurred investment activities in firms.

![Net Investment outflow](image)

**Figure 6: Change in Net Investment outflow post IBC**

This figure plots the trend of average annual net investment cash outflow of treated and control firms around the IBC implementation. The vertical axis represents the average investment in millions (rupees). The blue (orange) line represents control (treatment) firms.

**CONCLUSION**

The implementation of the IBC has been a paradigm shift in the bankruptcy resolution process in India. It has led to an increase in overall equity inflow as well as equity inflows from non-controlling shareholders. The decrease in agency-agency conflicts aided by a decline in spurious RPT outflows by firms has helped outside investments. Further, this capital inflow has manifested into higher investment activities by the firms.

1 Aryan A. et al. (2019), “IBC takes 300 days, BIFR took 5-8 yrs: IBBI chairman M S Sahoo”, Business Standard, 1 April.
5 Supra Note 3.
6 Supra Note 3.
The introduction of the Insolvency and Bankruptcy Code, 2016 (IBC/ Code) was a watershed moment for private credit investors looking at India as a destination for their capital. Transparency, accountability, predictability, legal and institutional mechanism are fundamental to investment decisions. The IBC was aimed at developing a robust credit market. This article assesses the IBC from the perspective of private credit investors through the lens of predictability, insolvency costs, insolvency timelines and respect for fundamental concepts. In doing so, this article recognises many varied and significant achievements of the IBC, but also discusses certain gaps that need to be filled.

INSOLVENCY FRAMEWORK: PREDICTABILITY

The revolutionary legislation of IBC is a paradigm shift from the erstwhile regime of insolvency as it provides predictability and certainty to the insolvency process by providing the creditor-in-control model, voting rights to the committee of creditors (CoC), clean slate and much more. This has been further strengthened by judicial pronouncements to a great extent. Some of the notable cases are as follows:

(a) **Upholding constitutionality**: As is the case with any new law, the constitutionality of the IBC has been challenged several times and, rightly, upheld. These various judgments (particularly by Hon’ble Justice Nariman) have provided much needed predictability and stability to the IBC. It is no coincidence that there was an increase in private pools of credit looking at the Indian market.

(b) **Clean Slate**: The Hon’ble Supreme Court propounded the doctrine of ‘clean slate’ and held that that the intent of section 31 of the IBC was to provide a fresh start to a corporate debtor so that it can recommence its business afresh. If additional liabilities of the creditors are imposed on the succeeding resolution applicant after the approval of the plan by the National Company Law Tribunal (NCLT), the mischief sought to be remedied by IBC would simply continue. Private credit investors see this as an opportunity to finance acquisitions under the IBC and even before that lend with greater visibility on their downside scenarios. It also gives confidence of better recovery in the hands of pre-insolvency creditors as the incoming pool of resolution applicants will be robust once assured of this clean slate.
(c) **Prohibition on coercive measure:** The Delhi High Court in a detailed ruling on the interplay between the IBC and money laundering laws, allowed the Liquidator to proceed with liquidation, restraining the Enforcement Directorate from taking coercive measures. Keeping such enforcement action at bay has meant that private credit investors know that there is a true possibility of a ‘fresh start’ to a debtor they lend to and that wrongs of the promoter past will not continue to haunt the debtor.

While the judiciary has played a crucial role in strengthening the backbone of IBC, however, there are certain recent rulings that have created gaps and exhibit concerning departures from the legislative intent and earlier stand taken by various judicial fora including the Supreme Court. Such gaps if not filed in time will weaken the insolvency regime and act as a serious deterrent for private credit investors. Some of the notable cases are as follows:

(a) **Withdrawal of resolution plan taken too far:** The Hon’ble Supreme Court in *Ebix* held that in the absence of any exit routes being stipulated under the IBC for a successful resolution applicant there can be no withdrawal conditions under resolution plans. On the one hand there have been instances where successful resolution applicants have backed away from their obligations on frivolous grounds. However, equally, why shouldn’t the bargain reached between the CoC and the successful resolution applicant (including on withdrawal conditions) be respected? After all, the Supreme Court has in the past upheld the role of CoC arguing that they are best placed to decide the future course of a debtor. We fear that an IBC regime with no withdrawal rights will result in either serious recovery reductions or shrinking of the pool of potential resolution applicants. As a lesser alternative, if you look at the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, limited withdrawal conditions have been permitted which offers balancing the interests of various stakeholders. So *Ebix* seems to be a case of ‘one step forward and two steps backward’ on this count.

(b) **Admission of insolvency applications:** Under the Code, ‘default’ by the debtor and its threshold has been a trigger for initiation of corporate insolvency resolution process (CIRP). This is also supported by the legislative intent visible in the notes to clauses accompanying the bill introducing IBC in the Parliament. This has previously been upheld by the Supreme Court in its landmark judgements. However, committing a volte-face on existing jurisprudence, the recent judgment of the Supreme Court in *Vidharbha* appears to have given the NCLTs discretionary powers to assess whether to admit a debtor into insolvency even when debt and default have been proven. This judgment has already resulted in NCLTs refusing to open insolvency proceedings in some cases. This judgement is also likely to result in prolonging the insolvency opening process and timeline. This would particularly be a red flag for foreign investors who may now view the insolvency resolution process as having more uncertainties. The *Vidharbha* case merits a relook.

(c) **Treatment of statutory dues:** The legislative intent of the IBC was to subordinate trade debt including statutory dues. This intent is clear from Parliamentary debates and text of the IBC. This position has been reiterated in multiple judicial decisions.
However, the Hon’ble Supreme Court in *State Tax Officer v. Rainbow Papers Limited*,\(^8\) held that if a resolution plan excludes statutory dues payable to Government or a Governmental authority, it cannot be said to be in conformity with the provisions of the IBC, and as such, not binding on the Government and should be rejected by the NCLT. In fact, the preamble to the IBC itself speaks of ‘alteration in the order of priority of payment of Government dues’. Such serious (i.e., 180 degree) changes in the direction of the IBC could create unwarranted uncertainty. The IBC was designed to deepen the bond market and reduce emphasis on collateral and personal guarantees. However, if IBC no longer remains the preferred choice, credit investors will return to the safer haven of security and out of court enforcement over hard assets which will be more value destructive for Indian businesses, workers and employees and, needless to say, creditors.

**INSOLVENCY FRAMEWORK: TIMELINES AND COST**

**Resolution timelines**

The backbone of a sound insolvency framework is timebound and speedy resolution. In a recent case,\(^9\) the Supreme Court emphasising on the importance of time in the insolvency process held that the NCLT and National Company Law Appellate Tribunal (NCLAT) must endeavour to strictly adhere to the prescribed timelines under IBC and clear pendency. The Apex Court also noted that judicial delay was the one of the main reasons for failure of the earlier insolvency regime and it cannot allow IBC to meet the same fate. In fact, the Supreme Court\(^10\) itself observed that timely resolution of a debtor by an effective legal framework goes a long way to support the development of the credit market. The IBC, in its initial days, made strong strides in this direction. In recent times, the IBC has faced multiple headwinds, including non-cooperation from management, pendency in NCLTs, inadequate capacity of the NCLTs\(^11\) etc. The data in the quarterly reports published by the Insolvency and Bankruptcy Board of India (IBBI) indicate that delays in opening and closing insolvency has been increasing. We would hope that this trend is seriously looked at and attempts made to reverse this.

**Resolution cost**

Since insolvency costs are a drain on financial creditors (FCs), credit institutions focus on this and recognise that this is directly linked to insolvency timelines. Data\(^12\) indicates a continuous rising trend in insolvency costs.

<table>
<thead>
<tr>
<th>Insolvency Cost</th>
<th>Pre-COVID(^13)</th>
<th>During COVID(^14)</th>
<th>Post-COVID(^15)</th>
<th>Post-COVID(^16)</th>
</tr>
</thead>
<tbody>
<tr>
<td>as % of liquidation value</td>
<td>0.75%</td>
<td>0.94%</td>
<td>1.17%</td>
<td>1.19%</td>
</tr>
<tr>
<td>as % resolution value</td>
<td>0.38%</td>
<td>0.52%</td>
<td>0.62%</td>
<td>0.63%</td>
</tr>
</tbody>
</table>
So, the IBC was fast off the blocks, and compared to that, some latency was to be expected. However, this, again, is a trend that, we hope is soon reversed on account of delays.

**INSOLVENCY FRAMEWORK: RESPECTING FUNDAMENTAL CONCEPTS**

(a) **Senior and junior creditors:** As per the World Bank Report, a factor that plays a key role in determining the strength of an insolvency system is respecting creditors rights and respecting their priority. Often creditors have *inter se* contractual arrangements to determine the order of priority. As per the report, *inter se* rights of creditors are to be respected. However, inconsistent views have been taken by the Hon'ble NCLAT in recent cases. In our humble opinion, these decisions have extended the remit of the supremacy of the committee of creditors beyond their statutory limits. The consequence should not be that ‘might is right’ and that fundamental concepts of inter-creditor relations set aside by majority vote. This impacts minority investors in a debt stack. They are usually the last mile financiers who provide much needed liquidity to avoid insolvency. If their position in insolvency becomes uncertain, last mile financing may become more expensive, thereby, and oddly, precipitating the very distress they were designed to avoid. For e.g., the Government of India’s SWAMIH fund’s last mile finance is treated as super senior. Should this benefit be also provided to other last mile private credit financiers at least in so far as respecting their senior-junior security priority?

(b) **Each guarantee is separate:** There have been several decisions of the NCLAT which have cast doubt on whether a creditor can initiate insolvency proceedings simultaneously against the principal debtor and multiple guarantors. This should be clearly permitted as the guarantee is almost always drafted as a joint and several obligation. These decisions await clarity from the Supreme Court. These are well recognised principles internationally and the hope is that the IBC can continue to move forward with pace as these are clarified.

The NCLAT in *Pirama* was faced with the question of maintainability of two CIRPs against two corporate guarantors based on same sets of claims, debt, default and record. The NCLAT, while noting that there is no bar under the IBC for filing simultaneously two applications under section 7 against both the guarantors, however, once the CIRP is initiated against one of the corporate guarantors, after such initiation, the FC cannot trigger CIRP against the other corporate guarantor(s), for the same claim amount. The Supreme Court directed a stay on the order passed by the NCLAT in the *Piramal* matter until the next date of hearing and directed maintaining of status quo in the matter. However, the NCLAT in *Athena* when faced the issue as to whether after an application under section 7 had been admitted against the principal borrower, an application by the same FC could be admitted against the corporate guarantor on same set of claims and default, ruled that if two applications can be filed for the same
amount against the principal borrower and the guarantor, the applications can also be maintained keeping in view section 60(2) and 60(3) of IBC. Also, the Supreme Court in Lalit Kumar\textsuperscript{22} ruled that ‘the sanction of a resolution plan and finality imparted to it by Section 31 does not per se operate as a discharge of the guarantor’s liability’, thereby strengthening the view taken by NCLAT in Athena judgment.

CONCLUSION

There is much to be celebrated about the IBC. It has brought about a huge change in debtor-creditor relationships. It has brought insolvency laws to the centre of credit debate in India and significantly reduced insolvency costs and timelines. There have been several landmark decisions. However, as with any new venture, periodic course review and, where required, correction is necessary.

1 World Bank (2021), “Principles for Effective Insolvency and Creditor/Debtor Regimes”.
8 Civil Appeal No. 1661 of 2020.
9 Supra Note 4.
13 Till June, 2020 250 CIRPs yielded resolution plans. Cost details of 178 CIRP are available with the IBBI.
14 Till June, 2021 396 CIRPs yielded resolution plans. Cost details of 367 CIRP are available with the IBBI.
15 Till March, 2022 480 CIRPs yielded resolution plans. Cost details of 455 CIRP are available with the IBBI.
16 Till June, 2022 517 CIRPs yielded resolution plans. Cost details of 498 CIRP are available with the IBBI.
17 Supra Note 2.
22 Lalit Kumar Jain v. Union of India & Ors., 2021, Transferred Case (Civil) No. 245/2020.
Part V
Ideas, Ideals and Inspiration
India’s digital economy has grown significantly in recent years, through both public and private initiatives, and it is predicted to reach a trillion-dollar value in the near future. The ambitious ‘Digital India’ programme aims to create a digital infrastructure for all citizens, provide governance and services on demand and to empower citizens. Discussion of the infrastructure needed to support a digital economy has often focused on technical aspects, such as broadband provision, but a legal environment is also important if potential is to be realised. As its main focus, the article considers the legal infrastructure needed to support businesses so that the entrepreneurial spirit and inventiveness of individuals can be fostered, and sustainable businesses can be built.

The article will provide an overview of the impact that the digital economy is having in transforming the Indian society, although it is inevitable in a widespread and diverse society that progress is yet to be made in some areas. The empowerment of citizens will naturally lead to a skilled workforce and the emergence of innovators and entrepreneurs, and this article will consider how the digital economy can support emerging and established businesses, as well as examining how to handle insolvencies in this area.

**DIGITAL INDIA**

Much progress has been made since the ‘Digital India’ programme which was launched in 2015. Digital technologies are impacting everyday lives as, in a notable example, India has developed the world’s largest digital identification programme, Aadhaar, which has enrolled over 1.2 billion people. This remarkable example of e-governance development has been identified as offering enhanced prospects for the delivery of government services and, as well as enabling greater information about the Indian economy and society to be obtained and the tax base to be widened. E-governance can promote greater progress towards social inclusiveness, reaching persons who did not previously have access to bank accounts. Electronic transactions are also safer in terms of public health and have increasingly been used in place of existing formalities in response to the COVID-19 pandemic, since for example electronic signatures are valid under Indian law and any formalities that require writing can be validly complied with electronically.
The Indian economy has benefited from opportunities for business growth and the export provision of services. The benefits of digitisation are compelling from a business perspective as they enable access to finance to be improved and costs of transactions to be lowered. The digital economy can also impact positively on other sectors, for example by improving levels of education and enabling improvements to manufacturing methods and agricultural and medical technologies. It offers the potential for rapid, inclusive and sustainable development, potentially enabling rural areas to play a more active role in the economy and also potentially diversifying the workforce by providing opportunities that can equally be taken by female workers and disabled workers who may have been marginalised by existing labour opportunities.

There have already been successes and the digital economy is contributing to rising prosperity in India. Entrepreneurs have gained record amounts of funding for start-up projects, more than United States and Chinese businesses in the equivalent period. The press carries success stories of entrepreneurs and startups. In particular, entrepreneurs can benefit from the digital economy in ways that were not previously achievable, due to technological advancement. It is acknowledged that there is progress still to be made, in relation to network connectivity and reduction of downtime. This article focuses on another possible need for development, namely the legal framework needed to support these prospects in a sustainable way. First, however, the technologies that are creating opportunities will be considered.

WHAT ARE DIGITAL ECONOMIES?

Part of the fourth industrial revolution, digital economies have potential both for industrial and consumer markets and are commonly regarded as including the following technologies.

(a) Artificial intelligence (AI), where human intelligence is simulated by machines. With programming, systems can be improved through machine learning, to identify patterns, study data and make decisions without human intervention beyond the programming stage. These systems can then perform a wide range of functions, such as pattern recognition, customer service, personalisation of internet adverts and searches. There are many excellent examples of improvements to medical procedures and agricultural techniques in India using AI. This is a promising technology for India, which ranks 3rd in the world in Stanford University’s Global AI Vibrancy Index and leads globally in the inclusiveness of its workforce in this sector.

(b) Cloud computing, which offers on-demand computing resources. Cloud computing is scalable and can be used, for example to enable big data analytics or to cope with spikes in customer demand for online services. Cloud computing enables companies to obtain infrastructure, platforms and software more cheaply than could be achieved on-site. Although cloud service provision is dominated by global companies, which have acquired some Indian service providers, there are good examples of smaller Indian providers, such as NetMagic and HostingRaja.
(c) The Internet of Things (IoT), which enables objects to be embedded with sensors, software and other technologies. This technology is used in smart home devices and security systems including those for biometric cybersecurity. It has been used, for example, to develop a collision-avoidance system for the high-speed Vande Bharat Express train.20

(d) Big data analytics, which is used to process data that would be too large for traditional data-processing software. In India this aspect of the digital economy was used for example by the Bhartiya Janta Party to understand voter sentiments.21

(e) Blockchain, which enables transactions to be immutably verified using shared calculations across a peer-to-peer network. A time-stamped ledger is created and stored in a distributed way and this model avoids a single point of failure. The blockchain therefore enables transactions to be verified through consensus, rather than parties relying on verification from traditional trusted intermediaries. A well-known application is in smart contracts, which enable transactions to be automatically triggered in cases where specific conditions are met. Blockchain has been identified in a report as having potential to improve processes including those for land registration, pharmaceutical drugs supply and verification of educational certificates.22 Blockchains also provide the basis for many cryptocurrencies.

These technologies are transforming businesses and improving ways of doing things across a variety of sectors.

BUILDING A LEGAL FRAMEWORK TO SUPPORT DIGITAL INDIA

The laws needed to support the digital economy have been discussed as part of the evaluations by international organisations, notably the United Nations Conference on Trade and Development (UNCTAD) and the World Bank. As part of these evaluations, these organisations have considered the range of factors that are important in the establishment of a digital economy. Relevant factors can be broadly grouped into technical improvements, such as increased availability of broadband and internet exchange points, and legal improvements, both hard and soft law. Figure 1 illustrates how these factors can aid a digital economy strategy, as well as the benefits that digital economies are expected to bring.23

In wide-ranging reports, the UNCTAD has conducted a holistic evaluation of digital economy development and highlighted several areas of law as demanding attention as a priority, including those to protect the labour market, intellectual property rights to protect and reward creativity, taxation, competition and laws to protect data rights, including safeguards for minorities so that personal information is not used to facilitate persecution. These aspects of law relate mostly to the operational stage of digital economy businesses, rather than the start and end stages. Such laws can reassure users that a country is a safe place to entrust their business and their data. Some matters will inevitably be beyond what an individual state will be able to effectively control through legislation. For example, effective control of cybercrimes may require attention at international levels.24 In addition,
companies need sound systems for the protection of customer data to avoid damaging scandals and persecution of minorities.

Whilst the above aspects are important elements for any digital economy, attention needs to be paid to the broader legal framework for the companies that operate in the digital economy. Laws are important at three stages of the company’s life cycle:

(a) opening;
(b) operation; and
(c) closure.\textsuperscript{25}

The laws in the first category, relating to conditions for start-ups will not be considered other than to note that in addition to entrepreneurship talent and availability of workers and infrastructure, an enabling legal environment is important for the sustainability of digital economies.\textsuperscript{26} It is important, therefore, to have a regulatory system that supports entrepreneurs, enabling businesses to be started and grown without excessive costs. Without such laws, the motivations of entrepreneurs can be damaged and processes of creative destruction, where innovation drives development, \textsuperscript{27} are stifled.
Naturally in the second stage, operation, is the most important aspect for the support of a sustainable digital economy with resilient businesses and an examination of corporate governance can help in this regard. Sustainability is a flexible concept and in the context of this article, it refers to mechanisms to enhance business longevity in the digital economy. A proactive approach towards failure ‘prevention’ at this stage is important to the resilience and sustainability of digital service providers. In the event of businesses experiencing financial difficulties, supportive laws at the third, closure, stage can enable reorganisation and recovery as an alternative to liquidation of a company but more often the productive elements of the company will be the subject of a business sale, with the company itself being dissolved. In the digital economy context, continuity of service is particularly important, at least on a temporary basis, for reasons to be outlined, and insolvency laws can be shaped to enable this.

This third aspect, handling digital suppliers who have failed, is important as firms operating in the context of the digital economy will not be immune to risks that can lead to financial difficulties, such as poor strategy, an economic downturn, an incident such as a pandemic or hacking. Some businesses will face financial difficulties as a result, and some will fail. At that point, if the business has significant levels of operation, there can be wider public impact. The problem is that essential public services in the age of the internet can be carried out by companies, rather than the state, which presents risks of vulnerability to market forces as well as incidents such as cyberattacks. Mechanisms are needed to limit the impact on individuals in cases where suppliers of important services fail. The interruption to digital services in the event of financial difficulties will be disruptive to businesses and it will potentially be difficult to resolve. Customers may face not only harm to productivity, but they could lose access to services and data permanently, without the possibility of replacement, which can be economically damaging. Even a temporary outage is economically costly for those using digital services and an insolvency would be potentially catastrophic and might lead to calls for a costly bailout.

The prospect of market-based insolvency proceedings as an alternative to a bailout, to cater for digital service companies is a possibility that has hitherto received limited attention. Even in advanced and mature commercial economies, few jurisdictions have yet enacted suitable laws to handle insolvencies in the digital economy and so any jurisdiction that has developed suitable laws could potentially gain an advantage as an international hub for digital services, as well as a place for the sustainable development of local businesses. A lack of suitable legislation could present a risk to the sustainability of digital economies, including in developing countries, as it could lead to a loss of confidence in a jurisdiction’s digital economy. The sustainability and transformative potential of digital economies will therefore depend in part on minimisation of insolvency risks at the operational stage, through effective corporate governance and insolvency regulation. A combination of proactive and reactive steps is needed to ensure that digital economies are sustainable so that both the risk of failure of digital service providers can be minimised and also that failures can be handled effectively, avoiding significant disruption to users.
PROACTIVELY CONTROLLING BUSINESS RISKS IN THE DIGITAL ECONOMY

The sustainability and transformative potential of India’s digital economy will depend in part on minimisation of insolvency risks through effective corporate governance. Firms operating in the context of the digital economy will not be immune to risks that can lead to financial difficulties, such as poor strategy, an economic downturn, an incident such as a pandemic or hacking. India has prepared a good legislative framework in general terms, with modernised insolvency laws and related legislation on company law, including hard law requirements in respect of corporate social responsibility. There are also taxation and intellectual property laws that create a legislative architecture that will give confidence to those dealing with Indian technology companies.

Corporate governance, ‘the system by which companies are directed and controlled’ has given rise to a vast multi-disciplinary literature and can only be briefly touched upon here, as far as it relates to digital economies. Good corporate governance, commonly focused on mechanisms of accountability and disclosure, can enhance digital economies through sound information governance and can be addressed both by hard laws enacted through state legislatures as well as through soft laws and best practices from within industry sectors and individual companies. These latter voluntary forms of civil regulations can provide an effective alternative to governmental authority and may be particularly suitable in the globalization era.

As previously noted, hard law is important in some areas, nonetheless, and in developed systems these include in relation to intellectual property, consumer protection, employment law, privacy and data protection. Such laws can prevent damaging scandals and reassure users that a country is a safe place to entrust their business and their data. Some matters will inevitably be beyond what an individual state will be able to effectively control through legislation. For example, effective control of cybercrimes may require attention at international levels. In addition, companies need sound systems for the protection of customer data to avoid damaging scandals.

Not everything can most appropriately be addressed through hard law and there is an important place for the identification of best practices, addressed through soft law. To this end, there is potential for preventive protocols to be addressed in order that expertise can be shared. For example, information security will be crucial and will include ethical standards and security policies for employees.

These best practices should be a central part of corporate governance approaches to companies operating in digital economies. Effective governance enhances the reputation of digital economies as well as enhancing business values and minimising risks and costs. For long term sustainability, companies in this sector need to be both proactive, to anticipate and avert the possibility of failure, as well as reactive, so that if failure occurs it can be swiftly handled. Proactive approaches would primarily depend on good internal processes within companies, including staff training. As well as the usual processes for accounts and audit there is a need for good cybersecurity, maintenance standards and
processes for incident identification and reporting. Record keeping is essential as steps taken in this regard can be vital in the event that an insolvency occurs. Various preventive protocols can be developed by state and industrial bodies in the digital economy sector for all of these purposes. It is also essential for reactive protocols to be developed to respond to cybersecurity and other incidents. A need for reactive protocols also arises in the event of financial crisis, as this can enable financial distress to be swiftly addressed and this will be the focus next.

WHY INSOLVENCY LAWS ARE IMPORTANT TO INDIA’S DIGITAL ECONOMY

Behind services offered in the digital economy sector lie companies and these service providers can and do get into difficulties. For example, in the USA, Nirvanix filed for US Chapter 11 bankruptcy protection in 2013 and gave customers two weeks’ notice and in the UK, the data centre 2e2 collapsed in 2013 and the Insolvency Administrator demanded £1 million (around ₹ 93,675,280) from customers to keep the business going while their data was preserved. Indian examples of failures in this sector have included Rubique Technologies India Pvt. Ltd. and TMW Fintech Pvt. Ltd. Reasons why companies in digital economies can get into difficulties include a downturn in economic conditions, mismanagement, reputational damage, hacking, terrorism and natural disasters leading to financial difficulties and insolvency. There is also potential for damage to reputations of suppliers from service problems to have a spiralling effect and as confidence in the business is damaged further and further there is the potential for a ‘run on the banks’ scenario. This would entail a widespread loss of confidence by customers and a rush to withdraw their data, dealing a fatal blow to the business. Such circumstances could impact negatively on other customers who were unable to withdraw their data and cause widespread public impacts.

In some cases, of course, a company may have prospects as a going concern and customer interests can be safeguarded using insolvency procedures, such as the corporate insolvency resolution process (CIRP), under the Insolvency and Bankruptcy Code, 2016 (IBC/ Code). It might be possible with operational or financial changes to keep a company going, or to facilitate a sale of its underlying business to another company, in a way that will not impact negatively on customers. The discussion that follows, however, concentrates on the hypothetical example of a digital service supplier which is experiencing such difficulties that it does not have prospects as a going concern.

A service provider in this position, which is insolvent and unable to pay its creditors in full, and lacks going concern potential, is a likely candidate for liquidation laws to enable orderly distribution of its assets among creditors. Problems can arise in such cases as a tension arises between the interests of creditors and the interests of users of services. Where customers have data stored remotely that they want to retrieve this can take an amount of time that many would find surprising. In the 2e2 case noted above, the UK Administrator had estimated a period of 16 weeks for retrieval of customer data. Examples
of cases where customers might wish for services to continue being provided temporarily, include, to enable the recovery of data stored in cloud services and data produced from IoT activities. Customers may also need ongoing services to process their data as the software that they access through the cloud may be bespoke or otherwise not readily replaceable. Delays may also arise if there are uncertainties regarding the ownership of digital property held by the insolvent service provider, a point considered below.

In liquidation, the possibility of ongoing trading is often limited by insolvency laws in order that costs are minimised. The Indian approach might feasibly enable better account to be taken of the interests of customers than in some other systems, however. Under CIRP the continued trading of a company as a going concern could enable customers to be protected. Although the hypothetical example is of a company which does not have prospects as a going concern, the CIRP could potentially be used for a managed close down in the interests of customers.

In a case where a company is eligible to enter fast-track liquidation under section 56 of the Code, the prospects for a managed closedown would seem to be more limited. Under section 35(e) of the Code, the Liquidator can carry on the business of a company for its ‘beneficial liquidation as he considers necessary’ and the question would be how a ‘beneficial liquidation’ is to be regarded, whether this is only from the perspective of creditors or also includes the impact on stakeholders, including customers. Since stakeholders are mentioned in the preamble to the Code, it might be argued that a generous approach can be taken.

Customers could yet face problems in recovering data as there could potentially be greater clarity in the Code regarding the ownership of digital assets. Preferably ownership entitlements would be the subject of agreement between the user and the service provider to avoid uncertainty and the potential costs of establishing implied ownership so that the user’s property does not end up as part of the bankruptcy estate. Section 36(4) of the Code excludes from the insolvency estate assets owned by a third party that are in the possession of the debtor. This would seem to exclude customer data from the scope of the estate, although the position is not squarely covered in the non-exhaustive list of assets in section 36(4)(a) of the Code. As noted, it is important for customers to specify in their contracts that they retain ownership of data but in any event it is strongly arguable that such a term should be implied.

Few jurisdictions have as yet addressed the problems presented by service provider insolvencies more directly. One example of existing provision for digital economy insolvencies is in the cloud computing sector. Article 567 of the Luxembourg Code de Commerce, as adapted, enables the recovery of intangible property, such as software, entrusted to a debtor, in recognition of the growing importance of cloud computing. Such a law would not suffice in itself, since having an entitlement to recover content in the event of the insolvency of a cloud service provider is only one problem and temporary continuity of service to enable recovery of the content is also needed. An equivalent provision would however strengthen the claims of customers to overcome the uncertainties of section 36(4) of the Code.
CONCLUSION

The digital economy of India offers much potential, and it can contribute significantly to the economic development as well as enabling improvements in social inclusion and day-to-day transactions and activities. The country enjoys modern corporate governance laws and insolvency laws, as well as being among the countries with wider laws to facilitate entrepreneurship. Yet it is among the countries that has not developed specific approaches tailored to the digital economy. India should not be singled out for criticism as the need for legal regulation in respect of services provided in digital economies has as yet been scarcely addressed, even in developed countries with sophisticated insolvency systems. From the point of view of failure prevention, good corporate governance standards are desirable and these may be facilitated by preventive protocols which establish good practices for digital economy enterprises to follow in order that a proactive approach can be taken to the risks of failure. Attention should also be paid to insolvency frameworks, including the possibility of a temporary continuation of service to enable alternative arrangements to be made. Such an approach can potentially be accommodated under the Code.

It is also notable that technologies such as the internet and cloud computing, as well as threats such as cybercrime, are international and indeed supranational since they may be beyond the control of any State. This may require a global approach to governance. India can be a leader in drawing attention to this issue in order that the digital economy should not suffer from problems that have arisen in corporate social responsibility and international taxation, where globalised firms have evaded regulatory efforts.

4 Section 3, The Information Technology Act, 2000 (IT Act).
5 Sections 4-10, The IT Act.
9 Note however possible reluctances: OECD (2018), “Bridging the Digital Gender Divide, Include, Upskill, Innovate”.
17 European Parliament, “What is artificial intelligence and how is it used?”, March 2021.
19 Stanford University, Global AI Vibrancy Ranking, 2021.
20 Fodor G. et al. (2020), “At the speeding edge: How railway digitalization is on the rise in India” Ericsson Blog, 18 November.
India’s Digital Economy, Building A Legal Framework to Support its Transformative Potential

23 This table and accompanying text is drawn from Parry R. “Building a legal framework to facilitate the transformative potential of digital economies”, Nottingham Insolvency and Business Law e-Journal, forthcoming.


25 Following the discreditation of the World Bank’s Doing Business Reports, these three indicators are used as measures of the business environment in economies, refer World Bank’s Business Enabling Environment.

26 For a detailed review of relevant factors and their presence in different countries, see IMD’s World Digital Competitiveness Ranking 2021.


34 Supra Note 32.


36 In contrast, Nigeria’s digital economy has been impacted by uncertainties regarding the application of law and investors have preferred to use holding companies incorporated in jurisdictions such as Mauritius and the UK; Idris A. (2019), “Why Your Favourite African Startups are Incorporating Abroad”, Techcabol, 12 December.


40 Supra Note 24.


43 National Institute of Standards and Technology, Cybersecurity Framework.


47 Supra Note 32.


49 In the US, a company that is in liquidation under USC, Title 11, Chapter 7 may continue to operate if it is in “the best interest of the estate and consistent with the orderly liquidation of the estate” under 11 USC Section 721. Whilst this could feasibly enable a limited period of trading to enable customers to make alternative arrangements there would be questions as to how this continued trading should be funded. Under the legislation in the UK, the liquidator of a company may continue to carry on business “so far as may be necessary for its beneficial winding up”, according to Insolvency Act, 1986 of UK, Schedule 4, para 5, but this does not guarantee that there will be ongoing trading or that any period of ongoing trading will again be long enough to enable customers to recover their content and make alternative arrangements.

50 Section 20, IBC.


A quarter of a century of adoption of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (MLCBI) has provided some insights into implementation of cross-border insolvency framework. MLCBI may be reckoned to be leaning partially to the universalist approach to cross-border insolvency. It, inter alia, provides for: (a) the conditions under which persons administering a foreign insolvency proceeding have access to local courts; (b) the conditions for recognition of a foreign insolvency proceeding and for granting relief to the representatives of such a proceeding; (c) allowing foreign creditors to participate in local insolvency proceedings; (d) a framework for courts and insolvency practitioners from different countries to cooperate more effectively; and (e) coordination of insolvency proceedings which occur concurrently in different States. While MLCBI has contributed significantly to obtaining more efficient, cost-effective cross-border restructuring and insolvency processes involving creditors and assets in multiple jurisdictions – establishing an international framework for recognition, cooperation and coordination according to clear, distinct and agreed principles and legal concepts, and guaranteeing greater consistency and determinate outcomes for creditors and investors, some implementation issues remain to be addressed.

Going forward, this cooperative solution would have important macro-financial implications, supporting global investments, financial stability and economic growth. Yet, despite the significant support the MLCBI has provided to businesses globally in terms of reducing frictions and uncertainty, it is critical now to increase consistency, recognition, coordination, predictability and certainty under a global cross-border restructuring and insolvency framework. In particular, efforts should be made for adoption and implementation of corresponding cross-border protocols under the UNCITRAL Model Law on the Recognition and Enforcement of Insolvency-Related Judgments and the UNCITRAL Model Law on Enterprise Group Insolvency, ensuring substantial cooperation amongst public and judicial authorities and establishing communication protocols developed by the International Insolvency Institute, the American Law Institute, the European Union and the Judicial Insolvency Network.

The prevailing consensus is that the globalisation of the world economy and globalisation of business organisations across countries based on comparative advantage has supported the economic growth, but consequently enhanced the challenges posed by cross-border insolvencies. As per the Analytical AMNE database, the multinational enterprises and
their foreign affiliates account for one-third of world output and GDP and two-third of international trade. The foreign affiliates are also more oriented towards international markets (through exports), buy more intermediates, and source these intermediates more from abroad, thereby incorporating greater foreign value added in their output. The globalised world order may lead to a significant increase in international business disasters, and hence the probability of multiple insolvency proceedings in multiple jurisdictions may increase as creditors seeking recovery may try to seize assets in any country in which they are located. Considering the differences between national insolvency laws, the diverse public policy choices entrenched in those laws, and the uncertainties intrinsic to specific insolvency frameworks, MLCBI has attempted to preserve jurisdictional flexibility to countries to make changes while exhorting them to adhere carefully to the agreed text with a view to ensure uniformity. MLCBI recognises that the uncertainties and differences would imply that the model law would require a degree of supplementation. This article, *inter alia*, attempts to bring in some pragmatic experiences in resolving international businesses, especially the global systemically important financial institutions (G-SIFIs).

**ESTABLISHING COOPERATION FRAMEWORKS FOR INSOLVENCY RESOLUTION: LEARNINGS FROM FINANCIAL SECTOR**

The draft amendments to the Insolvency and Bankruptcy Code, 2016 (IBC/Code) for cross-border insolvency provide for a framework of cooperation between the courts and insolvency professionals of the member countries and one form of which is coordination of administration and supervision of corporate debtor’s assets and affairs. It would be instructive to learn from the experience and working of similar framework of cooperation for G-SIFIs.

**Cross-Border cooperation and information sharing for G-SIFIs**

The key attributes of effective resolution regimes for financial institutions (Key attributes) of the Financial Stability Board (FSB) mandate home and key host authorities of FSB-designated G-SIFIs to maintain Crisis Management Groups (CMGs) to prepare for and manage a cross-border financial crisis affecting the financial firm. CMGs, *inter alia*, provide a forum for the discussion and agreement of resolution strategies and plans and the coordination of resolvability assessments. The Key attributes seeks to maintain a balance between efficiency and inclusiveness in the establishment and operation of CMGs. For reasons of operational efficiency and pragmatic and effective decision-making, the membership of CMGs is usually restricted to the important jurisdictions and public authorities which are critical for group-wide resolution of the financial firm. However, some non-CMG hosts are also represented in the CMG where the G-SIFIs have locally systemic operations. The FSB Key attributes provide for various provisions that support cross-border cooperation and information-sharing including the following:

(a) There should be no impediments to cross-border information-sharing for the purposes of planning or carrying out resolution strategies, subject to establishment of sufficient confidentiality arrangements.
(b) CMGs comprising home and important host authorities should be established for all G-SIFIs, as a forum for coordination and information-sharing. Since not all G-SIFIs host authorities are included in CMGs, home authorities should also establish cooperative arrangements with the authorities of jurisdictions where the G-SIFIs has locally systemic operations (non-CMG hosts).

(c) National law should provide unambiguous and timely processes for implementing and executing foreign resolution measures related to local assets or liabilities of a foreign financial institution in resolution.

The FSB report lists out good practices which have facilitated the functioning of CMGs to enhance their preparedness for the management and resolution of a cross-border financial crisis affecting a Global Systemically Important Bank (G-SIB) as per the FSB Key attributes.\textsuperscript{2} It is based on a survey carried out by the FSB in 2020 and experience of CMG members during the COVID-19 pandemic. While some learnings are specific to G-SIBs and may not be relevant for non-financial firms, such as, regulatory resolution planning and crisis-preparedness, as resolution of a non-financial firm starts after actual default not when that firm is in financial stress. The good practices are organised under the following four broad heads and are focussed on 16 desired outcomes that CMGs seek to achieve:

(a) The structure and operation of CMGs;
(b) Resolution policy, strategy and resolvability assessments;
(c) Coordination on enhancing firm’s resolvability; and
(d) Enhancing home-host coordination arrangements for crisis preparedness.

**Application of FSB norms to resolution of non-financial firms under IBC**

In so far as the structure and operation of CMGs for G-SIBs is concerned, it usually comprises of relevant resolution authorities and prudential authorities, and some also include central banks, deposit guarantee schemes/deposit insurers, ministries of finance and other regulatory bodies. In the case of non-financial firms, the financial sector regulatory authorities and public authorities (including Resolution Professionals (RPs) and Adjudicating Authorities (AAs)) of the sector concerned should be included, especially the sector regulator (For example - Telecom Regulatory Authority of India, for telecom companies). This would ensure that any special regulatory dispensation for the firm or the industry in general, if there is industry-wide stress, could be discussed and considered as part of the resolution plan. The members’ representation in a CMG meeting should be of such form and capacity which combines appropriate decision-making capability and relevant expertise. The meetings and regular communications of such CMGs should be structured on a formal basis and the detailed relevant documentation should precede any meeting to increase efficiency of such meetings. Section 23 of the draft amendments to IBC (Draft Part Z) provide for a person or a body at the discretion of the AA and CMG could be subsumed in that.
In so far as resolution policy strategy and resolvability assessments of G-SIBs are concerned, the 'living-wills' or ‘recovery and resolution plans’ (RRPs) are not prepared for non-financial firms in advance, however, a resolution plan, post-default of a non-financial firm, is to be prepared by RPs in coordination with committee of creditors. However, CMG could assess the resolution plan and consider the probable barriers to resolvability of the non-financial firm.

The CMGs could assess the firm’s capability over the operationalisation and reliability of resolution plan both at the group and local level. The CMG could demand relevant information and data to review and monitor implementation of the resolution plan. The CMGs including the home authorities could exchange information on firm’s capability for resolution and monitor the important milestones for execution of resolution strategy.

A paper by Bank for International Settlements examines cross-border cooperation and information-sharing arrangements for G-SIBs and other foreign-owned locally systemic banks, with a particular focus on arrangements other than CMGs. Not surprisingly, it finds that there is perceptible progress on cooperation and information-sharing arrangements where a bank’s operations are material for both home and host authorities, while progress is not very visible where bank is locally systemic only for the host jurisdiction. It also finds that both home and host authorities employ multilateral non-firm-specific arrangements for a variety of activities to support or complement cross-border cooperation and information-sharing. Although the findings of this study indicate progress, however, such arrangements are still a work-in progress. This underscores the point that information exchange amongst CMGs for non-financial firms (these may be better called ‘Resolution Groups’, as their focus is not avoidance of an impending financial crisis, but tackling the actual financial stress, post-default) may be supplemented with other forms of cooperation agreements, such as, mutual legal assistance treaties (MLATs) for both civil and criminal matters.

**Cooperation arrangements for avoidance transactions**

The draft amendments to IBC seek to create a framework of cooperation in enforcing the decisions of the AAs on avoidance transactions under section 20. It would be instructive to examine how the public authorities could ensure cooperation under IBC and under other laws. The world is witnessing an emergence of a disturbing trend, where an individual or a group of individuals commits grave economic frauds in their countries and flees the jurisdiction of courts, anticipating the commencement, or during the pendency, of criminal proceedings. These fugitive economic offenders often take refuge in foreign havens to evade judicial and criminal proceedings of the country in which such economic crimes have been committed. This makes tracing the offenders and their illicit assets more challenging and results in deferred justice. Absence of such offenders from courts has several deleterious consequences. Along with undermining the rule of law, it hampers investigation in criminal cases and wastes precious time of courts of law. The impact of economic offences such as money laundering, banking fraud, tax evasion, etc. on economy of a country and the global economy is substantial. These crimes pose major threat on financial and fiscal sustainability of a country. There are several cases of economic offences that involve corporate debt
default and result in non-repayment of bank loans. The magnitude of these offences have the potential of undermining the resilience of banking sector and draining public resources. Large sums of money that get diverted or siphoned off further aggravate tax liabilities and debt sustainability. The normal legal process in a foreign country to trace and attach the proceeds of an offence, extradition of the accused and repatriation of the proceeds of crime becomes a long-drawn and time-consuming process which intricately gets woven in a web of legal formalities and procedures.

**The Fugitive Economic Offenders Act, 2018**

In its efforts to further strengthen its domestic law and deter the fugitives from evading the law, India has recently enacted the Fugitive Economic Offenders Act, 2018. The law defines ‘fugitive economic offender’ as any individual against whom a warrant for arrest in relation to scheduled offence has been issued by any court in India and who has left the country so as to avoid criminal prosecution; or being abroad, refuses to return to face criminal prosecution. This law lays down measures to empower authorities to attach and confiscate proceeds of crime and properties associated with economic offenders in the event of such offenders becoming fugitives from the law enforcing authorities and judicial processes. This law makes two special provision:

(a) It provides for confiscation of all properties which are proceeds of crime, and personal properties owned by such fugitive economic offender and allows disposal of all such properties by the Administrator on the directions of the Government. The law provides for ‘innocent owner’ exception. So, if anybody including a bank or financial institution proves that its interest in the property, which is a proceeds of crime, was acquired *bonafide* and without knowledge of the fact that the property was proceeds of crime, then the Special Court may exempt such properties from confiscation.

(b) Judicial recourse may be debarred till such time as the fugitive economic offender submits to the court, and the court or a tribunal, in any civil proceeding before it, may disallow such individual, who has been declared as a fugitive economic offender from putting forward or defending any civil claim.

It is expected that creation of a special forum for a speedy confiscation of the proceeds of crime and adoption of a ‘non-conviction based confiscation’, in the home country or abroad, will force the fugitive economic offenders to return to their country and face trial for their offences. This would also help the banks and other financial institutions and tax authorities to achieve higher recovery from financial defaults committed by such fugitive economic offenders, improving the financial health of these institutions and also facilitate in tax recovery.

**Complementarities with International Cooperation Arrangements**

The Organisation for Economic Co-operation and Development (OECD), United Nations Office on Drugs and Crime (UNODC), World Bank and the Financial Action Task Force (FATF) have prescribed an extensive range of standards, good practices and international
cooperation mechanisms applicable to economic crimes. These organisations also constantly evaluate the legal, regulatory and policy frameworks implemented in their member and non-member economies to evaluate capabilities of countries to handle several forms of economic crimes, including through international cooperation. A paper prepared by OECD in collaboration with other international organisations shows that although the relevant international legal frameworks and mechanisms exist, international cooperation could be further strengthened to better understand the linkages between economic crimes, committed internationally, and therefore to efficiently handle them. However, this is subject to several conditions.

(a) First, all countries should abide by all international obligations relevant to economic crimes. In particular, countries should make sure that corruption related offences are criminalised comprehensively, including criminalising bribery and making bribes explicitly non-tax deductible, in accordance with the requirements of United Nations Convention against Corruption (UNCAC) and the OECD Anti-Bribery Convention.

(b) Second, there are inefficiencies in sharing information both within and between countries and these information sharing mechanisms may not be adequately proactive or systemic to tackle the growing risks of economic crimes. Strong mechanisms in information sharing that also cover safeguards for due process and the protection of fundamental rights of citizens, and suitable consultation and coordination mechanisms between public authorities can help fight different forms of economic crime, like money laundering. There should be regular training and capacity building of the authorities and networks between authorities should be established with clear responsibilities. Further, sufficient resources, both human and financial, should be allocated in enabling authorities to identify, audit, investigate and unsettle economic crime through international cooperation. Overall, seeing the relationship between corruption and other forms of economic crime, a whole-of-government approach and cross-agency cooperation in tackling the threats is recommended.

(c) Third, the effectiveness of international legal assistance could be increased by employing conduct-based tests to satisfy the requirements of dual criminality, including by waiving such requirements in specific cases, if possible and in conformity with the provisions of domestic legal frameworks. This could be further realised by embracing such measures as may be necessary to enable the provision of a broader scope of assistance in the absence of dual criminality, overall consistency of approaches to criminalisation of offences, and evidentiary thresholds for the provision of legal assistance.

(d) Fourth, law enforcement networks provide several mechanisms for countries to provide feedback on other countries’ provision of international cooperation. International cooperation on specific cases could be facilitated with access to independent expert views against existing standards to complement the functioning of such networks.

(e) Finally, there is a need to increase awareness of the international conventions, treaties and mechanisms as well as about their functioning which would ensure the effective implementation of international co-operation measures. Several existing platforms, like Interpol, the Egmont Group of Financial Intelligence Units and the regional Asset Recovery
International Networks, the OECD Task Force on Tax Crimes and Other Crimes, the United Nations and the FATF, provide valuable frameworks for information sharing and learning activities. The adoption of UNCAC, which identifies the return of stolen assets as a fundamental principle, has led to increased global interest and focus on asset recovery. The Sustainable Development Goals, which have specific asset recovery targets, have highlighted the importance of broader asset recovery objectives and the significance of asset recovery to development. The G20, through its Anti-Corruption Working Group, has maintained a resolute focus on asset recovery and in 2011 in Cannes agreed to important elements of an effective asset recovery framework and a set of nine key principles for asset recovery to be implemented by G20 members. In 2014, the G20 Anti-Corruption Working Group (ACWG) published national step-by-step guides on asset recovery, and in 2016 the ‘G20 High-Level Principles on Cooperation on Persons Sought for Corruption and Asset Recovery’. The ACWG countries also updated their 2012 asset tracing profiles in 2017. Further, the Stolen Asset Recovery (StAR) Initiative is a partnership between the World Bank Group and UNODC which strengthens international efforts to finish safe havens for the proceeds of corruption. These international platforms need to be used for creating best practices for not only information sharing about cross-border implications of resolution of insolvencies, but also enforcement of orders of domestic AA, especially in respect of avoidance transactions, which would help resolve cross-border insolvencies more effectively.

CONCLUSION

This article has dwelt on two major implementation issues in tackling cross-border insolvency - the use of soft law instruments and practices and complementarities with existing international legal arrangements for implementing the orders of AAs especially for avoidance transactions, which are reported to be over ₹ 2 lakh crore and therefore quite significant for corporate businesses and the Indian economy. The soft law instruments on restructuring and insolvency law result in less politicised settlements, are more flexible, and are developed relatively swiftly and less costly than hard law. Also, soft law instruments are amenable to develop ethical and professional standards and their use does not restrict the territorial sovereignty of states and judiciary. On the other hand, soft law instruments may be susceptible to interpretational problems, they may be hard to discover and are non-binding or non-enforceable. Furthermore, the impact of soft law instruments and practices may become visible after a considerable passage of time, and when they are used, they may be in the nature of ‘incomplete contracts’ and may not be suitable to conflict resolution. However, there is no harm in using such instruments and practices to supplement and not substitute the cross-border legal frameworks. Further, the existing international mechanisms, both legal and good practices, for tackling economic crimes need to be strengthened and made use of for executing the decisions of AAs, especially those relating to avoidance transactions.
1 Financial Stability Board, Guidance on cooperation and information sharing with host authorities of jurisdictions where a G-SIFI has a systemic presence that are not represented on its CMG, November, 2015
4 UN Office on Drugs and Crimes describes an economic crime as any non-violent crime that results in financial loss. These crimes comprise a broad range of illegal activities, including fraud, tax evasion and money-laundering. Economic offences pose a severe threat to socio-economic development. EUROPOL refers to illegal acts committed by an Individual or group of individuals to obtain financial or professional advantage. Principle motive of such crimes is economic gain. The likelihood that the fraud will be detected and prosecuted gets complicated because of complexity of investigation required. This is particularly so for cases that can be uncovered only through international cooperation.
6 Ibid.
A well-functioning cross-border insolvency framework that works in tandem with the domestic insolvency regime is crucial for insolvency resolution of distressed debtors with assets and creditors in multiple jurisdictions. The absence of such a framework can lead to conflicts between domestic insolvency regimes of multiple jurisdictions and create challenges, resulting in inefficient outcomes. Accordingly, in October, 2018, the Insolvency Law Committee, a government-appointed committee that monitors the implementation of insolvency law in India, submitted its report (ILC Report) recommending a comprehensive cross-border insolvency framework based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, 1997 (Model Law). The ILC Report contains a draft law, Part Z, which is the framework proposed to be inserted as a new part of the Insolvency and Bankruptcy Code, 2016 (IBC / Code). Thereafter, the report on the rules and regulation for cross-border insolvency resolution was released by the Cross Border Insolvency Rules/Regulations Committee (CBIRC Report). Draft Part Z provides a framework for recognition of foreign proceedings and cooperation amongst courts and Insolvency Professionals (IPs) in such proceedings across borders. Following the Model Law, draft Part Z introduces the concept of ‘foreign representatives’ in order to facilitate the implementation of this framework. As the Indian insolvency ecosystem prepares for the possible adoption of Part Z as a permanent feature of the Code, we attempt to examine how foreign representatives and their access may be regulated under the proposed framework and the manner in which this might affect the development of cross-border insolvency law in India.

As per the proposed scheme of draft Part Z, foreign representatives are to play a crucial role in its operationalisation. More specifically, Part Z empowers them to approach the designated bench of the National Company Law Tribunal (NCLT / Tribunal) in order to seek recognition of foreign insolvency proceedings and appropriate reliefs. The grant of recognition by the Tribunal having appropriate jurisdiction sets into motion several provisions of draft Part Z. Additionally, foreign representatives can seek cooperation from the Tribunal or Indian IPs even without receiving recognition for the foreign proceeding. Thus, as a procedural framework, draft Part Z relies heavily on the interaction between foreign representatives and other participants for it to be implemented effectively. However, since the treatment and role of foreign representatives varies across jurisdictions and given our limited experience in dealing with foreign professionals in other Indian statutes, it is likely that their proposed introduction and recognition under the Code may throw up some
implementational challenges.

This article attempts to demystify the concept of foreign representatives as envisaged under the proposed Part Z and evaluate how their interaction with the Code might shape the development of the cross-border insolvency regime in India. First, the article will examine the definition of foreign representatives as conceptually and statutorily understood. This will entail an examination of persons who can be foreign representatives. Thereafter, the article will delve into the (a) ‘right of access’ given to foreign representatives, (b) regulation of foreign representatives, and (c) participation and cooperation by foreign representatives in cross-border insolvency cases. In doing so, the article will rely on the Model Law, international practice and foreign case laws which will likely be the primary interpretive tools for Indian courts when draft Part Z is enacted. By looking to jurisdictions which have adopted the Model Law (including provisions relating to foreign representatives), this article seeks to predict the manner in which draft Part Z may take shape in India with a focus on foreign representatives.

**WHO IS A FOREIGN REPRESENTATIVE?**

Draft Part Z adopts the Model Law definition of ‘foreign representative’. Therefore, under draft Part Z, a foreign representative is a person or body authorised in a foreign proceeding to administer the reorganisation or the liquidation of the debtor’s assets or affairs or to act as a representative of the foreign proceeding in Indian proceedings. This may include a person or body appointed on an interim basis. ‘Interim’ or ‘provisional’ insolvency proceedings administered under persons appointed on an ‘interim basis’ are observed in several jurisdictions. The UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation (Guide to Enactment) notes that the objectives of the Model Law are to apply to such interim proceedings as well, provided that other requirements of the Model Law are met. Consequently, persons appointed on an interim basis in such interim proceedings are not intended to be treated differently than other professionals within the definition of ‘foreign representative’.

The concept of a ‘foreign representative’ could be found in insolvency and bankruptcy laws even prior to the enactment of the Model Law by UNCITRAL and its subsequent adoption by countries. Prior to adopting the Model Law, the United States Bankruptcy Code (US Code) defined a foreign representative as a ‘duly selected trustee, administrator, or other representative of an estate in a foreign proceeding’. The concept was developed in the US in the context of cross-border insolvency owing to a few reasons. First, US courts observed that there was a need to appoint a person to facilitate coordination of concurrent cross-border insolvency proceedings against the same debtor or against a debtor and its group companies. Second, due to general mistrust of the debtor-in-possession models followed in certain jurisdictions, foreign representatives were increasingly relied upon as objective professionals representing such foreign proceedings. Third, an important consideration was that the person facilitating coordination between cross-border insolvency proceedings should be a generally ‘disinterested person’. Thus, several cases in the US began to involve the appointment of ‘foreign representatives’ or similar persons in cross-border insolvency
proceedings (group and individual), even prior to the adoption of the Model Law.\textsuperscript{17} Similarly, erstwhile Canadian law also provided for the concept of a foreign representative in its ‘international insolvency’ legislation,\textsuperscript{18} prior to its adoption of the Model Law. One of the key features of such laws was that foreign representatives were required to be authorised by the foreign bankruptcy court itself. For example, in Canada, the international insolvency provisions in 1997 required that the foreign representative be a court-appointed officer operating under the authority of the foreign court.\textsuperscript{19}

However, the Model Law has brought about a significant change in the definition of foreign representatives across jurisdictions. It envisages that the foreign representative may not necessarily be authorised by a foreign court.\textsuperscript{20} Now, in US and Canadian law, a ‘person’ who can be a foreign representative includes individuals, partnerships and corporations (whether or not authorised by a foreign court).\textsuperscript{21} The definition of ‘foreign representative’ is largely similar across other jurisdictions as well. After adoption of the Model Law, US and Canada have permitted access to foreign representatives who are appointed by the debtor, rather than the foreign court, in case of foreign proceedings following debtor-in-possession models.\textsuperscript{22} For instance, in a US proceeding, a debtor-in-possession was permitted to appoint its own legal officer as the foreign representative.\textsuperscript{23} A US court has held that while ‘authorised in a foreign proceeding’ can be understood to include appointment by a foreign court, it is not necessary that a foreign representative is appointed judicially.\textsuperscript{24} Overall, courts primarily focus on the authorisation being provided ‘in the course of’ or ‘in the context of’ the proceeding, rather than ‘who’ appoints the foreign representative.\textsuperscript{25}

Thus, the international approach has been to interpret the requirements in the definition of ‘foreign representative’ broadly and widen access.

As noticed in the case of US and Canada above, Indian courts have also innovated to permit access to foreign representatives in case of cross-border insolvencies, even in the absence of an enabling framework.\textsuperscript{26} In the continued absence of legislative guidance, Indian courts are likely to continue following an ad-hoc approach to recognising foreign representatives as observed in the insolvency proceedings of Jet Airways.\textsuperscript{27} Incorporating draft Part Z in the Code will enable foreign representatives to access courts and seek recognition and reliefs in a regulated manner, with adequate safeguards as discussed in the next section. The definition of foreign representatives and its interpretation is crucial as applications for access, recognition and relief can only be brought by a foreign representative who satisfies the requirements of clause 2(h) of draft Part Z.\textsuperscript{28} Thus, the approach taken by courts as to who can be a foreign representative will also define the scope of application of draft Part Z.

**RIGHT OF ACCESS TO COURTS**

**Access**

Under common law, the right of access to courts by foreign persons depended on notions of comity between countries and their courts, and was usually accomplished through diplomatic channels.\textsuperscript{29} This was an inherently time-consuming and uncertain process. Draft Part Z adopts Article 9 of the Model Law to allow foreign representatives to have
direct access to the courts of the enacting State in an efficient manner. Article 9 enables expedited and direct access to courts for the foreign representative in the country in which she is seeking recognition, cooperation or both, without any other formal requirements (diplomatic or otherwise) as required earlier. UK and Singapore have adopted Article 9 without any deviations. US has adopted Article 9 subject to the requirement of recognition of the foreign proceeding in respect of which the foreign representative seeks access. The US Code carves out an exception to this requirement of recognition to permit a foreign representative to sue to collect or recover a claim that is property of the debtor. US courts have interpreted this exception to mean that the US Code does not require recognition to be granted to a foreign representative if she seeks to perform acts that do not require judicial assistance or for acts which do not implicate matters of comity or cooperation by courts. However, the US Code’s requirement of recognition prior to granting the right of access is not observed in other jurisdictions. Other jurisdictions may be inclined to provide direct access due to the time taken for decisions on recognition which can, in turn, delay the right of access and adjudication of recognition itself. As observed in the CBIRC Report, permitting direct access to foreign representatives facilitates quicker decision-making which can save time and costs. Following this rationale, draft Part Z has adopted Article 9 in the form of clause 7, without any deviations, which means that it proposes to provide direct access to foreign representatives in the same manner as UK and Singapore.

However, there may be certain challenges to providing the right to direct access. As discussed in the ILC Report, objections may be raised to granting direct access to foreign representatives as at least two classes of foreign professionals likely to act as foreign representatives (foreign lawyers and foreign chartered accountants) are not allowed to practice in India. However, considering the example of foreign lawyers, it may not be legally tenable to suggest that the right to access in the context of cross-border insolvency proceedings amounts to permitting them to practice law in India. First, the CBIRC Report notes that other jurisdictions which restrict foreign lawyers from practicing in their country, such as Bahrain and South Africa, still permit direct access to foreign representatives. In such countries, direct access in the context of cross-border insolvency proceedings has not been interpreted as removing the bar on foreign lawyers. Second, as noted in the ILC Report, foreign representatives are intended to form a separate class of professionals which are equivalent to domestic IPs under the Code, rather than lawyers. It is observed in practice that foreign representatives are encouraged to rely on local counsel in case of cross-border insolvency cases in order to understand local insolvency laws as well as to effectively protect the debtor’s assets. For example, in Chile, the appearance of a foreign representative before court must be through an authorised lawyer. This illustrates that the role of the foreign representative will be distinct from the role of lawyers and rather, they will likely be reliant on local lawyers (and other professionals, including IPs) to navigate the Indian insolvency framework. Arguably, then, the functions of a foreign representative cannot be conflated with functions which amount to the practice of law in pith and substance. Third, the right of access, as currently envisaged, is limited to the foreign proceeding in respect of which access is sought by the foreign representative. This
means that the foreign representative can only directly access the court for the interests of the foreign proceeding in which she has already been appointed for the purposes stated in Article 2(d) of the Model Law. Draft Part Z does not grant foreign representatives the right to directly approach any court for any other proceeding.44 Fourth, there are several safeguards against any misinterpretation of clause 7 of draft Part Z as permitting foreign lawyers to practice in India. India does not list legal services in its schedule of commitments in the General Agreement in Trade in Services (GATS) as a clear indication of its legislative intent and Indian courts have agreed that foreign lawyers are not permitted to practice in India.45 Thus, the argument that foreign lawyers are being allowed to practice under the right granted in clause 7 may not necessarily withstand judicial scrutiny.

Second, domestic stakeholders may desire clear demarcation of the scope of such a right to direct access and additionally, establishment of appropriate safeguards. The ILC Report and CBIRC Report have anticipated and discussed these issues. While the ILC Report suggests a conservative approach to providing access to foreign representatives, it recommends that the Central Government may provide the extent of access through subordinate legislation.46 The CBIRC Report suggests that the ‘right to access’ should entail access to the insolvency system and infrastructure, including appearing before the Tribunal, in India, for the limited purpose of cross-border insolvency cases.47 However, the CBIRC Report suggests certain requirements to be fulfilled prior to granting access under clause 7. This includes a system which is envisaged as a near-automatic authorisation system to be administered by the Insolvency and Bankruptcy Board of India (IBBI/Board).48 The CBIRC does not recommend that requirements akin to registration be made a pre-requisite to apply to the Tribunal.49 Rather, in case of any circumstances warranting rejection of authorisation of the foreign representative, it is recommended that the recognition and related reliefs granted to the foreign proceeding remain unaffected.50 Instead, it is recommended that the IBBI take other measures including requiring replacement of the foreign representative.51 If these safeguards are provided for in subordinate legislation, it will form a unique system for recognising and regulating foreign representatives as other jurisdictions do not have such mechanisms in place. Since the authorisation system is envisaged as near-automatic, the primary purposes of such a system could be (a) to gather information on foreign representatives, (b) rely on such information for the purposes of regulation as discussed below, and (c) prevent access to foreign representatives who may have been convicted of misconduct.

After establishing the suggested scope of the right to access, the ILC Report and CBIRC Report suggest certain safeguards in the form of regulation of the foreign representative herself. These safeguards are discussed below.

**Regulation**

Article 10 of the Model Law provides for a ‘safe conduct’ rule which ensures that the court of the enacting State does not exercise jurisdiction over the foreign representative or the debtor’s assets merely based on an application made pursuant to the Model Law.52 However, as noted in the Guide to Enactment, the legislative intent of Article 10 is limited
to enabling the foreign representative with meaningful access to the court of the enacting State without risking exposure of the entire estate to such courts.\textsuperscript{53} It does not provide an absolute shield against action under laws of the enacting State if the foreign representative commits an act of misfeasance.\textsuperscript{54} UK, US and Singapore have adopted Article 10. Draft Part Z also adopts this provision as clause 8.

In international practice, cases of misfeasance by foreign representatives have been observed and several solutions have been suggested to resolve such claims.\textsuperscript{55} For instance, in \textit{In re Cozumel Caribe, S.A. de C.V.},\textsuperscript{56} the US court had granted recognition to a Mexican insolvency proceeding of a debtor with assets in the US. A US creditor of the debtor petitioned the court to revoke recognition of the foreign proceeding, on grounds of public policy, citing alleged acts of misconduct by the foreign representative of the Mexican proceeding. It is crucial to note that the US law does not contain a provision for punishment of misfeasance by foreign representatives. However, the Court did not revoke recognition as it held that such a measure would not be appropriate. It held that all other remedies available to the creditor have not been exhausted and interests of creditors could be protected by granting comity in favour of certain foreign orders or judgements which do not harm US creditor interests.\textsuperscript{57} Further, the US court noted hesitance in condemning foreign representatives or foreign proceedings. This decision has been interpreted to mean that mere mishandling of a case or acting in bad faith by the foreign representative will not automatically lead to de-recognition of a foreign proceeding.\textsuperscript{58}

Similarly, in \textit{In re SNP Boat Service S.A},\textsuperscript{59} a US bankruptcy court had granted recognition to a French insolvency proceeding of a debtor with assets in the US. The bankruptcy court noted its dissatisfaction with the foreign representative of the French proceeding due to continued non-compliances with principles of due process under US law.\textsuperscript{60} Upon continued lack of cooperation by the foreign representative, the bankruptcy court dismissed the proceeding in entirety.\textsuperscript{61} However, in appeal, the district court reversed the decision of the bankruptcy court and held that dismissal is ‘appropriate only as a last resort, when less drastic sanctions would not ensure compliance with the court’s orders’.\textsuperscript{62}

De-recognition or dismissal of the foreign proceeding has been considered an extreme measure which has not been imposed in case of misfeasance by foreign representatives as discussed above. Two other cases have considered a less drastic measure in the form of lifting the stay granted upon recognition of a foreign proceeding.\textsuperscript{63} However, in both cases, this punishment was not ultimately imposed. It was observed that lifting the stay, which is granted upon recognition as a measure of providing respite to the debtor, would not harm the foreign representative but rather may harm interests of the creditors and debtor.\textsuperscript{64} This may be unfair to parties other than the foreign representative who may not have even authorised the foreign representative. Thus, while the US courts have contemplated remedies to the issue of misfeasance by foreign representatives in cross-border insolvency proceedings, no clear precedent has emerged.

One of the key stated objectives of the UK law is to provide direct access to foreign
representatives to seek temporary respite and to allow courts to ascertain the relief or coordination required to effectively manage the insolvency.\textsuperscript{65} However, in order to provide an appropriate safeguard against any misconduct by foreign representatives, the law has a penalty provision for such misconduct.\textsuperscript{66} The ILC Report discusses the existence of the UK penalty provision and suggests providing a penalty provision in the nature of the provision for punishment for Indian IPs.\textsuperscript{67} Accordingly, clause 8(2) of draft Part Z incorporates the punishment to be imposed by the Board for (a) contravention of the framework or rules and regulations framed thereunder, and (b) unlawful gain on account of such contravention. Additionally, the Board is empowered to give any direction that it is authorised to give an Indian IP. This mechanism envisages the Board as the body which will enforce punishment against foreign representatives. The Board is additionally tasked with providing a code of conduct for foreign representatives.\textsuperscript{68}

In UK law, the punishment for misfeasance by foreign representatives is to be determined and enforced through the courts, rather than a regulator.\textsuperscript{69} While there appear to be no reported decisions on the manner in which courts enforce such punishments against foreign representatives in the UK, it is presumed that this may be carried out through mutual legal assistance treaties (MLATs) or letters rogatory sent through diplomatic channels, if such issues arise.\textsuperscript{70} However, it is possible that routing investigation and punishment of foreign representatives through MLAT requests may be of limited utility in case of civil and commercial matters.\textsuperscript{71} Even if the scope of MLATs entered into by India permit investigation and punishment of foreign representatives, the cooperation enabled by MLATs or letters rogatory is most effective through a ‘single’ designated central authority (for e.g., ministries, government departments, law enforcement agencies) or courts.\textsuperscript{72} In light of this, enforcement of penalties through these methods by a regulator may pose challenges in a cross-border context. First, it may be difficult for an Indian regulator to conduct investigations in terms of obtaining evidence and other information regarding a foreign representative as foreign courts or authorities may be willing to only cooperate with the designated central authority or court in India. Second, as discussed above, the requirement of registration with the IBBI may provide the regulator with information about the foreign representative but it may not be possible for the regulator to authenticate such information without cooperation from foreign courts and authorities. Third, in practice, it may be feasible for foreign representatives residing in another jurisdiction to evade punishment by an Indian regulator, whereas the same may not be true for courts or other authorities in India. These issues may warrant providing for a clear framework for the manner in which the IBBI may be empowered to perform these functions in cooperation with foreign authorities. Alternatively, it may be considered if administration of such punishments may be performed by the Tribunal.

**ROLE OF FOREIGN REPRESENTATIVES – PARTICIPATION & COOPERATION**

Upon exercising the right to access, the foreign representative may receive recognition in respect of the foreign proceeding as a foreign main proceeding or a foreign non-main
proceeding. After recognition, the foreign representative is permitted to participate in Indian insolvency proceedings regarding the debtor, in accordance with Article 12 of the Model Law. Article 12 ensures that the foreign representative has the standing to make ‘submissions concerning issues such as protection, realisation or distribution of assets in the estate of the debtor or cooperation with the foreign proceeding’. This is not to be interpreted to mean that the foreign representative is given domestic powers, or that the nature of Indian insolvency proceedings or Indian insolvency law would be affected in any form by such participation. Further, the ILC Report and the manner of adoption of Article 12 in clause 9 of draft Part Z suggest that such power would be granted subject to the scope of the right to access. There are no significant interpretational issues faced by courts in reported decisions regarding Article 12 in international practice. Additionally, this power does not include the power to participate in ‘any’ Indian proceeding concerning the debtor, except the Indian insolvency proceeding. Rather, the foreign representative may prove that she has standing as a ‘party of interest’ in order to access any other Indian proceeding regarding the debtor.

The key role of a foreign representative is in protecting the estate of the debtor and seeking reliefs on behalf of the interests of the foreign proceeding in accordance with the recognition granted. In case of concurrent foreign insolvency proceedings with the Indian insolvency proceeding, the foreign representative performs several functions using the full range of powers provided under draft Part Z to coordinate such proceedings. However, even foreign representatives of un-recognised proceedings can communicate and cooperate with Indian courts and Indian IPs. For instance, the court in an Australian proceeding held that it merely needs to be established that there is a ‘foreign representative’ of a ‘foreign proceeding’ (main or non-main) in the manner defined in Article 2 in order to allow cooperation. The Guide to Enactment notes that the intent behind this provision was to enable complementary action in parallel proceedings within the framework of the law of each State in the absence of recognition. The crucial role of the foreign representative is highlighted in the provisions governing coordination of multiple recognised proceedings, as well as cooperation in case of un-recognised proceedings. Thus, the actions required to achieve the objectives of a successful insolvency resolution or liquidation proceeding are facilitated by the existence of the foreign representative in cross-border proceedings.

CONCLUSION

Given India’s brief encounters with cross-border insolvency cases in recent years, it is anticipated that the incidence of such cases will only increase. Consequently, the adoption of the Model Law in the form of draft Part Z or otherwise may be imminent, which will open the doors to foreign representatives as a new class of professionals recognised under the Code. As discussed throughout this article, the access and participation of foreign representatives is likely to be limited to the foreign proceeding in which she has been appointed - note that other jurisdictions have not encountered any significant challenges by limiting their access in this manner. Further, as discussed above, draft Part Z provides for regulation of foreign representatives in a unique manner (not observed in other jurisdictions).
Apart from the adaptations made for the Indian context, bearing in mind the international origins of draft Part Z, it is likely that Indian courts will follow established international precedent and adhere to the principles inherent to the Model Law while interpreting its provisions. However, the distinctive features of the Code and draft Part Z may result in India’s own unique contributions to the jurisprudence and best practices on cross-border insolvency law in general. In order to accomplish this, it is imperative to extend comity to foreign proceedings and the persons or bodies appointed as their foreign representatives as envisioned in the Model Law. Foreign representatives will form an integral part of cross-border insolvency proceedings and thus, their effective participation in operationalising Part Z will be pivotal in getting the framework successfully off the ground in India.

3. Supra Note 2, Annexure II.
11. Ibid.
14. Ibid.
15. Ibid.
16. Ibid.
17. Ibid.
22. Bill C-55, S.C., ch. 47 (Can.).
27. Ibid.
32. Section 1509, Chapter 15, Title 11, US Code.
33. Section 1509(f), Chapter 15, Title 11, US Code.
34. In re Lida, 377 B.R. 243 (9th Cir. BAP 2007).
36. Ibid.
38. Bar Council of India v. A.K. Balaji, AIR 2018 SC 1382. Qualifications and skills of foreign chartered accountants are recognised in India subject to the requirements of reciprocal agreements entered into by the Institute of Chartered Accountants of India (ICAI) with corresponding foreign bodies; such as the Institute of Chartered Accountants in England and Wales (ICAEW). However, agreements entered into with such foreign bodies do not, typically, provide a right to practice including, specifically, to conduct public accounting services or act as a tax agent, etc.; ICAI, MoU/MRA/Joint Declarations signed with Foreign Bodies; ICAI, Eligibility Criteria for the Members of ICAEW to become the Member of ICAI through Pathway Route (for those with more than five years membership).
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42. Article 308, Chilean Insolvency Law No. 20720, 2013 (Chapter VIII). Similarly, in Japan, the FR can apply to courts for recognition subject to certain procedural requirements, including the appointment of an attorney at law to act as an agent to ensure smooth progress, if the court so desires. See Article 17, Act on Recognition of and Assistance for Foreign Insolvency Proceedings, 2000.


44. Draft Part Z has not adopted Article 24 of the Model Law which permits intervention by the foreign representative in other proceedings pertaining to the debtor.

45. See Article 17, Act on Recognition of and Assistance for Foreign Insolvency Proceedings, 2000.


50. Ibid.

51. Ibid.


53. Para 110, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation.


56. Ibid, pp. 335-337.


59. Ibid.

60. Ibid.

61. Ibid.

62. Ibid.

63. Ibid.

64. Ibid.

65. Ibid.

66. Ibid.

67. Ibid.

68. Ibid.

69. Ibid.

70. Government of India, Ministry of External Affairs, Mutual Legal Assistance Requests.

71. Scoie P. (2014), “The Role of Mutual Legal Assistance Treaties in Obtaining Foreign Evidence” Litigation, Vol. 40(2). MLAT requests are generally restricted to criminal matters and civil cases which are ancillary to criminal matters. However, it is possible that the scope and nature of MLATs entered into by the Government of India may permit investigation and punishment of misconduct by foreign representatives through MLAT requests depending on an analysis of individual MLATs.

72. Supra Note 70. In India, the Department of Legal Affairs, Ministry of Law and Justice performs this function for civil and commercial matters.


75. Page 58, UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation.


77. Ibid.


79. Supra Note 25.

80. Ibid.

81. Ibid.


83. Pages 27 and 28, CBIRC Report.


Insolvency proceedings, as opposed to any other legal proceedings, are unique. The filing for insolvency not only results in a complete reshuffling of the rights of the debtor and the various classes of claimants, but it also overrides the legal rights that exist outside the formal insolvency proceedings. Given the breadth of its application and interception, domestic insolvency regimes involve an intersection of a diverse mosaic of legal rules, rightfully earning insolvency law the title of a ‘meta-law’.

Intellectual property (IP) licensing is a particular intersection of insolvency regulation that has resulted in intense judicial controversy and scholarly disagreement. From judicial misinterpretation and disagreement to congressional course correction and cross-border uncertainty, the intersection of IP licensing with insolvency has witnessed many controversies. Interestingly, the issue of IP licensing in bankruptcy remains unexplored in Indian bankruptcy jurisprudence. Partial blame for the situation can be accrued to the fact that before 2016, the Indian insolvency regime remained ‘multi-layered and fragmented’. In 2016, the Insolvency and Bankruptcy Code, 2016 (IBC / Code) substituted a multitude of operational bankruptcy laws. However, even the IBC does not explicitly regulate issues of IP licensing in insolvency transactions.

This article relies on the American bankruptcy jurisprudence to identify judicial disputes where the intersection of bankruptcy laws with IP licenses has yielded problematic conclusions. These judicial disputes are then examined within the mandate of IBC. The individual provisions of the Code are examined to determine the scope of interference warranted within the remit of the Indian insolvency regime.

**EXECUTORY IP LICENSES IN BANKRUPTCY**

**Implications for domestic insolvency**

IP licenses and their regulation within bankruptcy share a controversial history in American bankruptcy jurisprudence. The judicial and academic disagreements regarding this intersection can be traced back to section 365 of the American Bankruptcy Code. The provision allows a bankruptcy debtor to reject onerous contracts that were entered into before the initiation of the insolvency proceedings. Rejection allows a bankruptcy estate to absorb the contractual arrangements offering a net benefit while rejecting potentially burdensome arrangements. Rejecting burdensome and onerous contractual covenants...
reduces the prospective debts and the overall corpus of available funds to a business. These funds can then be restructured into payments to creditors.\textsuperscript{13}

The threshold requirement for the application of section 365 is that the contract must be ‘executory’. While the American bankruptcy law does not define the term executory, judicial and academic commentary provides sufficient guidance to create a workable definition.\textsuperscript{14} Prof. Vern Countryman suggests that an executory contract would be ‘a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach’.\textsuperscript{15} This definition has assumed approval from the judiciary\textsuperscript{16} as well as the American Congress.\textsuperscript{17} Since IP licenses usually include continuing material obligations,\textsuperscript{18} an overwhelming majority of courts find such licenses to be executory.\textsuperscript{19}

Once the threshold inquiry of executoriness is completed, the debtor is allowed to reject a license.\textsuperscript{20} Once rejected, the non-bankrupt party’s claim is relegated to a pre-petition general unsecured claim,\textsuperscript{21} which usually receives only a fraction of the original claim.\textsuperscript{22} Once rejected, the contract is treated as if the rejecting party breached it.\textsuperscript{23} However, owing to US Congress’ omission to enlist the repercussions of the breach and the lack of an obvious contract law analogue to the term ‘rejection’, the interpretation of this provision has been far from consistent.\textsuperscript{24}

Applying the rejection principle becomes even more problematic when it intersects with IP licenses.\textsuperscript{25} In 1985, the US Court of Appeals for the Fourth Circuit in \textit{Lubrizol v. RMF} interpreted that the rejection of an IP license would not only free the licensor from material foregoing obligations but it would also restrain the licensee from using the licensed IP.\textsuperscript{26} The court’s decision effectively meant that a rejection of an IP license within section 365 would constitute complete recission of the license.\textsuperscript{27} After the decision, licensees realised that in a case of bankruptcy, they were extremely vulnerable to a rejection of the license by a bankrupt licensor. The decision was met with an immediate demand to structure transactions as complete sales, thirty party software escrows and requiring security interest in the licensor’s estate.\textsuperscript{28}

The potential effects of the \textit{Lubrizol} ruling on the IP licensing market were so dire that American Congress had to adopt the Intellectual Property Bankruptcy Protection Act, 1988 (IPBPA) to denude \textit{Lubrizol} from its precedential authority.\textsuperscript{29} The Act introduced section 365(n) into the legislative scheme of the American Bankruptcy Code.\textsuperscript{30} The section provides an option to the licensee to retain the continued rights to exploit the licensed IP post rejection.\textsuperscript{31} While such retention would release the licensor from his set of contractual obligations, the licensee would continue using the licensed IP.\textsuperscript{32} Hence, section 365(n) acts as a substantial ‘veto power’ allowing the licensee to determine the effect of the rejection of an IP license.\textsuperscript{33}

Despite the clear and absolute enunciation of the law by IPBPA, the controversy related to IP licenses continued in American bankruptcy jurisprudence till 2019. When the IPBPA was legislated, the Congress omitted trademarks from the definition of IP.\textsuperscript{34} This omission led numerous courts to argue that the treatment of IP licenses as decided by \textit{Lubrizol} should
continue to apply in the trademark licenses. In 2019, the United States Supreme Court confirmed that the concerns of distorted competition, which underlined the promulgation of IPBPA, should also extend to trademark licensing.

**Implications for cross-border insolvency**

Apart from domestic insolvency, inconsistency related to IP licensing in bankruptcy has also yielded problematic results in cases of cross-border insolvency. In January 2009, a manufacturer of semiconductor chips, Qimonda, initiated insolvency proceedings in Germany. Since a significant proportion of Qimonda’s IP assets were registered in the US, the proceedings assumed the nature of a cross-border insolvency.

The US Bankruptcy Code, through Chapter 15, adopts the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, 1997. Making very ‘narrow and limited’ deviations from the Model Law, Chapter 15 allows a foreign bankruptcy representative to file a petition for recognition of foreign insolvency proceedings and request administration of American assets. The US Bankruptcy Code allows a foreign representative to file an application for recognition of foreign proceedings and request the administration of American assets. Citing his entitlements, the German Trustee requested the administration of Qimonda’s 4000 patents registered in the US. However, there was a potential difference between the treatment of bankrupt debtor’s IP licenses in the bankruptcy legislations of the US and Germany. While the American Congress had legislated IPBPA, protecting the interests of licensees during the debtor’s bankruptcy, a concomitant protection was absent from the scope of the German insolvency legislation. Within the German insolvency law, it was possible that a rejection of an IP license would amount to its complete recission.

When the dispute was presented before an American Bankruptcy Court, the German Trustee’s application to transfer administration of assets was denied. In its decision, the court relied on the public policy limitation, which allows a bankruptcy court to ‘refuse to take any action under Chapter 15 if such action would be manifestly contrary to the United States Public Policy’. The Court argued that IPBPA constitutes ‘fundamental US public policy of promoting technological innovation’. Therefore, any deviation from the protections offered therein would violate US public policy, thus activating the ‘safety valve’ embodied in the public policy limitation.

On appeal, the US Court of Appeals for the Fourth Circuit relied on a different argument to arrive at the same conclusion as the Bankruptcy Court. The Circuit Court argued that the administration of assets was a discretionary relief and can be granted only if ‘the interests of the creditors and other interested parties, including the debtor, are sufficiently protected’. The court argued that any grant of discretionary relief inherently calls for a ‘balancing test’, where the countervailing interests of the creditors must be considered alongside the interests of the debtor. In the present case, when Qimonda’s licensees approached the bankruptcy court citing the potential detriment to their interest by reason of unilateral rejection, the court opined that the licensees should be sufficiently protected in the grant
of a discretionary relief even if it adversely affects the bankrupt debtor. The court opined that licensing agreements’ unilateral recission could constitute an overwhelming burden on the licensees. Such a conclusion tilted the balancing test in favour of the licensees. Arguing thus, the application for transfer of administration was denied.\textsuperscript{45}

The confluence of the two arguments and the courts’ decisions meant that the licensees of the American patents would receive a dramatically different treatment compared to German licensees.\textsuperscript{46} While the decision received considerable criticism in academic scholarship,\textsuperscript{47} the United States Supreme Court rejected an appeal of \textit{certiorari} against the Circuit Court judgement.\textsuperscript{48} Therefore, the decision in \textit{Qimonda v. Jaffe} substantially colours the conduct of the courts and the parties in a cross border insolvency dispute involving IP licenses, particularly in the American jurisdiction. Further, given the close association that Chapter 15 shares with the Model Law, it is possible that the decision in \textit{Qimonda} can colour the interpretation of the Model Law itself.\textsuperscript{49}

\textbf{TREATMENT OF EXECUTORY IP LICENSES IN INDIA}

Unlike the US and some other countries,\textsuperscript{50} the IBC does not explicitly protect IP licensees.\textsuperscript{51} Partial blame for this situation can be accrued to the fact that international projects dealing with contractual relationships fail to provide any guidance on the recognition and enforcement of IP licensing relationships.\textsuperscript{52} Further, the projects initiated by UNCITRAL to create a legal framework for initiating, maintaining, and concluding effective IP licensing transactions during bankruptcy have not assumed finality.\textsuperscript{53} Unfortunately, the Indian judiciary has not had the opportunity to deal with issues of IP licensing in bankruptcy.\textsuperscript{54} The resulting situation is ‘a glaring gap in judicial and legislative guidance on the treatment of IP licenses in bankruptcy’.

While the IBC does not include a provision as exhausting and far-reaching as section 365 of the American Bankruptcy Code, multiple provisions in the Code harbour similar powers of rejection and avoidability. This part discusses those provisions and examines their scope considering their statutory construction and judicial guidance.

\textbf{During liquidation}

The IBC allows an Insolvency Trustee to disclaim onerous property.\textsuperscript{55} Tracing its roots in English Bankruptcy Law,\textsuperscript{56} the Trustee’s disclaimer is the closest enunciation to an American bankrupt debtor’s power of rejection.\textsuperscript{57} A disclaimer effectively terminates the relationship between the parties and ‘discharges the Bankruptcy Trustee from all personal liability in respect of the onerous property’.\textsuperscript{58} It determines the ‘rights, interests and liabilities of the bankrupt in respect of the onerous property disclaimed’.\textsuperscript{59} Further, onerous property includes any unprofitable contract or any property which cannot be disposed off for value.\textsuperscript{60} The provision to disclaim property is designed to avoid the financial incidence from maintenance of contracts that are unprofitable and can result in depletion of the pool of assets available to a bankrupt estate.\textsuperscript{61}
The law on disclaimer originates from English Bankruptcy jurisprudence, and the statutory language employed by the two statutes is also identical.\textsuperscript{62} Therefore, judicial decisions from the English jurisprudence should serve to determine the scope of the Indian provision as well. In 1997, the House of Lords opined the ‘\textit{rights and obligations of these other persons (counterparty in a rejection) are to be affected as little as possible. They are to be affected only to the extent necessary to achieve the primary object: the release of the company from all liability}’.\textsuperscript{63}

Applying this rationale to IP licenses should mean that a disclaimer would apply only to the extent of releasing the debtor from liability. It should not affect the foregoing interests of the licensee to continue using the licensed IP. However, given the lack of any judicial or administrative guidance on the issue, this conclusion can be very fragile.

\textbf{During corporate insolvency resolution process}

While ‘disclaimer of onerous property’ can be the closest enunciation to the American Bankruptcy Code’s power to ‘reject executory contracts’, the two share an important difference. The power of disclaimer is limited to cases of liquidation and insolvency. It does not extend to cases of reorganisation or corporate insolvency resolution process (CIRP).\textsuperscript{64} This section, therefore, turns to the CIRP and examines the extent up to which interference is warranted within IBC.

The IBC warrants avoidance powers for four ‘vulnerable transactions’: preferential transactions, undervalued transactions, transactions defrauding creditors and extortionate credit transactions.\textsuperscript{65} Through avoidance of vulnerable transactions, \textit{‘the bankruptcy law allows the ex-post alignment the ex-post alignment of incentives between factually insolvent debtors and their creditors’}.\textsuperscript{66} The power to avoid contracts allows a bankrupt debtor to reclaim the assets that a corporate debtor has surreptitiously distributed.\textsuperscript{67} However, the avoidance powers apply in very specialised situations, and their application is limited by a curated set of procedural guidelines.\textsuperscript{68} For example, if an undervalued or preferential transaction has been entered into in the ordinary course of business, it cannot be avoided.\textsuperscript{69} All vulnerable transactions should have been concluded less than two years prior to the initiation of insolvency proceedings.\textsuperscript{70} Therefore, the statutory guidelines which govern the applicability of avoidable transactions limit the applicability of the empowering provisions.

Apart from the maze of statutory guidelines and strict timelines,\textsuperscript{71} the avoidance powers do not warrant review or rejection of commercial transactions that constitute fair and equitable business transactions. Deliberating on the scope of the avoidance provisions, the Indian Bankruptcy Law Reforms Committee noted that vulnerable transactions ‘fall within the category of wrongful or fraudulent trading…. Or constitute unauthorised use of capital by the management’.\textsuperscript{72} The UK Supreme Court opined that the underlying policy of avoiding vulnerable transactions is ‘to protect the general body of creditors against a diminution of the assets by a transaction which confers an unfair or improper advantage on the other party’.\textsuperscript{73} Explaining the scope of the avoidance powers, the Supreme Court of India opined that ‘\textit{The IBC has made provisions for identifying, annulling or disregarding “avoidable transactions”}'

\textit{...[rest of the text]...}
which distressed companies may have undertaken to hamper recovery of creditors'. Hence, while avoidance powers may allow interference with pre-petition contracts, they are concerned with fraudulent transfers and providing fraudulent preference to a specific class of creditors. Hence, owing to the statutory design and legislative intention, avoidance powers cannot be comparable to the scope of section 365.

Another provision cited as enabling interference with pre-petition bankruptcy transactions is section 20(2)(b) of IBC. The provision allows a Resolution Professional or an Interim Resolution Professional to ‘amend and modify’ the terms of pre-petition contracts. However, judicial and administrative instruction dictates that the power incorporated in section 20(2)(b) cannot be exercised unilaterally. The National Company Law Tribunal (NCLT) Hyderabad in EIH v. Subodh explicitly noted that pre-petition contracts cannot be unilaterally amended or modified. The NCLT Mumbai extended this rationale further and opined that even a resolution plan cannot alter legally valid pre-petition agreements. Pre-petition contractual obligations shall be conducted and disposed in the same manner as they would have been had insolvency proceedings not intervened. Therefore, no unilateral amendments can be allowed within section 20 and thus, its mandate is not comparable with section 365 of the American Bankruptcy Code.

**CONCLUSION**

An examination of the treatment of IP licenses during insolvency reveals a curious deficiency under IBC. It omits any discussion about IP licenses and their relevance within insolvency. The legislature and administrative committees have overlooked an important interpretational guideline that can propose problematic domestic and cross-border insolvency conclusions. Examining the powers granted under IBC reveals that an insolvent debtor’s ability to interfere with pre-petition contracts is very limited. The interpretation and application of these powers would not result in a situation as dire as the American Bankruptcy jurisprudence experienced with **Lubrizol** or **Qimonda**. However, this conclusion remains very fragile due to the lack of administrative, legislative or judicial guidance on the subject. What will happen if an Insolvency Trustee disclaims an exclusive IP license? In such a case, the exclusivity requirement will constitute a substantial impediment to the licensor’s ability to monetise and exploit the subject IP right. Would the exclusivity requirement be frustrated with a disclaimer by the Trustee? To answer these questions coherently and identify the policy-based justifications for their application, the authors suggest that an administrative enquiry be conducted to eliminate the scope of speculation as to the treatment of IP licenses within IBC.

Section 365(f)(1), Title 11, The U.S. Code; if a security interest was created, the status would be that of a general secured creditor. Section 502 relates to allowance and disallowance of claims; Supra Note 14, Chapter 365.02.


12 Section 365(f)(2), Title 11, The U.S. Code.


14 Section 365(n)(2), Title 11, The U.S. Code.


20 Section 365(f)(1), Title 11, The U.S. Code; if a security interest was created, the status would be that of a general secured creditor. Section 502 relates to allowance and disallowance of claims; Supra Note 14, Chapter 365.02.


25 Section 365(f)(1)(b), Title 11, The U.S. Code; Supra Note 9, pp.8-9.


28 Section 365(a), Title 11, The U.S. Code; Apart from rejection, an executory contract can also be assumed within section 365(a) or assigned within section 365(f)(1).

29 Section 502(g)(1), Title 11, The U.S. Code; if a security interest was created, the status would be that of a general secured creditor. Section 502 relates to allowance and disallowance of claims; Supra Note 14, Chapter 502.08.


31 Section 365(f)(2), Title 11, The U.S. Code.


44 Section 1521(b), Title 11, The U.S. Code.
47 Canada: Bill C-86 Budget Implementation Act, 2018; The German legislature also attempted to enact a similar protection. However, it was unsuccessful; Fammler M. A. and Krieger C. (2020), “The Fate of a Trademark License in the Case of Bankruptcy of the Licensor — The U.S. Supreme Court Decision Mission Product Holdings Inc. v. Tempnology, LLC in the Light of German Law & Practice”, GRUR International, Vol.69, p. 36.
49 Supra Note 41.
50 Canada: Bill C-86 Budget Implementation Act, 2018.
51 Supra Note 7.
53 Supra Note 7, pp. 24-25; ibid. p.1257.
54 Supra Note 9, p.3.
58 Section 160(3)(b), IBC.
59 Section 160(3)(a), IBC.
60 Section 160, IBC; Frosdick v. Fox, 2017, EWHC 1737 (Ch).
62 Supra Note 9.
64 The power of disclaimer is made available by the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, which applies exclusively in reference to liquidation proceedings.
65 Sections 43, 45 & 50, IBC.
67 Ibid., p.711.
68 Supra Note 62.
69 Section 43(3) and 45(2), IBC.
71 Supra Note 9, pp.38-39.
74 Phoenix ARC (P) Ltd. v. Spade Financial Services Ltd., (2021) 3 SCC 475, 482.
76 Section 20(2)(b) read with section 23(2), IBC.
On August 15, 2022, as the nation marked 75 years since independence from British rule, the Hon'ble Prime Minister Narendra Modi pledged, from the ramparts of the Red Fort, to raise millions out of poverty and turn India into a developed country in the next quarter-century. To achieve this, the Hon'ble Prime Minister said India would be guided by the ideals of self-reliance and the spirit of international partnership to attain excellence in science and technology, set up industries, and attain food and energy security. He said the journey of the last 75 years had seen ups and downs with India battling against all odds with resilience and perseverance. He called upon the people to remove any trace of a colonial mindset. 'It is a big resolution, and 'we' should work towards it with all our might', he said.

To become a developed nation, reforms are required in various areas which have long been hamstringing India. Futuristic and visionary policies will have to be formulated at multiple levels. Besides, India will need to meet the threshold of high-income country in terms of economic indicators. Applying the criteria prescribed by the World Bank for high-income countries and the unchanged population base for India over the next 25 years, the Indian economy would need to grow at a particular rate to reach the goal. While reforms and policy initiatives in multiple areas are needed to support the grand target of turning India into a developed country in the next 25 years, two areas which assume greater importance and demand priority attention in the early years of Amrit Kaal are, judicial reforms to expedite enforcement of contract; and making the country’s insolvency system, more robust, and globally, palatable. These two areas, inter-linked in many ways, are the emphasis of this article.

EFFICIENT CONTRACT ENFORCEMENT

Efficient contract enforcement is essential to economic development and sustained growth. Economic and social progress cannot be achieved without a well-functioning judiciary that resolves cases in a reasonable time and is predictable and accessible to the public.
Economies with a more efficient judiciary, in which courts can effectively enforce contractual obligations, have more developed credit markets and a higher level of development overall. Overall, enhancing the efficiency of the judicial system can improve the business climate, foster innovation, attract foreign direct investment and secure tax revenues.\textsuperscript{6} Enforcing a contract through the courts in developed jurisdictions takes significantly less time than it takes in India. For instance, it can take less than 10 months in Singapore and New Zealand.\textsuperscript{7} Many studies and reports have spoken aloud about the pressing need for reforms in area of enforcement of contract in the country. The Government of India has been monitoring an array of legislative and policy reforms to strengthen the enforcing contracts regime in India. These incremental steps, although commendable and in the right direction, have helped, but it is time to adopt some path breaking reforms, to meet the laudable goal set by the Hon’ble Prime Minister.

ROBUST INSOLVENCY SYSTEM

Every year, billions of rupees in business value, jobs, and capital are lost or side lined as a result of businesses becoming insolvent and closing their doors. An efficient insolvency system encourages enterprise, underpins investment and economic growth, and creates wealth. It helps create a sound climate for investment, and enable market participants to more accurately price, manage and control default risks and corporate failure. An effective exit law ensures maximum play in a fair reallocation of assets to more efficient market users. A robust corporate restructuring can prevent many viable businesses in financial distress from continuing as going concerns when they are in a state of insolvency.

In 2016, India introduced the Insolvency and Bankruptcy Code, 2016 (IBC/ Code) paving the way for a much-needed modern framework to deal with the insolvency and bankruptcy of corporate entities in India. The Code has moved forward in leaps and bounds in a very short span of time. Due to effective implementation of the Code, green shoots have already emerged. While the speed with which the Government acted to enact and implement the Code is applaudable, continued absence of significant provisions, like the cross-border insolvency, group insolvency and others, and delays in appointment to National Company Law Tribunal (NCLT) and in approval of resolution plans by NCLT is starting to take some sheen off an otherwise shining piece of legislation.

To support the goals set by the Hon’ble Prime Minister, India needs a robust insolvency system that ranks amongst the best in the world and an adjudication authority (as part of the judicial framework) that complements such insolvency system. No degree of substantive law improvement—even world’s ‘best practice’ substantive law—will bring the Code robust without effective enforcement from one end of its spectrum to the other. Better performing courts have been shown to lead to more developed credit markets.\textsuperscript{8}
LEAP OF FAITH DECISIONS

This article suggests, some macro and other micro, but bold and out-of-box decisions, reforms and other measures needed that will contribute to formulating the collective ‘might’, as referred by the Hon’ble Prime Minister referred in his address, to achieve the target set by him. Implementing some of these would require a leap of faith.

New approach: Ministry of Economic Affairs

In the Amrit Kaal, the names and businesses of many ministries, both in the Central and State Governments, should represent the aspirations of the new age India and its global status. A Ministry of Economic Affairs could be formed to be made the charge-de-affairs for fulfilling the nation’s economic aspirations, and to serve as the nodal ministry for judicial reforms, reforms in other economic laws, including further reforms in the insolvency laws, as also in the laws that orbit around such economic laws. The judicial independence and the strength and efficiency of judiciaries are directly associated with economic growth. However, when people think of how courts affect them, they typically think in a public law mindset. They think about the ‘big issues’ decided under the Constitution. That type of judicial action dominates both public perception and legal scholarship. Thus, when people think about how courts affect them, they think more about hot-button political issues and the ubiquitously reported criminal cases. This slant toward thinking predominantly about public law is readily apparent in the multiple stories presently covering arrests and standard criminal trials and marquee constitutional litigation. Private law often gets shunted to the back of people’s minds because they think of it as solely affecting the parties. Far less coverage is given to contract actions involving businesses or individual citizens in their economic lives. This perception, and mis-understanding of the role of Judiciary has, for many decades, undermined the importance of judiciary in economic prosperity of the country. Furthering commerce has to be one of the central goals of the courts, alongside protecting the rights of the citizens. Similarly, insolvency law is an essential part of any country’s financial architecture, as emphasised in the earlier paragraphs. There are many other economic laws that play key role in the economic development.

Bringing the inter-linked areas of the ministries that are responsible for administrative rules of business for the judiciary and other economic ministries together, under one ministry, will provide the much required co-ordinate approach, result in greater cooperation, avoid delays on account of inter-ministerial consultations, centralise the reform process and help accelerate delivery. It will also send out a powerful message and give a thrust to the narrative to make the goal set by the Hon’ble Prime Minister, a national mission. From a perception advantage, it will help break away from the mindset shackles of the past.

Thinking big: India as next restructuring capital

Indian insolvency regime is just over five years old. It is still to deepen its roots. Yet, the development of a sophisticated insolvency system in a short period of time shows that the
Indian Government and its institutions have the capacity to implement complex economic laws with great maturity, its stakeholders are quick learners, and the Indian professionals are capable of providing high quality services. To top it all, it has the judges who can produce high-end jurisprudence in a branch of economic law new to the country. Therefore, there is no reason, why India should not shift gears and press the accelerator on upgrading the insolvency ecosystem. India should set the aim to become to most attractive jurisdiction for restructuring. Creditors and debtors prefer to choose the most efficient jurisdiction for resolution of insolvency. A developed country is a natural claimant of this space as it has the supporting infrastructure to effectively apply a sound legislation. India need not wait to become a developed country to stake claim for this space. It should aspire to become a global capital for restructuring, sooner. This will require a world-class insolvency ecosystem. A case in study for this purpose is Singapore.

Singapore has put in place a national strategy to become a global hub for dispute resolution in economic matters, including commercial arbitration, and to pitch the country as an effective and efficient jurisdiction for restructuring. They are rapidly creating soft and hard infrastructure to support this mission. Global institutions are being encouraged to set up regional shops in Singapore. Both, the judiciary and the executive are working in tandem and cooperation to advance this national goal, as is evident from the architecture and mission of Asian Business Law Institute. A similar national strategy by us.

Use of soft power to build awareness about the Code

Soft power is the most critical diplomatic tool. Countries package their soft power by emphasising the qualities of governance, culture, diplomacy, education, and business innovation. This packaging requires innovative use of public and private resources to subserve the larger national purpose. As implied by its absence from ‘The Soft Power 30 Index’ (India does not figure in a list of top 30 countries in terms of soft power), India does not yet benefit as much from international awareness, positive associations or investments in cultural diplomacy as many other countries. Most cultural diffusion to overseas audiences through private sector is limited, from yoga to Indian food, to Bollywood, and other select areas. One of the pillars of the soft power is business and trade. Soft power has a significant impact on the decisions made by the people, businesses, entrepreneur, and the governments. The perception of a country/nation forms a key component in economic development and for corporate. The Code is considered one of the most significant economic reforms in Independent India. The Indian judiciary stands alongside the best, globally. We need to make an effective use of soft power to communicate this through the use of soft power. India should encourage this through an integrated approach that amalgamates public diplomacy at the global level with a creative economy at the local level by involving stakeholders and artists, entrepreneurs, academics, policy makers and civil society. Films, literature and other creative modes, subtly provide information and create impressions, and help maximise the reach. This, over time, develops into a narrative. A coherent effort is needed to raise India’s brand value abroad regards the insolvency system and judiciary, by use of this creative soft power. There should be a shift from the
past and outdated narrative. This will have significant implications for the conduct of Indian diplomacy and the broader economic role of India, globally, in the coming years.

**G20 Presidency as a catalyst for reforms**

The G20 over the years has become a premier platform for global economic co-operation. The G-20 initiative is a coalition of the world’s most-powerful economies plus the EU. It’s role as an influencer, has expanded over the years. India will hold the G20 Presidency from December 1, 2022 to November 30, 2023, and host the 18th G20 Summit in 2023. Hundreds of official meetings will be held around employment, health, digital economy, trade, investment, climate, anti-corruption, tourism, culture, socio-economic development, education, and women empowerment will continue to stay on course. There will be academic interactions and meetings around the international financial architecture, financial inclusion and sustainable finance, financing for infrastructure, climate finance, and tax matters. These conversations must continue on the sides of the bigger issues. India’s presidency of the G20 grouping next year presents an enormous opportunity to accelerate sustainable growth within India, in the emerging world, and beyond, and become the launch pad for rolling out the agenda of policy decisions and reforms needed to accomplish the aspiration turn India into a developed country in the next quarter-century. The G20 members and delegations should be showcased, through public and private sector interactions, the progress made in the areas of enforcement of contracts and insolvency, as well as the supporting infrastructure. Path breaking reforms, including the judicial reforms and upgradation of insolvency system to make it truly global, should be launched during the G20 Presidency, by implementing the reforms in pipeline. Cross-border insolvency, group insolvency, introduction of hybrid insolvency system, mediation, law for financial institutions insolvency resolution, and other reforms should be planned for introduction and implementation during the G20 Presidency. Agenda for more futuristic reforms should also be set during this period.

**Adopt hybrid insolvency system**

Our legal system is based the common law system – a system of law based on recorded judicial precedents- came to India with the British East India Company. Many of these laws continue even after 75 years of Independence. As the Hon’ble Prime Minister said, we should word missing the colonial mindset. Free markets operate efficiently in countries that were not colonies of the British.

Like many common law countries, India has a ‘creditor-in-control’ style insolvency model. The Code enables taking control of the company away from the owners and give it to the creditors through appointing an independent Insolvency Professional. The thinking being that we shouldn’t leave company control in the hands of the very parties that got the company into its financial problems. The creditor-in-control model comes from the scale to which the country relies on credit to fuel the growth of its economy and subsequently, the country’s social tolerance to accepting business failure to promote risk taking and
entrepreneurship. Chapter 11 bankruptcy in the United States of America, on the other hand, is a popular debtor-in-possession model. Around the world, insolvency laws are evolving to incorporate more forgiving debt relief and restructure arrangements. Many countries are thus, making room for debtor-in-possession system in their insolvency framework, and adopting a hybrid model. This hybrid process comes with the debtor-in-possession and creditor-in-control model. In 2017, Singapore introduced new restructuring laws, adopting parts of the Chapter 11 bankruptcy laws, reducing the barriers of entry for distressed businesses to seek support. In Australia, piecemeal changes were made to soften the perceived ‘creditor favouring’ insolvency laws through introducing safe harbour in late 2017 and a stay on *ipso facto* clauses in mid-2018.

In 2021, India introduced a ‘debtor-in-possession’ style of arrangement through the pre-pack regime for small and medium business restructure. Through this reform, the government has set the stage to allow directors to retain control of their businesses while seeking external professional support. India should consider making a recalibration of the balance between debtor and creditor control, to attract investors from both, the ‘credit-in-control’ and ‘debtor-in-possession’ jurisdictions. This will help make the Code, globally palatable.

**Rethink the structure and composition of NCLT**

The delays in deciding cases by NCLT has shaken the confidence of some stakeholders, albeit not irretrievably. There is a definite need for improvement in the functioning of NCLT to make it more efficient. Although efficiency is only one aspect of the quality of a judiciary, it nonetheless is measurable, unlike some of the other essential qualities. One important aspect of efficiency is time to disposition of a case.\(^1\) One of the common complaints by NCLT and other stakeholders is lack of resources. More money and especially more judges would presumably, other things equal, lead to faster disposition of cases and perhaps more effective judiciaries. Although budgets are a big problem, it is reasonably clear that neither budgets nor numbers of judges are the heart of the problem. Ecuador and Peru have only one judge per 100,000 people, but Singapore has less than one judge per 100,000 people (compared to 27 per 100,000 in Germany and 10 per 100,000 in France).\(^2\) While a score of measures are needed to address this issue, there is a need to go back to the drawing board and reimagine the adjudicating authority. The NCLT structure was introduced nearly two decades ago. We are a different nation now, 20 years later. In a free market dynamic economy, where private sector is the central engine of growth, it is imperative that NCLT (in its reinvented avatar) should have an adequate representation from the private sector. An equal percentage of judicial members should be appointed by inviting senior and experienced members of the Bar, and from other expertise available in the market. They will bring with them the readily usable experience. Reputed professionals guard their reputation through their conduct and behaviour. The establishment should show trust in reputed professionals. In National Company Law Appellate Tribunal, the experience of technical members is not optimally used as appeal proceedings are mainly on questions of law. Their experience can be better utilised in other forums. Other structural changes are required.
Pre-insolvency resolution and preventive insolvency process

Pre-insolvency proceedings, at their core, inhabit a space on the spectrum somewhere between a pure contractual workout and a formal insolvency or rehabilitation proceeding. They are restructuring proceedings that corporate debtors can access before they become insolvent with the aim of avoiding insolvency. They entail a surgical debt restructuring and an early intervention at the first signs of distress, concentrating on financial creditors rather than creditors of the operating business, permitting no, or limited, court involvement, avoiding stigma and reputational damage. Such proceedings may preserve value better than later-stage intervention through formal insolvency proceedings that implicate all stakeholders, and almost invariably result in distressed asset sales of one form (liquidation, break up) or another (pre-pack designed to achieve a going concern, or at least a ‘better than liquidation’ outcome). Ever since the fall of Lehman Brothers and the financial crisis that followed, the world has witnessed a proliferation of various ‘light touch’ financial restructuring techniques in the form of pre-insolvency proceedings. These proceedings inhabit a space on the spectrum of insolvency and restructuring law, somewhere between a pure contractual workout, the domain of contract law, and a formal insolvency or rehabilitation proceeding in the domain of insolvency law. Policymakers, especially in the European Union, have responded to market developments by embarking on an aggressive new phase of corporate rescue oriented legislative endeavour that focuses on so-called pre- insolvency or preventive insolvency proceedings. This current vogue for pre-insolvency proceedings is the latest phase of a global effort to fashion a comprehensive range of debt resolution tools for use at various stages of the corporate life cycle. While pre-pack process has been introduced for small and medium enterprises, it has not been used by its consumers due to complex legal and regulatory provisions. It is time to develop a simple, effective and efficient pre-insolvency resolution toolkit, which also includes tools to prevent insolvency, which should be available to all classes of debtors. This will benefit the Indian corporate and financial sectors, immensely.

Develop the legal and regulatory framework for out-of-court dispute resolution (arbitration and mediation) and debt recovery

Time taken in insolvency resolutions concluding has been a matter of contention and debate. The commencement of an insolvency case reveals the debtor’s problematic financial situation and hinders business. Mediation provides strong incentives for both parties to engage in fast and efficient dispute resolution and look for a common business solution. Insolvency is not an adversarial process. Yet, disputes arise between parties, which has clogged the NCLT with avoidable cases. It also adds to the cost of resolution and provides uncertainty. As of now mediation has not been utilised for resolving of insolvency disputes. Mediation can be a viable option in a country like India, where the population is enormous, and wealth is not equally distributed. It is time for the framework of the Code to make room for mediation. Mediation is rapidly becoming as an acceptable mode of dispute resolution in insolvency in many countries with advanced insolvency systems as it allows the parties to reach an agreement through persuasion and ‘party-driven solutions’. India should start
preparing the legal framework for mediation which can deliver top end mediation through qualified and trained cadre of professionals to complement the efficiency of the Code. This is likely to reduce the over-bearing workload of the benches of NCLT.

**Develop a community in pursuit of scholarship**

Another key initiative needed by the country is to strengthen the interaction between the Government and academics in public policy making in due course. Academic knowledge, evidence and expertise can help inform, design, improve and test policy—and ultimately make government policy better. Research based analysis bridges the gap between policy and practice, and can leads to strong, inclusive and thorough implementation of the insolvency regime. The policy makers can build on experience of scholars. In developed countries, academics continue to play a very important role in supporting policy development, industry research and finding innovative solutions. As a country, we should aim to develop a community in pursuit of education, research and scholarship in the field of economic laws, in particular insolvency laws.

**Development of stressed assets market**

India’s stressed assets market is estimated at $115 billion. The enactment of the Code has created an efficient market for resolution of distressed assets. A massive amount of capital is needed among the intermediaries in the resolution process of stressed assets. A secondary market for distressed assets can reduce the debt collection burden on banks and free up resources and capital to support new lending. It can also enhance bank’s risk management strategy by providing another instrument to manage credit and market risks.

In a developed economy, market participants are less reliant on loans from banks to finance their projects. The stressed assets funds and investors are looking for opportunities to invest in India. There is a genuine interest amongst global investors in the distressed assets investment markets with their inherent ‘buy low-sell high’ potential. But they are hesitant to take the leap of faith in the absence of an ecosystem that enables quick acquisition, provides an early closure of transactions, leaves no uncertainty from litigations challenging the resolution plans approved by the NCLT and allows repatriation of funds. We need to make the insolvency system more robust to attract these players.

**CONCLUSION**

To achieve the high target set by the Hon’ble Prime Minister, India needs to show persistent and unprecedented resolve and efforts. India should catch the bull by its horns and launch the next generation reforms which will propel the country to amongst the top thinkers on the global insolvency table and establish its leadership in the subject. This will require taking a leap of faith. It would be a boon, not just to every Indian, but to the world at large, if India becomes a developed nation by 2047, lifting millions of Indians out of poverty.
Different global bodies and agencies classify countries differently. The ‘World Economic Situation and Prospects’ of the United Nations classifies countries into three broad categories: developed economies; economies in transition, and developing economies, to reflect basic economic country conditions. To categorise countries by economic conditions, the United Nations uses the World Bank’s categorisation based on Gross National Income (GNI) per capita (in current US dollars).

At present the World Bank categorises India as a lower-middle income economy which is designated for countries that have a gross national income per capita of between $1,086 and $4,255.

Recently, the World Bank updated the per capita income criteria for high-income countries to more than $13,205, while India’s GDP per capita is currently around $2,200.

Amrit Kaal is a Vedic astrology term which signifies the perfect time to start a new venture. This is the time when bigger success can be achieved with proper efforts. Prime Minister Narendra Modi, and before him Finance Minister Nirmala Sitharaman, talked about Amrit Kaalam or Amrit Kaal. The PM mentioned Amrit Kaal many times in his Independence Day 2022 speech as well.


Asian Business Law Institute website.


Over the years, the number of conglomerates, amalgamations, related-party transactions, amongst others, has exponentially risen in India, due to which the interconnectedness between different corporate bodies has increased. This has led to numerous instances of situations wherein the group holding company lands into indebtedness and is on the verge of being insolvent, thereby impacting all its subsidiary companies, or vice versa, wherein indebtedness of a subsidiary creates risk for the larger group.

Such instances are categorised as ‘group insolvency’, which refers to the process of collective judicial or administrative proceeding, including an interim proceeding, pursuant to a law relating to insolvency in which the assets and affairs of an enterprise group member debtor are or were subject to control or supervision by a court or other competent authority for the purpose of reorganization or liquidation.

Group insolvency seeks to balance the doctrine of separate legal entity as laid down in *Solomon v. A Solomon & Co. Ltd.*,\(^1\) on one hand and on another, it recognises that despite this distinct juristic personality, a consolidated insolvency process is advantageous for all stakeholders, as their resolutions can be consolidated before one court of law and its combined assets can be utilised to the greatest advantage for the entire group particularly, the corporate debtor (CD). This approach factors in the situation that group companies usually have cohesive operations commercially and managerially and project themselves as a whole institution.

**MEANING OF GROUP COMPANY INSOLVENCY**

A group company therefore is a cluster of corporate entities of parent and subsidiary companies in a vertical structure or horizontal structure format that operates with economic inter-dependence with common control. According to the Reserve Bank of India (RBI),\(^2\) group company means two or more enterprises which, directly or indirectly, are in position to:

(a) exercise 26%, or more of voting rights in other enterprise; or

(b) appoint more than 50% of members of board of directors in the other enterprise.

Group companies with financial relations, like interlinked corporate guarantees, loans and advances are more prone to group company insolvency rather than group companies with
operational relations. When one of the group companies becomes insolvent, it is likely that all the other companies financially linked with the insolvent company gets dragged for insolvency proceedings.

**INTERNATIONAL PRACTICES**

In New Zealand, section 271(1)(a) of the Companies Act, 1993, dealing with pooling of assets of related companies, empowers the courts to order one company in a group to contribute towards the assets of a fellow group company in the event of latter’s insolvency. Such orders are to be granted when Court considers this just and equitable and attention will be paid to the role of the parent company especially its part in the subsidiary’s collapse. In the case of collapses of the group as a whole, the New Zealand law grants judges an analogous discretion to pool the assets and liabilities of the group. Further, under section 342 of the Companies Act, 1993, New Zealand creditors are entitled to invoke pooling rules contained in section 271 of the Act to reach New Zealand assets of a solvent foreign company related to the company in liquidation.

In this context, the New Zealand courts must have regard to-

(a) the extent to which the related company took part in the management of any of the other companies;
(b) the conduct of any of the companies towards the creditors of any of the other companies;
(c) the extent to which the businesses have been combined;
(d) the extent to which the causes of liquidation of any of the companies are attributable to the actions of any of the other companies; and
(e) such other matters as the court thinks fit.

A similar approach has been adopted in Ireland and, in Australia. In the latter jurisdiction, the Corporations Amendment (Insolvency) Act, 2007 introduced legislative amendments to provide that the courts may, by order, determine (on ‘just and equitable’ criteria) that a group is a ‘pooled group’. The effect of such an order is that unsecured creditors are able to claim against any or all of the companies in the pooled group – who are rendered jointly and severally liable for the unsecured debts owed by each member. The Court’s power here requires that each company in the group is being wound up and the pooling order applies to debts or claims that are present or future, certain or contingent, and whether ascertained or sounding only in damages.

In USA, the court may order consolidation (known as substantive consolidation) under the auspices of its general equitable powers and will do so where the companies affairs are inextricably linked or the creditors can be shown to have dealt with the debtor companies as a single economic unit in such consolidation the group assets and liabilities are dealt with as a single unit as part of a pooling arrangement.
GROUP INSOLVENCY AND IBC

With the advent of the Insolvency and Bankruptcy Code, 2016 (IBC/Code), there has been a transformative turnaround in the corporate insolvency resolution framework in India. However, the IBC does not accommodate and provide for specific arrangements or contains any provision for group insolvency as the legislation itself is still evolving and is designed for a single economic entity. The IBC envisages a framework to deal with the insolvency and liquidation of corporates on a standalone basis.

Nonetheless, with the growing demand for the process considering the ease of undergoing it and many benefits which come with it, for the prejudiced party and the ability to prevent fraud, the courts have started taking cognisance of the same to fill in the gap.

Power of IRP and Liquidator over solvent subsidiaries under IBC

Before delving into the case study, let’s take a look at what the Code offers with respect to the powers/ rights of the Interim Resolution Professional (IRP) or Resolution Professional (RP) or Liquidator over the solvent subsidiaries where the parent company has become insolvent.

Section 18 of the Code, which deals with the duties of the IRP, *inter-alia* provides that the IRP can take control and custody of any foreign asset over which the CD has ownership rights and securities including the shares held in any subsidiary of the CD. The relevant excerpt of the provision is reproduced below:

18. Duties of interim resolution professional.— The interim resolution professional shall perform the following duties, namely:

(a)....

...........

(f) take control and custody of any asset over which the corporate debtor has ownership rights as recorded in the balance sheet of the corporate debtor, or with information utility or the depository of securities or any other registry that records the ownership of assets including—

(i) assets over which the corporate debtor has ownership rights which may be located in a foreign country;

(ii) assets that may or may not be in possession of the corporate debtor;

(iii) tangible assets, whether movable or immovable;

(iv) intangible assets including intellectual property;

(v) securities including shares held in any subsidiary of the corporate debtor, financial instruments, insurance policies;

(vi) assets subject to the determination of ownership by a court or authority;......
Further, section 36 of the Code provides as under:

36. Liquidation estate.—

........

(3) Subject to sub-section (4), the liquidation estate shall comprise all liquidation estate assets which shall include the following:—

(a) any assets over which the corporate debtor has ownership rights, including all rights and interests therein as evidenced in the balance sheet of the corporate debtor or an information utility or records in the registry or any depository recording securities of the corporate debtor or by any other means as may be specified by the Board, including shares held in any subsidiary of the corporate debtor;

........

(4) The following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation:—

.....

(d) assets of any Indian or foreign subsidiary of the corporate debtor;...

From the above, it is clear that sections 18(f) and 36(3) of the Code gives control of the shares of the subsidiary to the IRP and Liquidator of the parent company. The control rights given to the shareholders of a solvent company may be used by the IRP or Liquidator to obtain information from solvent group entities easily. Further, a resolution plan of a parent company would deal with the assets of the company, which would include its shares in subsidiary companies.

JURISPRUDENCE RELATED TO GROUP INSOLVENCY IN INDIA

State Bank Of India v. Videocon Industries Limited:§

The consortium of lenders to Videocon Industries Limited (VIL) led by State Bank of India (SBI) had explored restructuring the loans of Videocon under the RBI circular, but the company could not get the required ratings. The RBI referred VIL and Videocon Telecom Limited (VTL) in its List II on January 1, 2018 for initiation of corporate insolvency resolution process (CIRP).

SBI filed petitions under section 7 of the Code for initiation of CIRP of VIL + 14 other CDs in the group. The Adjudicating Authority (AA) admitted these 15 CDs into CIRP between June - September, 2018. The AA in the respective admission orders also appointed the IRPs for each CIRP, who were subsequently confirmed as RPs / substituted by another RP, as per the decision of the committee of creditors (CoC) of the respective CD. Expression of interests were invited for each CD. However, no interest was received.

Considering interdependencies of the CDs and obligor and co-obligor structure, SBI filed for substantive consolidation of CIRP of the 15 CDs. A similar application was also filed by Mr. Venugopal Dhoot, ex-director/promoter of Videocon group. Accordingly, on August 8,
2019, the AA passed an order directing consolidation of CIRP of the 13 CDs and appointed Mr. Mahender Khandelwal as the IRP. It did not include two CDs, namely, KAIL Limited and Trend Electronics Limited and allowed those CIRPs to continue separately.

A preliminary question as to under what circumstances, an order of consolidation can be demanded or *suo-motu* be passed by a court/tribunal arose and the National Company Law Tribunal (NCLT), Mumbai Bench answered that the right recourse is to examine the necessity of consolidation. The tribunal took reference from the principles laid down by judicial authorities in U.K. and U.S.A. courts.

The Tribunal stated that it is appropriate and suitable to give a ruling at this occasion that there is no single yardstick or measurement on the basis of which a motion of consolidation can or cannot be approved. The essential ingredients to be examined are, namely: (a) common control, (b) common directors, (c) common assets, (d) common liabilities, (e) inter-dependence, (f) interlacing of finance, (g) pooling of resources, (h) co-existence for survival, (i) intricate link of subsidiaries, (j) inter-twined of accounts, (k) inter-looping of debts, (l) singleness of economics of units, (m) cross-shareholding, (n) interdependence due to intertwined consolidated accounts, (o) common pooling of resources, etc.

The tribunal made it clear that the list is not exhaustive. These are the elementary governing factors, *prima facie* to activate the process of consolidation. After examining the essential ingredients, the Tribunal ordered the consolidation of 13 companies out of the 15 companies proposed for consolidation.

This ruling, in essence, laid the building blocks for the introduction of the single economic entity principle in the IBC, and for initiation of group insolvency regime in India although at a very nascent stage.

In June, 2021, NCLT Mumbai bench has approved the resolution plan of Twin Star Technologies Ltd., marking it as the first major group resolution plan in India.

However, on January 5, 2022, National Company Law Appellate Tribunal (NCLAT) set aside the Mumbai bench of NCLT order on the ground that section 30(2)(b) of the Code has not been complied with and hence, the approval of the resolution plan is not in accordance with section 31 of the Code. It remitted the matter back to Videocon’s CoC for completion of CIRP in accordance with the IBC.

In February, 2022 the Hon’ble Supreme Court agreed to hear Twin star Technologies Ltd.’s plea against the NCLAT’s January 5, 2022 order.

**Group insolvency has also been initiated to give relief to homebuyers:**

- In the case of *Edelweiss Asset Reconstruction Co Ltd v. Sachet Infrastructure Pvt Ltd & Ors.*, the NCLAT ordered for a simultaneous CIRP to be initiated against a group of five companies through a common RP in order to develop a residential real estate project and complete it in one go.
• Similarly, in the matter of *Chitra Sharma v. Union of India*, the Supreme Court directed the parent company (Jaypee Group) to deposit a substantial amount in lieu of the insolvency proceedings initiated against its group companies.

• Going one step further, albeit exercising its powers under Article 32 of the Constitution, the Supreme Court in *Bikram Chatterji & Ors. v. Union of India*, came to the aid of the aggrieved homebuyers by ordering attachment of properties of all 40 group companies in the Amrapali group and freezing of bank accounts of all companies and their directors.

• In another instance, while dealing with the insolvency process in the case of *Axis Bank Ltd & Ors v. Lavasa Corp Ltd.*, the NCLT consolidated the Lavasa group insolvencies in order to avoid potential losses likely to be caused by fractured insolvencies while noting that the insolvency of the subsidiaries largely depended on the outcome of their parent’s insolvency.

**Group Insolvency in other cases:**

• The recent downfall of IL&FS group comprising of 348 companies also brought the need to regulate the group insolvency framework under IBC. As recently as on June 22, 2021, the NCLAT, while dealing with IL&FS cases specifically, held that by virtue of various settled cases, the law has developed where group insolvency is also permissible.

• The AA *vide* separate orders dated October 8, 2021 admitted the application under section 227 of the Code read with rule 5 of the Insolvency & Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 for initiating CIRP against Srei Infrastructure Finance Limited (SIFL) and Srei Equipment Finance Limited (SEFL) and appointed Mr. Rajneesh Sharma as the Administrator. The NCLT *vide* order dated February 14, 2022 ordered for consolidation of CIRP of SIFL and SEFL.

**ADVANTAGES OF CONSOLIDATION**

There are inherent limitations to an individualistic approach of CIRPs of group companies. Consolidation can easily be overcome to benefit all stakeholders with the objectives enshrined in the preamble of the Code. In an isolated approach:

• asymmetry of information may cause a problem in the conduct of the CIRP;

• interconnected operations and entangled business may confuse the investors concerning the allocation of resources within the group, which might discourage investment in the absence of any sustainable or independent business model;

• there might be a waste of time and effort in identifying or understanding the dynamics of the related party transactions and, thereafter, in pursuing the inter-company or intra-group claims;
there would be extravagant process costs and duplication of effort for each entity, such as when piecing together information about common exposures and investments;

RPs may look to maximise the value of the companies and face friction with respect to the continuance or termination of the often onerous related-party transactions and the claims or counterclaims in respect of inter se guarantees or cross-collateralisation; and

coordination in collecting information on avoidable transactions undertaken by insiders or promoters may be difficult and detrimental to the group creditors. Individual entities may have neither requisite information nor finances to pursue recovery from such transactions.

All these problems can easily be resolved through an appropriate framework for consolidation of group insolvencies. While the rationale for consolidation may mostly be cost advantages, in other cases, it may simply become necessary when separation of financial affairs of the entities is impossible.

ISSUES AND CHALLENGES WITH CONSOLIDATION

The benefits of consolidation also present certain issues or challenges:

- lack of lender homogeneity (i.e., different loan profiles and security interests) creates tension in the resolution and distribution mechanism. In such cases, procedural consolidation is more desirable since it focuses on a coordinated CIRP without merging the group assets or liabilities;

- mutually owed liabilities may form a reasonable part of the overall group debt, which is considered in the computation of the liquidation or fair value of each company. Given the conflicting interest of different lenders in such cases, the ordinary practice of ignoring related party debts may not be feasible;

- the extent or scale of business in a diversified group may often require the appointment of other professionals to aid the functions of the RP, which may add to process cost. However, such added costs would certainly be less than the cumulative costs of running the individual CIRPs; and

- in cases of multinational conglomerates, there might be coordination problems with foreign representatives and taking custody or control of foreign assets would be difficult in the absence of a cross-border insolvency framework. In the Videocon case, the claims regarding guarantees that were given to the creditors of foreign subsidiaries were admitted; however, their assets could not be merged, which led to a heavy mismatch between the assets and liabilities of the group.
REPORT OF THE WORKING GROUP ON GROUP INSOLVENCY

Recognizing the growing need for a holistic framework for group insolvency, the Insolvency and Bankruptcy Board of India constituted a Working Group which submitted its recommendations on September 23, 2019. The Working Group primarily considered three elements - procedural coordination mechanisms, substantive consolidation mechanisms and rules for perverse behavior of companies in a corporate group; and addressed key aspects pertaining to identification of a group, the extent of grouping and the mechanics involved. Among several recommendations, it recommended the implementation of the group insolvency framework in a phased manner.

Phase 1: The first phase should initially be applied only to companies in a domestic group with adoption of procedural coordination mechanisms as a trial mechanism. Procedural coordination mechanisms are rules which coordinate the different insolvency processes of various group companies, without disturbing the division of assets and substantive claims of creditors of each of the group companies. This mechanism lowers costs and reduces the time associated with different insolvency processes. It consists of the following elements:

- Joint application process for insolvency of multiple companies
- Communication, cooperation and information sharing between different insolvency professionals (IPs), NCLTs and CoCs under IBC
- Single AA to administer insolvency proceedings
- Single IP for companies in a corporate group
- Creation of a group creditors’ committee
- Enabling of group coordination proceedings
- Extension of overall time frame for conclusion of CIRP of group entities to 420 days

Phase 2: The second phase should introduce mechanisms of group insolvency in cross-border group insolvencies and substantial consolidation, depending upon the implementation of first phase of framework. The concept of substantive consolidation seeks to consolidate the assets and liabilities of group companies so that they are considered as a single economic unit for the insolvency process.

In drafting the framework, the Working Group has taken into consideration the UNCITRAL Legislative Guide on Insolvency Law on ‘Treatment of enterprise groups in insolvency’ and the ‘World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes, 2016’ and has extensively drawn references from legislation in European countries and United States, with the aim of designing a comprehensive and practical framework, to facilitate insolvency resolution and liquidation of companies in a group.

Subsequent to the report of the Working Group on group insolvency, the Cross-Border Insolvency Rules/Regulation Committee (CBIRC) which was constituted by Ministry of Corporate Affairs submitted first part of its report on the rules and regulatory framework for cross-border insolvency on June 15, 2020. On February 1, 2020, the remit of CBIRC was
expanded to analyse the UNCITRAL Model Law on Enterprise Group Insolvency and to make recommendations governing the resolution of group enterprises for the purpose of IBC.

CRITICAL ANALYSIS OF WORKING GROUP RECOMMENDATION

Upon analyzing the recommendations of the Working Group, there are a few grappling concerns that need to be addressed:

• Definition of the term ‘corporate group’ provided by the Working Group for the purpose of this framework so as to include holding, subsidiary and associate companies, is vague and fails to be inclusive

• Inherent ambiguity between jurisdictional issues arising due to the recommendation of a single AA to mandatorily monitor the group insolvency process and the liberties provided to stakeholders to have different AAs during the process of transfer of their applications

• Applicability of cross-border insolvency provisions with relation to group insolvency since the development of provisions related to cross-border insolvency is itself at a nascent stage

• Non-settlement of the application of the principle of extension of liability as far as the Indian jurisprudence related to group insolvency proceedings is concerned

• Lack of consideration of issues relating to provisions for dealing with multiple tax jurisdictions, the concept of group moratorium, the procedure to move out from group insolvency proceedings in case of settlement between creditors and CD, the feasibility of insolvency proceedings of a CD having cross investments and backward or forward linkages with other group entities without consolidation, alignment of management of multiple group companies by single RP, etc.

WAY FORWARD

Individual insolvency proceeding against each group company is not the way of moving forward and we are in a dire need of a robust cross-border insolvency framework. Without it, the enforcement of the orders of the tribunals over the foreign subsidiaries becomes cumbersome and complex. Moreover, a plain reading of section 2 and 3(7) of the Code read with section 2(2) of the Companies Act, 2013 indicates that the Code applies only to Indian companies and not to foreign companies. The UNCITRAL Model Law on Cross Border Insolvency must be adopted to overcome such challenges and to reduce the burden on tribunals/courts.

Until then, the process of consolidation of group companies must be made using equity and fairness as a yardstick to lift or pierce the corporate veil and should be used as a mechanism to maximize the value of financially stressed corporate entities. The extent to which assets of the corporate entities are found to be hopelessly commingled must necessarily be decided on a case-by-case basis.
The need of an efficacious framework for group insolvency has become all the more important since the onset of COVID-19 pandemic. The effects of pandemic have posed challenges of various nature at economic, societal and individual levels including survival threats to many group companies and conglomerates and has pushed some of them to proceedings under the IBC.

Interestingly, the recent amendments to IBC in the year of 2021 have not dealt with group insolvency, and therefore it will be noteworthy to see how the suggestions of the working group, are placed as a legislative proposal before the Parliament, hopefully in the near future.
India as we know it today, not only stands at the threshold of becoming one of the most progressive nations in the world but has also proven its business strength by engaging its financial activities in multiple jurisdictions through subsidiary holdings as the most preferred format of expansion. In fact, India stands at number 20 out of 190 countries in the related transaction party index.\(^1\) Indian law like most others has elaborate business and commercial laws protecting the rights of all the stakeholders involved in the business, be it shareholders, investors, debtors, creditors, employees, and employers. Recognising the risk of failure that looms large on any business house, the Insolvency and Bankruptcy Code, 2016 (IBC/Code) was enacted in the year 2016.

The current Code is said to be based on the concept of ‘separate legal entity’ birthed from the famous case of Solomon v. A Solomon & Co. Ltd.\(^2\) According to the doctrine, the business entity has a separate existence and identification of its own distinct from its members and stakeholders. There essentially lies a ‘corporate veil’ between the entity and key management personnel and owners. Not only the owners and stakeholders but all different corporate bodies within a single group company hold their separate legal existence even though they continue to function as a single economic entity, most commonly known as a ‘group enterprise or group of companies’. A company is a highly flexible form of vehicle for carrying on business, whether profit or not-for-profit. Incorporation and registration of a company according to the provisions of the Companies Act, 2013 (previously 1956) vests it with a corporate personality distinct and independent from its members. It thus becomes a separate entity capable of suing and being sued.\(^3\)

Under the Code, the insolvency process is also based on this premise. Meaning hereby, if one entity named ‘X’ in a group of companies stands on the cusp of insolvency then the proceedings will be initiated only against that entity and not the enterprise as a whole. This often leads to the key management staff and the board of directors to misappropriate funds and assets to their other subsidiary companies or entities in an enterprise strongly affecting the rights of the shareholders and the creditors. It is a widespread business practice for group entities to regularly engage in related party transactions such as inter corporate loans, cross collateralisation, and significant influence arrangements. While such structures largely respect the separate legal status of the group companies, practice suggests such interlinkages in business, operations and management often raise significant challenges when individual group entities become insolvent.\(^4\) There are several cases where
the corporate debtor (CD) undergoing corporate insolvency resolution process (CIRP) has business models that are inextricably linked to other sister/subsidiary/parent companies. In such cases, the objectives of the Code have not been realised in full due to the absence of a framework in law for bringing the defaulting groups companies under the same CIRP. These include, but are not limited to, Bhushan Steel, and Bhushan Energy; Jet Airways, and Jet Lite; Monnet Ispat and Energy Limited, and Monnet Power Company Limited; Adhunik Group of companies.⁵

Prominent cases that highlighted the need to lift the corporate veil for group entities in certain situations and regulate the insolvency of groups include the IL&FS Group, which involves 169 group entities, Videocon group, Sachet Infrastructure, Amtek Auto, Jaypee group, etc.⁶

Whether or not group insolvency proceedings can take place still remains a gray area in Indian law. Sometimes, the judiciary has even used the ‘doctrine of lifting the veil’ to remove this difference between the entity and its other sister concerns. The Supreme Court of India in *Life Insurance Corporation of India v. Escorts Ltd & Ors.*⁷ observed that the corporate veil can be lifted in cases where the associated companies are connected to each other in such a way that they are a single concern depending on the provisions of the law and the objects to be achieved. However, in *State of Uttar Pradesh v. Renusagar Power Co. & Ors.*,⁸ it was also held that the corporate veil may not be always lifted but has become more transparent in modern company jurisprudence. Thus, leaving a gap for discretion in the said matter. This means that in some exceptional cases, the courts will disregard the rule of ‘separate legal entity’ and instead consider who the real people are behind a particular organisation.

While the jurists and economists across the world have realised the risks and complications involved in the insolvency proceedings based on the premise of ‘separate legal existence’ so much so that the UNCITRAL Legislative Guide on Insolvency Law on Treatment of Enterprise Groups in Insolvency (UNCITRAL Guide)⁹ also suggests that such group corporate structures lead to various difficulties in insolvency proceedings such as expenditure of money and time to differentiate the layers of related transactions between the group companies, non-commercially viable transactions outside the group companies, ignorance of high intra group transactions, etc.

To address this issue, the Insolvency and Bankruptcy Board of India constituted the Working Group on Group Insolvency (WG) under the chairmanship of Shri U.K. Sinha. The WG in its draft Report proposed a procedure for initiating group insolvency proceedings in India so that the group can be restructured, and the combined assets of the group company result in better value maximisation of the corporate group, as a whole.

**THE LEGISLATIVE AND JUDICIAL STAND ON THE ISSUE**

Although IBC doesn’t recognise the single economic entity concept, another important legislation of the business & commercial laws in India, the Companies Act, 2013 recognises the concept of a single economic entity. Thereby, the parent companies must file
consolidated financial statements for all their subsidiaries. This mandate is listed under section 129(3) of the Companies Act, 2013. It reads as:

Where a company has one or more subsidiaries or associate company, it shall, in addition to financial statements provided under sub-section (2), prepare a consolidated financial statement of the company and of all the subsidiaries and associate companies in the same form and manner as that of its own and in accordance with applicable accounting standards, which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2).

Interestingly, the Competition Commission of India in many cases has also accepted the principle of a single economic entity. It has often been observed that internal agreements between subsidiaries of the same economic group cannot be challenged for anti-competitive practices under the Competition Act, 2002.

Coming to the judicial point of view it’s a settled law that the doctrine of lifting the corporate veil should be used judiciously and sparingly. It has often been held that cogent evidence or proof has to be led to convince the Court that a particular company holds certain subsidiaries/enterprises. In Vodafone International Holdings BV v. Union of India, it was observed that for considering the group companies as a single entity, it must be essentially shown that the core activities of the company are controlled by the parent company.

Maybe the IBC not recognising the concept of group insolvency lies in the judicial precedents of not resorting to piercing the corporate veil in the winding up proceedings of the holding companies. With group structures holding prominence in the business aspects of India, there has been a gradual need to outline and frame a comprehensive group insolvency framework. There are situations where the stakeholders may expand their interests and the chance of revival of organisations might become higher if organisations in a group are settled and resolved together. However, IBC doesn’t conceive a structure to either synchronise indebtedness procedures of various organisations in a group or to resolve their insolvencies together.

In one of the oldest cases, Shri Ambica Mills Ltd., Re, the court emphasised that when company officers commit criminal acts of fraud, the court has the power to cut through the red tape and get to the heart of the matter.

However, slowly but surely, the trend is changing, and the National Company Law Tribunal had laid the foundation stone for this changing trend leading to initiation of group insolvency proceedings through one of its orders of the principal bench in Venugopal Dhoot v. State Bank of India & Ors. This is a landmark order as it directed the hearing of insolvency proceedings for various different group companies of the Videocon group to be heard by the same Adjudicating Authority (AA) to avoid any conflict of orders at the request of the parties in the matter.

In yet another landmark order in State Bank of India v. Videocon Industries Ltd. & Ors., the AA ordered the substantive consolidation of the assets of the thirteen Videocon companies in pursuance of the common directors, common assets and the singleness of
the economics of units. This ruling, in essence, laid the building blocks for introduction of the group insolvency regime in India, and the introduction of the single economic entity principle in the IBC.\textsuperscript{13}

Following this trend, many similar orders were passed by the tribunals and judicial forums in the country such as the insolvency proceedings of the (a) Lavasa Corporation Ltd., Warasgaon Assets Maintenance Limited and Daswe Convention Centre Limited, (b) Aircel Group, (c) Essar Steel India Limited and others.

Thereby, leading to the WG being constituted to assess the viability for introduction of group insolvency regime in India who submitted the report with a draft framework whose thrust was based on ‘facilitation’, ‘flexibility’ and ‘choice’.\textsuperscript{14}

The WG primarily considered three elements,\textsuperscript{15} those are-

(a) Procedural coordination mechanisms,
(b) Substantive consolidation mechanisms, and
(c) Rules for perverse action behavior of companies in a corporate group.

Considering that India is at a very nascent stage in adopting the process of group insolvency, WG recommended the implementation of the framework in phases, with reforms in the procedural mechanisms in the first phase. In furtherance of this approach, the WG also recommended that the framework should initially be applied only to companies in a domestic group, and subsequently extend it to cross-border group insolvency and substantive consolidation after taking into account the success rate of the first phase.

The WG in its report has also considered the judicial burden and backlog the country is already facing and thus has recommended a single AA to overlook the insolvency of a group of companies. This will not only help in reducing costs but also de-clogging the judiciary in the long run. However, this is yet to be practically tested and owing to the already established procedural laws in our country, this development could also face jurisdictional problems.

Before starting off with the three phases of implementation, the WG aimed at defining the term ‘corporate group’ to avoid leaving the interpretation at the discretion of the AA. The WG analysed definitions of ‘group company’ in different Indian and global enactments or legislations like, Foreign Direct Investment Policy, the Competition Act, 2002, regulations issued by Securities and Exchange Board of India, the Companies Act, 2013, European Union Regulations on Insolvency Proceedings and UNCITRAL Guide. In such a manner, the WG perceived that the rules of ‘control and ownership’ are common over every one of these enactments. It was put forward by the group that the meaning of corporate group ought to incorporate associate, holding and subsidiary organisations and if an organisation isn’t covered within the said definition and yet is characteristically connected to frame some portion of a group in a ‘commercial understanding’, at that point the AA may include such company for the group of companies.\textsuperscript{16} Thus, a ‘corporate group’ be defined to include holding, subsidiary and associate companies.
To ensure maximum coordination amongst the stakeholders, the WG procedural coordination mechanisms are rules which coordinate the ‘procedure’ of insolvency keeping the assets of the group separate. This includes coordination and cooperation between courts, the appointment of a single insolvency representative, information-sharing negotiations, etc. The adoption of procedural coordination mechanisms is recommended by the UNCITRAL Guide and World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes, 2016.17

The teachings of the WG were followed in a number of instances.

The Hon’ble Supreme Court, in the matter of *Jaypee Kensington Boulevard Apartments Welfare Association and Ors. v. NBCC (India) Limited and Ors*18 has among other issues looked at the assets of a 100% subsidiary Jaypee Healthcare Limited (JHL) of the CD Jaypee Infratech Limited (JIL) for a proper resolution and taking care of resolution of the CD in order to take care of the interests of the creditors of the CD, who are among others homebuyers allotted flats by the CD.

It was held that ‘...137. Indisputably, the corporate debtor JIL owns 100% equity shareholding in JHL which has three operational hospitals in the State of Uttar Pradesh...’. Viewed from the angle clarified in the mentioned text of the judgment, the shareholding of the CD in the Respondent No. 2 company, is over 97% in the asset of the CD and should therefore be part of information memorandum. Thus, there exists a cogent case of undertaking joint CIRP.

Also, in *Edelweiss Asset Reconstruction Co. Ltd. v. Sachet Infrastructure Pvt.*19 various entities had pooled their land for development of a township and consequently, it was held by the Hon’ble National Company Law Appellate Tribunal that in such a situation, a group insolvency approach has to be adopted.

The Hon’ble Supreme Court in *ArcelorMittal*20 opined on lifting the corporate veil in the following words:

29. The opening lines of Section 29A of the Amendment Act refer to a de facto as opposed to a de jure position of the persons mentioned therein. This is a typical instance of a “see-through provision”, so that one is able to arrive at persons who are actually in “control”, whether jointly, or in concert, with other persons. A wooden, literal interpretation would obviously not permit a tearing of the corporate veil when it comes to the “person” whose eligibility is to be gone into. However, a purposeful and contextual interpretation, such as is the felt necessity of interpretation of such a provision as Section 29A, alone governs. For example, it is well settled that a shareholder is a separate legal entity from the company in which he holds shares. This may be true generally speaking, but when it comes to a corporate vehicle that is set up for the purpose of submission of a resolution plan, it is not only permissible but imperative for the competent authority to find out as to who are the constituent elements that make up such a company. In such cases, the principle laid down in *Salomon v. A. Salomon and Co. Ltd.* [1897] AC 22 will not apply. For it is important to discover in such cases as to who are the real individuals or entities who are acting jointly or in concert, and who have set up such a corporate vehicle for the purpose of submission of a resolution plan.
Group insolvency has discovered its way in India through courts and now, discovering its way into the legal books.

**ISSUES AND CHALLENGES WITH GROUP INSOLVENCY**

(a) Monetarily independent organisations with a massive turnover being dragged in the insolvency because of the group members is going to affect the economic situation of not only the business owner but its employees, investors, and shareholders. For instance, in the famous Videocon Case, KAIL Ltd. was one of the fifteen Videocon group entities which were requested to be consolidated. The court chose to keep it out of the union or consolidation since KAIL Ltd. was an independent and self-sufficient organisation with an immense turnover and was autonomously equipped with keeping up itself as a going concern.

(b) Right now, the cross-border group insolvency and consolidation has not been rolled out but as and when it is, in the cases of multinational conglomerates, there might be coordination problems with foreign representatives, and taking custody or control of foreign assets would be difficult.

(c) Linked to the above issue, the conglomerates raise loans from creditors spread over various jurisdictions and forming a committee of creditors (CoC) with representatives from various jurisdictions may be a challenge. A cross-border guidelines may be facilitative in addressing the issue.

(d) Even though WG has extensively dealt with the procedure and its implementation in a phased manner, there are some things that need more explanation and precision. For instance, there is vagueness surrounding the definition of ‘corporate group’ and the jurisdictional problems that could crop owing to the single AA mechanism.

It is evident that value can be destroyed unless the CDs with inter-linkages are subjected to consolidation, across the stages of appointment of Resolution Professional, conduct of business before CoC and selection of resolution applicant. Else, significant value, time and efforts are wasted aligning the different stakeholders and in endless litigation, as already been seen in a few cases struggling from pendency of multiple interim applications. Given that value maximisation and continuation of business are key objectives of the IBC, it is imperative to approach such CIRPs in a consolidated manner. Moreover, the negotiation power of the creditors through joint resolution is expected to be much stronger than standalone resolution.\(^{21}\) Further it will address the issue of arbitrage of assets between group entities and address the issue of financial frauds being carried out.

**CONCLUSION**

All in all, WG Report is worth the effort and must be implemented in a phased manner. Although, a certain threshold must be determined, or the definition ‘corporate group’ should be categorised in a manner to create classes of enterprises and the situations in which group insolvency is viable. Group insolvency might be the ideal way in some cases...
but at the same time one should tread carefully keeping in mind the conditions applicable to them.

We also have to understand that IBC is a relatively young legislation in India. It does not provide for specific arrangements and provisions identifiable for Group insolvency. The Courts have up till now carried out this burden through judicial interpretations/legal translations in handling the cases.

However, a student of law and economics looks at insolvency reform from a much deeper perspective. One believes that every economic actor has bounded rationality and cannot anticipate all possible contingencies. That is why it enters into contracts and renegotiates and modifies its terms, as and when circumstances change, and yet every contract at any point of time remains an incomplete one, with gaps and missing provisions.  

It will slowly but surely evolve with time to cater to the ever-changing needs of new India.

2. (1897) A.C. 22.
5. Ibid.
6. Ibid.
12. M.A 1306/ 2018 & Ors. in CP No. 02/2018 & Ors.
17. Supra Note 13.
It is well recognised that the time is the essence of any resolution process. Any undue delay in resolution can yield negative returns, and rate of such diminishing return can be exponentially high with the passage of time. Such unintended outcome goes against the principles of value preservation and value maximisation. The objective of timeliness of the insolvency process has been under scanner and has emerged as a major concern of all the stakeholders within the Insolvency and Bankruptcy Code, 2016 (IBC/Code) ecosystem. The corporate insolvency resolution processes (CIRPs) that resulted in resolution till March 2022, on an average, took 450 days till conclusion against the mandated period of 180 days extendable to 270 days or 330 days (inclusive of period involved in litigation). Similarly, the processes resulting in liquidation order, took 412 days on an average. Liquidation processes lasted 456 days whereas voluntary liquidations lasted 422 days on an average. Delays under IBC have necessitated the quest for alternative mechanism(s).

The inordinate delays on account of various reasons exacerbate the uncertainty around the successful resolution of the corporate debtor (CD) and eventually lead to high haircuts to the creditors and other stakeholders. Of late, average haircuts have risen to nearly 65% during last about two years, though there are other contributing factors as well.

Though IBC and regulations made thereunder envision a non-adversarial framework, timelines have been prescribed for almost all key activities. Yet it is observed that timelines are directory and not mandatory, as has been adjudicated by several landmark judgements including by Hon’ble Supreme Court. Moreover, National Company Law Tribunal (NCLT) benches are bound to adjudicate upon every application filed by any stakeholder, even if found frivolous in nature at a later stage. Such adjudication process coupled with counter litigation and multiple appeals, result in unending delays defeating the sacrosanct objective of timeliness.

As per a study undertaken by the Indian Institute of Insolvency Professionals of ICAI (IIPI) during 2020, every CIRP on an average takes three litigations, involving 113 days and costing about ₹ 18 lacs, which is an eye-opener. Moreover, the data shows that currently 66% of the ongoing cases (1852 nos.) have been running past 270 days’ norm.
The Standing Committee of Finance in its recent report on ‘Implementation of IBC – Pitfalls and Solutions’, though without referring to mediation mechanism, has noted as follows:

It is a matter of grave concern for the Committee that the insolvency process has been stymied by long delays far beyond the statutory limits. It is disconcerting that even admission of cases in NCLT has been taking an unduly long time, which thus defeats the very purpose of the Code. There have also been instances of frivolous appeals, which further drags the resolution/recovery process leading to severe erosion of asset value. The committee would therefore recommend that misuse/abuse of well-intended provisions and processes should be prevented by ensuring an element of finality within the statutorily stipulated period without protracted litigation.4

Disputes and disagreements among stakeholders in any insolvency resolution are common and cannot be brushed aside in the interest of natural justice. For viable solution, focus therefore needs to be on creating an additional, effective, and efficacious dispute resolution mechanism, keeping in mind the cardinal legal principles of natural justice. The public debate often alludes to sprucing up the capacity of NCLTs as one viable solution. However, it cannot be a lasting solution since the volume of litigation shall catch up with increased infrastructure sooner than later. The solution, as an out-of-box approach, may lie in resorting to out-of-court processes with blessings of legislative recognition and hence mediation as Alternative Dispute Resolution (ADR) mechanism can come to the rescue and ensure speedier resolution of disputes. This would unburden judiciary greatly to be able to focus on substantive matters of resolution. The added advantage of ADR mechanism can come from availability of pleadings, documents/reports, and expert opinions to NCLT benches.

Mediation can be seen as such an alternative method of resolving business disputes outside the formal court of law. It is a facilitative and consultative process which helps the concerned parties resolve disputes in a non-confrontational way. As the parties are guided by the expert mediator to arrive at a mutually acceptable solution, such parties are usually more satisfied with the outcomes. Besides, they can sustain their business relationships. Confidentiality is also a quintessential element in mediation, unlike in-court proceedings. There are various models of mediation that can be adopted depending upon nature of dispute viz.:

(a) Facilitative mediation
(b) Evaluative mediation
(c) Court-mandated mediation
(d) Transformative mediation

Mediation can only commence when all parties involved voluntarily agree to the same. During a typical mediation process, disputing parties will be given opportunities to voice their issues and concerns. The mediator then guides them towards resolution of these issues, facilitating the negotiation to reach a mutually acceptable solution. Depending on the situation, the mediator may interact with each party separately. The mediation sessions
are held confidentially. There are no transcripts or formal recordings of the session. Only the mediator, the parties and/or their authorised representatives are usually allowed to be present during the proceedings. Upon reaching settlement/agreement, the terms and conditions are recorded and signed by the concerned parties. Such agreement is a contractual document and is binding on them. It can be converted into a court order (subject to enabling provisions) which are enforceable in the court of law, if warranted, even if both parties did not commence any legal proceedings in the first instance.

**MEDIATION - A PREFERRED OPTION OVER ARBITRATION**

Often the two terms ‘Arbitration’ and ‘Mediation’ are used in connection with ADR. These are, however, different in approach:

(a) In mediation, a neutral third party aims to assist the parties in arriving at a mutually agreeable solution whereas arbitration is like a litigation which is outside the court, and which results in an award-like order.

(b) Mediation is not binding on the parties whereas arbitration is binding per-se.

(c) Mediation is more collaborative; arbitration is more adversarial.

(d) The process of mediation is more informal than that of arbitration.

(e) The outcome in mediation is controlled by the parties whereas in arbitration it is controlled by the arbitrator.

(f) In mediation, the dispute may or may not be resolved whereas in arbitration it is always settled in either party’s favour.

The advantages of mediation particularly in resolving commercial disputes over arbitration are well appreciated given the obvious benefits as follows:

(a) Speedier and cost-effective mechanism compared to litigation

(b) Sustain the business relationships through relatively non-adversarial approach

(c) Addressing the underlying stigma attached to insolvency, in view of confidentiality

(d) Flexible and more controllable over court-driven processes

(e) Results in solutions acceptable to all, obviating the need of further appeal(s)

**INTERNATIONAL EXPERIENCE**

Though the contemporary international institutions focused ADR on commercial disputes for decades, mediation in insolvency cases has emerged as an option only in about last decade or so. The World Bank in 2001, developed the ‘Insolvency and Creditor Rights Standards’ (ICR Standards). The focus, however, was on judicial proceedings. The possibility of resorting to mediation was only considered as the residual process. In 2005,
Mediation as ADR Mechanism to Fortify IBC

United Nations Commission on International Trade Law (UNCITRAL) also developed the ‘Legislative Guide on Insolvency Law’, which also focused on court proceedings.\(^6\) In the context of expedited reorganisation proceeding, the informal and out-of-court voluntary restructuring mechanism, was considered as the subject matter of the court’s supervision.

Following the financial and economic crises in 2008 and the one caused by the COVID-19 pandemic (2020/2021), insolvency law has also been applied to small and medium-sized enterprises and private individuals in many countries globally. As a parallel development however, international mediation was gaining momentum, a trend noted by the European Union in its 2019 directive on ‘preventive solutions are a growing trend in insolvency law’.\(^7\) The increasing attention paid to mediation since 2015/2016, led UNCITRAL to issue a document on the insolvency of small and medium-sized enterprises and a document on the use of mediation in ‘Investor State Dispute Settlement’ as late as in November, 2020.\(^8\)

The experience across several developed markets is enunciated in following paras:

**United States**

U.S. has been at the forefront of applying mediation at various stages of bankruptcy proceedings like claims, creditors’ disputes, resolution plan, avoidance transactions, cross-border, and group insolvency. In 1998, U.S. Congress passed the Alternative Dispute Resolution Act. Over half of U.S. bankruptcy courts explicitly authorise mediation.

**United Kingdom**

The Chancery Courts Guide encourages the use of ADR methods, particularly mediation. It imposes an obligation on legal representatives to consider the use of ADR methods and keep their clients informed of cost-effective means of resolving disputes. The courts generally do not order parties to mediate, however, if parties are unreasonably refusing to attempt ADR, then the court may direct the parties to take reasonable steps to consider ADR.\(^9\)

**Australia**

Section 53A of the Federal Court of Australia Act, 1976 enables courts to refer parties to mediation with or without their consent. The Civil Dispute Resolution Act, 2011 mandates filing of ‘Genuine Steps Statement’ before filing an application in a Commonwealth Court. The statement must specify the steps that have been taken to resolve the disputes between the parties or the reason for not doing so.

**Japan**

In Japan, Turnaround ADR mechanism was established in 2007 as a process to facilitate negotiations between distressed debtors and its financial creditors under the supervision of licensed mediators. The Japanese Association of Turnaround Professionals (JATP) is the only body permitted to mediate turnaround cases. A panel of three mediators is appointed
to oversee the process: one lawyer, one accountant and one consultant or another lawyer.

**Singapore**

While mediation has not been used extensively in restructuring cases in Singapore so far, steps have been taken there to encourage the use of mediation in insolvency proceedings. In 2015, ‘the Committee to Strengthen Singapore as an International Centre for Debt Restructuring’ recommended that Courts should encourage parties to take recourse to mediation to resolve disputes. It is also recommended that panels of mediation bodies should include expert mediators with experience in cross-border restructuring.¹⁰

**INDIAN EXPERIENCE**

In the Indian context, though there are no specific provisions for mediation/arbitration in IBC, following provisions have some resemblance to mutual settlement or agreement outside courts:

(a) Section 12A (inserted via amendment in 2018) allows the Adjudicating Authority to approve withdrawal of insolvency proceedings by the original applicant, with the approval of 90% voting share of the committee of creditors.¹¹

(b) Prepack framework (PPIRP) for micro, small, medium enterprises (MSMEs) allow the CDs to initiate, in consultation with lenders, a prepack insolvency resolution process, as largely out-of-court process. Towards the end, court can be approached to grant, subject to checks and balances, the legal sanctity to the resolution plan agreed upon. Once commenced, PPIRP allows the erstwhile management of CD to remain in saddle to have the effect of ‘debtor in possession’ model.¹²

Till June, 2022, 643 CIRP cases have resulted in withdrawal of applications, whereas 774 cases have resulted in closure including via settlement. These numbers are significant, when compared to overall 3637 cases concluded so far and 1999 ongoing cases at the end of June, 2022. Another interesting data to note is that so far 22411 applications involving ₹ 7.10 lakh crores have been resolved even before getting admitted, indicating a behavioral shift in stakeholders because of IBC.¹³

The Arbitration and Conciliation Act, 1996 provides for conciliation process which is like mediation. Conciliation can be seen as a confidential and voluntary dispute resolution process in which an independent expert helps the parties reach a negotiated and mutually acceptable agreement. As per section 73 of the Arbitration and Conciliation Act 1996, upon signing the agreement by the parties, it shall be final and binding on them.

At present, there are two ways to initiate mediation proceedings in India namely, private mediation and court-referred mediation. Several statutes also provide for mediation as a method of resolving disputes. Private mediation has failed to garner support due to the lack of a regulatory framework on the enforceability of the settlement reached through this process. Court referred mediation has also not been effective so far. The insertion of section
89 via the 2002 amendment to the Code of Civil Procedure, 1908 (CPC) failed to provide impetus to mediation in India because of certain ambiguities or drafting errors under section 89 of the CPC, such as lack of clarity on the use of phrases like ‘judicial settlement’ and ‘mediation’ as highlighted by the Supreme Court in Afcons Infrastructure Ltd. v. Cherian Varkey Construction Co. (P) Ltd. The provision does not provide for the appropriate stage for referring the matter to mediation. Further, there is lack of uniform rules of procedure governing mediation; thus, proceedings take place as per the rules prescribed by each High Court. All these factors have caused impediments in reaping its full benefits.

The Companies Act, 2013, the Micro, Small and Medium Enterprises Development Act, 2006, the Industrial Relations Code, 2020 etc., provide for mediation as a means of dispute resolution mechanism. However, these processes are unregulated at the pre-litigation stage while at post-litigation stage, these cases are governed by the CPC.

**THE WAY FORWARD**

Underlying principles and international experience show that mediation can be gainfully used under the IBC to address disputes in the following areas:

(a) Before commencement of insolvency proceedings
(b) For settlement after admission of CIRP
(c) In prepack processes for MSMEs
(d) Verification of claims
(e) Disputes relating to assets of CD
(f) Third party disputes
(g) Post-approval of resolution plans
(h) Avoidance actions (other than involving element of criminal offences)
(i) Matters involving features of cross-border and/or group insolvency

The Mediation Bill, 2021 referred to the Standing Committee on Personnel, Public Grievances, Law, and Justice seeks to promote mediation, particularly institutional mediation, and provide a mechanism for enforcing mediated settlement agreements. The draft bill provides for establishment of the Mediation Council of India, promotion of private, online and community mediation as an acceptable process, enforcement of the successful outcome of the mediation in the form of ‘mediation settlement agreements’, and international mediation.

The Bill requires parties to try to settle civil/commercial disputes through mediation before approaching any court. The mediation process must be completed within 180 days, which may be extended by another 180 days by the parties. Agreements resulting from mediation will be binding and enforceable in the same manner as court judgments. The effectiveness of proposed framework is however impacted as unwilling parties can resort to section
26(1) of the draft bill, wherein parties can withdraw from mediation proceedings after communicating with the mediator.

Currently, under the IBC, there are provisions related to moratorium which mandates the ongoing civil legal proceedings to be stalled until conclusion of CIRP or liquidation process. These statutory provisions would need to be modified appropriately to make way for mediation-related provisions including making mediated settlements binding and enforceable. Roles, rights, and responsibilities of professionals/stakeholders in such processes would need to be thought about and clarified. Besides, there is a need to create awareness about mediation for stakeholders in the insolvency ecosystem. Correspondingly, the mediation practitioners and institutions would need to be created apart from their capacity building. In the final analysis, mediation as an ADR mechanism is quite an enabler to fortify the IBC.
The Insolvency and Bankruptcy Code, 2016 (IBC/Code) is a landmark legislation, providing remedies not only for corporates but also for natural persons who are indebted in various ways. Part III of the Code, which pertains to this latter category of natural persons, is for the most part yet to be notified. It outlines traditional resolution mechanisms like the ‘insolvency resolution process’ and the ‘bankruptcy process’, and also the unique ‘fresh start process’ (FSP). The FSP is a low-cost quasi-bankruptcy process applicable for low-income, asset-light debtors holding minimal debt, and allows for a complete discharge of their debt provided they satisfy certain economic and procedural criteria.

While the reasons for the delayed notification of Part III have not been formally disclosed, it is possible to conjecture that they have to do with the rather more complex issue at hand in Part III, relative to Part II, which deals with corporate insolvency. Personal insolvency cases are categorically different from corporate insolvency cases, because the later make for a context where both the creditor and the debtor can be treated as economic entities alone, and therefore the matter of insolvency can be solely adjudicated in terms of a market-based logic, whereas the former implicates, at least on the debtor’s side, the rather more complex (and thorny) matter of a human subject who is in distress. Policymakers must therefore contend not only with how the workings of Part III will impact credit markets and the wider financial system, but also with the ethical question of whether a natural person deserves relief in some form and if so, why.

The dilemma is not unlike that faced by the moneylender Shylock in Shakespeare’s ‘The Merchant of Venice’. In the play, Shylock has advanced credit to Antonio, and Antonio is unable to repay because his commercial venture has failed. The debt contract requires that Antonio repay Shylock instead with a pound of flesh from his heart. Shylock understands the human tragedy that must unfold if he demands that the contract be honoured, yet is unable to forgive the debt because then he will have created moral hazard for himself and his fellow moneylenders who will ex-communicate him from their tight-knit community. Here, we have one natural law – the law of the market that would cause debt forgiveness
to encourage reckless borrowing – grating implacably against another – the primacy of preserving a human life that has not committed a sin of violence upon another human life. How is this unyielding tension to be resolved? The answer is not only not obvious, but rather appears impossible.

In this essay, the authors take up this dilemma for consideration, not with the conceit of being able to resolve it conclusively, but with a view towards providing perspectives that may help us get closer to a resolution. These perspectives help because they provide arguments for clemency, mercy, and forgiveness – none of which qualities the market intrinsically rewards. Our submission is that perspectives like these are needed to illuminate some of the thorny issues implicated in Part III of the IBC so that Part III can be brought closer to being notified.

The authors, in the next section, start by tracing the historical treatment of natural persons deemed to be debtors in default, and the discourse on the protections afforded to such debtors in bankruptcy cases. Here, the authors also include a metaphysical reading of financial capitalism over the course of the last 60 or 70 years. Such a reading is relevant here because it highlights the critical role that debt plays in fuelling the entire economic system at the regional, national and global levels, and the implications of such a role for the nature of the human subject who does not so much rest as fidgets restlessly at the centre of this drama.

The authors then move on to discuss perspectives that would allow us to provide some respite to the figure of Shylock. The authors cover the human rights approach, the capabilities ‘approach’, and finally, an approach they shall call trans-humanism. Collectively, their presentation of these approaches constitutes a philological and philosophical commentary on insolvency and bankruptcy law. The authors are not arguing for the primacy of any one of these perspectives over the other two, but rather aim to present all of them as equally available for consideration by policymakers who are wrestling with some of the subtler, more complex issues implicated by the matter of personal insolvency.

FROM ANCIENT BANKRUPTCY LAW TO MODERN DAY FINANCIAL CAPITALISM

It is widely accepted that the history of insolvency and bankruptcy procedures (bankruptcy law) dates back to the origins of credit, and their presence in modern formal law ‘dates back to the biblical era’ (Levinthal, 1918). Over time, bankruptcy law has evolved significantly from the phenomenon of ‘debt slavery’ during classical antiquity (Levinthal, 1918) to the simultaneous inventions of ‘debt discharge’ (Tabb, 1991) and ‘capital punishment (for fraudulent defaulter)’ (Kadens, 2010) in 1705 England. Subsequently, capital punishment was indeed abolished, and more debtor-friendly approaches, like the modern-day FSP, were also introduced.

This is mostly a history of the ‘West’, as it were, and it is the Western legal canon to which the origins of India’s bankruptcy law may also be traced. Therefore, confining ourselves to
Europe from antiquity to the modern period, and then folding in its colonies including the USA during the modern period, and finally also considering American-style capitalism in the 20th century, we trace four distinct temporal phases in this long arc of development of bankruptcy law. We find, though, that the fundamental underpinnings have remained the same in all this time, i.e., in the event a person is unable to pay their debts, the creditors have a right to seize all (or a portion) of the debtor’s assets and (or) the debtor’s future incomes as well. The tradition of common law that spread around the world during the modern era did not break with earlier epochs in almost always privileging the creditor’s rights over the debtor’s, if not de jure then certainly de facto.

The first of the four phases we delineate spans the period of classical antiquity (ranging from 8th century BC to 1st century BC), when indebtedness was a rarity and therefore bankruptcy law did not exist in any concrete sense (Levinthal, 1918). Yet, where indebtedness and subsequently insolvency did appear, the norms seemed to favour the creditor over the debtor. Thus, the State apparatus (if one can imagine such a thing for antiquity) stood by in acquiescence as creditors deployed various strategies to recover what was owed to them. These could take the form of attempts to guilt the debtor, for instance, by remonstrating in front of the debtor’s house threatening to fast until death if repayment were not made. Or, in more extreme cases, and with the State bearing witness, the creditor could even enslave the debtor and their family (Levinthal, 1918; Tabb, 1991). Indeed, almost all European (especially Greco-Roman) societies in antiquity sanctioned some form of debt slavery (Levinthal, 1918).

The various strategies used to resolve insolvency during the first phase did not have formal legal sanction. Rather, they were rooted in some form of pagan religiosity or another, from which the State (in whatever form it existed at that time) also drew its power and legitimacy. Rome was perhaps the only exception to this rule, since the Twelve Tables of BC 450-451 did encode debt slavery into formal law. The wider spread and consequent amalgamation of Roman law with those earlier practices marks the second distinct phase of historical development of bankruptcy law that we can identify, crystallizing around the 1st century AD and continuing for almost 15 centuries thereafter. During this long duration, a creditor’s presumptive right to possess the defaulting debtor’s person now received formal legal sanction, but also came to be circumscribed, only in the cases of individual debtors who held certain kinds of political offices. In ancient Rome, creditors had to approach the senate and prove the unpaid status of the debt, whereupon they were ‘granted by the Praetor a missio in possessionem (receiving order)’ against the debtor’s property. This practice may be said to have laid the foundations of modern-day principles surrounding the acquisition and auction of the bankruptcy estate. But even into the 16th century, the punishment for a defaulting debtor who did not enjoy some kind of privileged political status remained legally sanctioned slavery and even though formal law did not sanction death, it did not rule it out either, allowing creditors to inflict injury upon their enslaved debtors even to the point of death, as in Shakespeare’s play (which is set in the latter half of the 16th century in Italy).
The year 1542 AD, during which the first statute under English law to deal with insolvency and bankruptcy was passed, signals the beginning of the third phase, and this phase continues till the late 18th century. It is distinguished from earlier phases by the advent of rational-legal principles offering some protections to the debtor (Carlos, 2019). The most important of these was the principle of debt discharge, introduced in 1705 in England, that would allow insolvent and bankrupt debtors to be discharged from their liability to repay, subject to certain provisions (Carlos, 2019). Paradoxically, however, the same year also witnessed the introduction of the death penalty in cases of fraudulent bankruptcy. This provision remained on the books till the early 19th century, i.e., for the entire third phase by our reckoning, but was rarely invoked. The fourth and the last person to be hanged for fraudulent bankruptcy was in 1813 and before that the last hanging had occurred in 1761. Finally, in 1820, the death penalty was abolished through an omnibus death penalty reform bill (Kadens, 2010). A notion of equity was also legislated during this third phase, directing the proceeds from the sale of the bankrupt’s estate to be distributed amongst the various creditors according to the ratio of the quantum of debt owed to each creditor.

The fourth phase, starting around the turn of the 19th century and continuing till the present day, coincides with 200 plus years of capitalist development. As such, the fourth phase is distinguished from earlier phases by its moulding and shaping of the rational-legal principles that had begun to ground bankruptcy law in the third phase, towards a fuller maturity and in the service of continuous capitalist innovation and growth, which is a unique feature of the modern period. The authors will elaborate this phase in a little more detail than what they have done the previous three, and will do so in two distinct but related registers. First, it will be important to understand those aspects of modern bankruptcy law that make it truly modern, and this will constitute the first register. Here, the authors argue that while the third phase introduced debt discharge, it is the advent during the fourth phase of explicit protections for the debtor’s assets and cashflows that represents the big step forward in bankruptcy law. But equally importantly, and second, the authors wish to argue that even though the step forward substantially elevates a debtor’s rights from its earlier subordinate status in the first three phases, the actual practice of bankruptcy law appears to stumble on realizing this promise. This is the second register of their account and it will require also a tracing of 20th century capitalism to its deep structural origins in debt finance.

Restricting themselves to the common law tradition, the authors find that the earliest instances of explicit protections appeared in the first half of the 19th century in England, in the form of various legislations that offered protections not only for a debtor’s assets and cashflows but also for the debt owed in the case of small debts (an early analogue of FSP). An example of these legislations is the Bankruptcy Act, 1825 of UK which allowed debtors to initiate their own bankruptcy. In time, the various features introduced by these legislations were crystallized in the Debtors Act, 1869 of UK. It may be noted how far bankruptcy law had traversed as a result of these new features from its earlier stance of legally sanctioning debt bondage. Such a significant shift in orientation was no doubt possible because of a new understanding of human agency that modernity was able to effect, and the recognition
that flowed from such an understanding, of the debtor’s intrinsic right to dignity and freedom. Yet, even if such sentiments were the proper antecedents of modern bankruptcy law, it would appear that academic scholarship has hesitated to fully acknowledge them. Contemporary scholarly accounts of why such statutory protections are deemed necessary, sum up the situation well. According to such accounts, it is because stripping the debtor of such protections would either compromise their usefulness as productive economic agents (White, 2011), or precipitate financial crises (Fiebelman, 2009), if not wider societal unrest (Hoff, 2000; Flint, 2009). In other words, the appeal is usually to some kind of consequential logic instead of an ethical one. There is no room here to privilege mercy or forgiveness for its own sake.

The second register complicates matters even more. Several astute commentators from across the disciplinary spectrum – philosophers, economists, sociologists, anthropologists, and even religious studies scholars – have written critical accounts of the mode of capitalism that has come to characterize much of the human condition during the latter half of the 20th century and into the 21st. There is a common thread that runs through these accounts and that is the linking of the capitalist logic to a distinctively financial origin and purpose, namely the proliferation of debt at the individual, regional, national and global levels. The work of Deleuze & Guattari (1972), Foucault (1979), Goodchild (2007), Harvey (2010), Agamben (2011), Graeber (2011), and Lazzarato (2012), to name only a few, is symptomatic of this style of criticism. These authors, some of them much more explicitly than the others, draw out the implications of a key feature of the modern banking system – it can create money as credit out of thin air. They argue that this makes for a financial system with an insatiable appetite for extracting profits through credit creation, which the governmental apparatus does nothing to pre-emptively limit, since it too is implicated in a perpetual cycle of money creation to fund its own deficits. All of this is accomplished, however, by engendering on the individual debtor’s side, a moral subjectivity of guilt and even shame, making for an unceasing imperative that the debtor comes to feel, to repay their debts or be expelled from accessing credit markets altogether. At the regional, national and global levels, there is an incessant churning of debt necessitated by the logic of capitalist growth. Periodic crises, becoming ever more devastating with time, intervene as system-level corrections, at which point it becomes urgently necessary for governments and central banks to print money into circulation so as to rescue whole financial systems on the brink of collapse. But never the individual debtor, whose debt cannot be forgiven outright, because that might create widespread moral hazard, and for whom, therefore, provisions in bankruptcy law become the subject of endless debate – such as the questions of what criteria should be applied for discharging debt, or to what extent assets and cashflows might be protected, and which assets and cashflows these might be, or how the precise thresholds for a fresh start are to be arrived at, etc.

The authors reading of this fourth phase of the development of bankruptcy law points to the fundamental hurdle that Indian policymakers face in notifying the majority of Part III of the IBC. This is the hurdle of finding good a priori arguments for debt forgiveness. In the next section, therefore, the authors attempt to address this stumbling block.
IN SUPPORT OF MERCY

Irrespective of where we stand in history, whether in antiquity or in modern-day societies, human beings create economic surplus, and it is the human body (labour) through which such surpluses are extracted. The common wisdom throughout the ages has been that an indebted person must always repay their debt, whether through slavery (in antiquity) or through income (in modern society). But, often, such repayments are genuinely impossible to make. One needs to look back just two years to the onset of the COVID-19 pandemic to realise that there are many catastrophic events that can strip a debtor of their ability to be economically productive to the extent that all of their debt can be repaid. At such times, the question becomes – what ethical arguments may be advanced for a forgiving of the debt?

The human rights approach

One approach is to appeal to the ‘human rights’ framework, which in turn borrows from earlier frameworks such as those of ‘natural rights’ (according to which, nature bestows certain rights on human beings) and the ‘rights of man’ (according to which, rights are not so much bestowed by an external agency upon a person as much as they emanate from that person themselves) (Donnelly, 1982). As it stands, however, the human rights framework does not offer a fully articulated vision of debt forgiveness. In a direct sense, it affords at best protections to the debtor’s life and other liberties. One may ask, however, if such guarantees are high-resolution enough to suffice, and if they are not contingent, rather, on prior and adequate protections to economic possessions such as assets and incomes. For example, in the event of bankruptcy, if the debtor’s assets and incomes are seized to the extent of extinguishing also the debtor’s capacity to pay for any medical support that they or their family members may require to maintain healthy lives, then the incongruity of such a bankruptcy law in the face of human rights is easily exposed. Yet, low-income households, in particular, are known to forego necessary medical expenses in order to fulfil their repayment obligations, even when bankruptcy may be far from imminent. Sometimes, debt-distress will cause low-income households to take children out of school, or reduce the quality and quantity of meals. A human rights approach that is sensitive to these forms of distress and that calls them out explicitly in terms of quantifiable indicators for activating the principle of forgiveness, is yet to be formulated. A pre-requisite for formulating such an approach would be a detailed study of the phenomenon of over-indebtedness (i.e., debt-distress) via a comprehensive monitoring of credit markets by the concerned regulator. Basing itself on such a mechanism of market monitoring that provides accurate signals about distress, the law can invoke a charter of debtor rights that speak explicitly to the necessity of debt forgiveness by sorting out its conditions.

The capability approach

Next, the authors dig a little deeper. If a charter of debtor rights were to be formulated, what might give the description of rights adequate substance? Are there intellectual resources already available to us that could help? The authors believe so, and they find
them in the capability approach (Nussbaum, 2007). In this approach, a human life of dignity requires opportunities for every human being to develop a core set of capabilities (such as – a long life; good health; freedom from bodily injury; the capacity to use one’s senses, to imagine, think and reason; etc.). Nussbaum notes, ‘Producing capabilities requires material and institutional support, and the [capability] approach thus takes issue with the facile distinction of rights as “first-generation” (political and civil) and “second-generation” (economic and social).’ This material and institutional support, i.e., the enabling economic, social, political and civil environment required for an individual to develop capabilities (to maximise their potential as a human being) must therefore be the responsibility of an entity beyond that of the person. Dreze and Sen place this responsibility on the State (Dreze, 2005). It may be argued that in the specific case of India, its Constitution already provides for such a responsibility. Article 21 of the Constitution of India states that an individual has a right to ‘life’, the judicial interpretation of which includes ‘the right to live with human dignity and all that goes along with it, namely, the bare necessaries of life such as adequate nutrition, clothing and shelter and facilities for reading, writing and expressing oneself in diverse forms’. But it is not necessary to rely on the Constitution for such guidance. The capability approach is more comprehensive in its detail than Article 21, and not rooted in this or that specific historical or political context, except to broadly recommend that the political system should ideally be that of a democracy, which India certainly is. The principle of protecting, at least in part, the assets and incomes of bankrupt debtors can derive its legitimacy from the capability approach in an obvious sense. But the real opportunity in utilizing such an approach is to articulate, rather, a set of minimum standards of social protection that every citizen is entitled to, so that they may develop ‘floor-level’ capabilities, and then to legislate that those standards are not to be evacuated in the case of bankruptcy, but rather insisted upon the more strongly even as debt-distress begins to set in, so that bankruptcy may be averted altogether. Herein lies the ethics of a merciful bankruptcy regime. It is one that is always already socially responsible. The pre-requisite is again a skilful monitoring of credit markets for reliable indicators of emergent debt distress.

The transhuman approach

In the previous two approaches, the authors have made the case for an ethics of mercy on the understanding that human nature becomes tragically constrained in its possibilities by the incapacity to repay debts. In this third approach, the authors shift the ground of argument to a new domain – namely, the rootedness of contemporary financial capitalism in debt-financed exchange, and the deep structural disharmony (in terms of both disequilibrium dynamics and inequalities) that such a system breeds. The case for a merciful ethics is now transhuman, arising from the necessity of confronting system-level forces that threaten to implode a society from within.

In order to develop the argument, the authors return to the characterisation of 20th century capitalism in the previous section. The authors will closely follow, in particular, the work of Goodchild (2007, 2020) who has written, perhaps more persuasively than anyone else, about
the necessity of debt forgiveness in financial capitalism. While the authors’ historical telling has dated financial capitalism to the 20th century, it’s advent, one might argue, occurs much earlier, in the last decade of the 17th century, when the King of England effectively creates the Bank of England by issuing promissory notes in his own name that could be used thereon as bills of exchange. Thus, is created the uniquely modern and fundamental form of money as debt (or credit), guaranteed by a sovereign government and its central bank. In turn, the banking system itself becomes authorised to create money as debt, although such money is still ultimately backed by the sovereign power of the State and remains therefore a liability for the State. This sequence of events unfolds all at once, really, as soon as the fundamental form of money as debt is ‘innovated’ – but it is in the latter half of the 20th century that it finds its full expression in a post-World War II era that has abandoned the gold standard. And yet, it is also in the 20th century that the true nature of money as debt becomes occluded in such repositories of knowledge and understanding as economics textbooks, which begin to claim en masse that money is merely an instrument, such as a medium of exchange, or a store of value, or a unit of account, and therefore only a veil, with no fundamental basis in a deeper network of obligations and counter-obligations. So then, is it not obvious that such an occlusion should be prone to creating structural disharmony? The point requires further elucidation.

The disequilibrium dynamics are the more easily explained. A bank is able to create money at will because it is able to originate a loan without having first received an amount in savings equal to the amount of the loan. Simply put, the bank’s balance sheet is not first changed by an entry on the liabilities side of a deposit and then by a corresponding entry on the assets side of a loan, but rather, by exactly the reverse operation. First, the bank advances a loan and then it opens a checking account for the amount of the loan in the name of the borrower. The asset (which is the loan) is created first, and then the liability (which is the checking account). Yet, the bank’s asset, in addition to mirroring a liability on the bank’s balance sheet, is itself a liability for two other parties also – the borrower because it is debt, and the State because it is money. The creation of money is, effectively, a swapping of liabilities between three parties. The State, though, is a passive party in this swapping, since the liability is not created (or originated) by the State. It is created by the bank. Thus, unless the State exercises some veto power on the creation of such liabilities, the demand for credit (by the borrower) has the capacity for creating its own supply (by the bank). That economics textbooks are able to elide the true nature of money (i.e., debt) is merely a feature of a reality in which, in point of fact, the State has no veto power over such money creation. There is then an unstable positive feedback mechanism hard-coded into the very structure of credit markets. The system must lurch from crisis to crisis, then – as indeed, it does – and financial stability therefore becomes a critical concern for central banks. In such a scenario, it becomes necessary for debt to be forgiven periodically to relax and extinguish the build-up of over-indebtedness before it has gotten out of hand. Yet, financial stability concerns are never expressed in such terms, being centred rather on a set of prudential norms that are inadequate for choking off the dynamic’s origin point.
This begs the question – why do central banks not do what is needed? The reason is that it would also choke off the possibilities for surplus extraction. Yet, who is extracting the surplus and from whom is wealth being so transferred? Herein lies the other reason for privileging an ethic of debt forgiveness – a system of debt-financed exchange will inevitably grow and perpetuate structural inequalities. This inevitability may be illustrated with the example of mortgage debt. Consider a buy-to-let speculator who puts down some cash towards a home’s purchase and then lets it out at a rate of rent sufficient to cover mortgage interest and maintenance costs. After a few years, the home appreciates in value, and the speculator finds that that value is sufficient for the home to be sold at a price that will cover both principal and interest payments owed to the bank and still leave him with a sizeable surplus. The home is accordingly sold to a family who wishes to live in it. It should be obvious where the speculator’s surplus comes from – it comes from the new mortgage debt that is owed by the family to whom the home has been sold. In turn, this family must now speculate, because otherwise it will not be able to replenish the funds that could have gone into a pension account but must now go towards mortgage payments. The general point may now be made. The unstable dynamic referred to earlier manifests in a cycle of debt-financed speculation and rising asset prices that put asset ownership further and further out of reach of those who do not already have accumulated wealth, and force a transfer of any wealth that they do have – via the same debt dynamic since to go into indebtedness is now the only option of such folk – towards speculators and lending institutions, whose shareholders may themselves be characterized as part-speculators. Yet, the ability of speculators and shareholders of lending institutions to appropriate wealth in this way is critically contingent on debt’s repayment, but that is the unstable dynamic asserting itself once again. Debt forgiveness, then, breaks the cycle of such appropriation, before debts become unlimited and unpayable. It is ethical because it is a corrective against growing inequalities.

CONCLUSION

In this essay, the authors have traced the history of bankruptcy law for natural persons and articulated a case for the creditor to forgive debt at periodic intervals. The reason our approaches are a respite for the figure of Shylock rather than the figure of Antonio, is that it is the creditor who faces the ethical dilemma and therefore it is the creditor whose imagination needs relief from a narrow market-based logic. Economics cannot be allowed to capture ethics. Otherwise, even with provisions for debtor protections, bankruptcy law will, as it has usually done, privilege the creditor’s rights. The case for an ethic of forgiveness recognizes that such a privileging of creditor’s rights does not indeed privilege rights qua rights but rather rights delimited to the market arena alone. Does the creditor not also have the right to forgive? Asking this question opens the room for defining the proper conditions for a creditor to forgive debt, and this is what we have attempted to do. The authors have also made the crucial point that a bankruptcy law for natural persons cannot
operate effectively without a sophisticated monitoring system for credit markets. As such, a condition prior to bankruptcy, namely that of debt distress, is sufficient to invoke an ethic of forgiveness. But identifying such distress is no simple matter, and therefore a system is needed, which India sorely lacks at present. Perhaps, then, the notification of the entirety of Part III of the IBC may be treated as a contingent business, awaiting first some kind of credible regulatory action towards the monitoring of India’s credit markets, and that would indeed be both welcome and ethical.

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‘Surely, nothing can be more plain or even more trite common sense than the proposition that innovation [...] is at the center of practically all the phenomena, difficulties, and problems of economic life...’ - so proclaimed the Austrian economist Joseph Alois Schumpeter, who is every so often referred to as the ‘father of entrepreneurship’ or the ‘father of creative destruction’, about innovation.\(^1\) Due to his ideas, both entrepreneurship and innovation have been closely linked in the popular mindset. In fact, entrepreneurial innovation is recognised as the catalyst of a new wave of economic resurgence and prosperity, breathing a new life into the markets stuttered and stagnated by the novel Coronavirus disease (COVID-19) pandemic.\(^2\) It has been reckoned as the true source of national competitive advantage and has acted as a crucial factor in maintaining economic competitiveness of many countries in a globalised economy.\(^3\)

However, in order for innovation and entrepreneurship to ensue, strong formal and informal institutions are required. Significant emphasis is also required to be placed on actions supporting innovation and entrepreneurship. This is an offshoot of the new institutional economics which reasons that the existing system of incentives or ‘rewards’ or ‘punishments’ in a given society and economy depends to a decisive extent on the quality of formal and informal institutions prevailing at a given time and place.\(^4\) A well-functioning insolvency framework that aims at preventing and mitigating the impact of insolvency and bankruptcy is essential to support growth and strengthen the entrepreneurial spirit and innovation.\(^5\) The progress of entrepreneurship and innovation in an economy requires special conditions, including formal institutions, i.e., laws that are ‘forgiving’, allowing second-chance policies, ensuring effective restructuring and, finally, efficient insolvency resolution and bankruptcy.

In the Indian legal landscape, there was a large chasm in the statutory framework related to addressing issues pertaining to firms moving towards insolvency. The processes laid down were so time consuming and tortuous, that it was almost impossible to come out with productive solutions in a reasonable time frame on issues related to resolution, liquidation and bankruptcy of companies. And by the time a resolution was obtained, the company would have become a hollow shell incapable of any productive activity, leading to loss of
entire value for all stakeholders in the company. This affected the ease and cost of doing business too in the country since the ‘freedom to exit’ effectively did not exist.

In this scenario came the path-breaking legal reform in the form of the Insolvency and Bankruptcy Code, 2016 (IBC/ Code) that strengthened the entrepreneurial spirit and innovation in the country. As an economic law, it ushered in the ‘freedom of exit’ in the economy whilst having a substantial nexus with a host of other sectors such as company, employment, foreign trade, and banking and finance laws. It facilitated the resolution and rescue of person(s), both natural and juristic, through the apparatus of laws. Since its enactment in the year 2016, it has prompted a modernisation of the legal and the institutional framework of insolvency and bankruptcy laws in India.

**FOSTERING THE INNOVATION IMPERATIVE THROUGH GIP**

The IBC is not a mere body of provisions: it enunciates elaborate procedures in which legal and administrative, formal and informal rules, policies and practices are operationalised by different economic actors. In fact, the efficiency and efficacy of any insolvency system is critically dependent upon those who administer and effect the processes outlined in the statutory framework. This makes the role and occupation of one of the economic actors’ viz., the Insolvency Professional (IP) paramount from a socio-economic, legal, and moral perspective. An IP is responsible for, or actively contributes to, leading and organising innovation efforts and for building entrepreneurial innovation capabilities in or for an entity in distress or approaching distress. The proficiency of the IP can allow troubled business to stay afloat and where this is not possible, enable vulnerable creditors to maximise their returns.

Hence, the systems demanded a set of bright professionals who could be entrusted with the job of not only running an insolvent company, but also realise value for the stakeholders by bringing a viable resolution plan for such a company. The law required that such a job may be normally entrusted only to a person having at least 10-15 years of experience. But recognising the need for bright well trained young professionals to act as IPs, it was felt that it was imperative that a new cadre of professionals in India be instituted. The Insolvency and Bankruptcy Board of India (IBBI) unveiled such a programme in the form of ‘Graduate Insolvency Programme‘ (GIP) in the year 2019. The GIP professionals were expected to cater exclusively to the needs of the economy, thus professionalising insolvency law education in India. The delivery of the programme was expected to bridge the experience requirement of 10-15 years and compress it to a span of two years.

The Working Group (WG) set up by the IBBI on the GIP aimed at producing a cadre of IPs of highest quality and standards. It recommended the structure, content, and delivery mechanism of the programme. The WG Report laid emphasis on the ‘proficiency of an Insolvency Professional‘ characterising it as an ‘institution onto itself‘. It emphasised upon the recognition of GIP by prestigious Universities and Institutes across the globe and its macro-level significance for the Indian economy. The Indian Institute of Corporate Affairs (IICA), under the aegis of the Ministry of Corporate Affairs (MCA), was selected as the first institution to steer the GIP.
A first of its kind programme, for those aspiring to take up the discipline of IP as a career or other roles in the value chain, and recognised by the IBBI, GIP has bolstered the institutional and behavioural change. Starting as a modest initiative in 2019 with 37 candidates, today the programme is in its fourth year at the IICA. Due to careful nurturing by the IBBI and the IICA, it has established its reckoning in the insolvency sector. It has reinforced the turn towards resolution under the aegis of the new insolvency law of our country and recognised that quality professional education must aim to develop good, thoughtful, well-rounded, and creative individuals. Its alumni are now spread across the globe demonstrating turnaround leadership in their organisations. The industry has come to accept the excellence of these professionals as seen from the competition amongst the industry partners in hiring these graduates even before the programme comes to completion. The industry has also come forward willingly to offer traineeship(s) required under the programme, even offering handsome stipends to the trainees.

Perhaps the reason for success of the programme is its focus on offering a blend of a critical appraisal of modern insolvency laws and practice landscape in an interdisciplinary perspective. The programme attempts to foster an interdisciplinary environment that has the potential to engender cross-fertilisation of ideas across knowledge formations while transcending the artificial divisions between academia and the world of practice. It has been designed to nurture critical thinking and develop a climate of conceptual analysis and introspection to inculcate a spirit of rational inquiry among the students. The best of academic resources, including the latest technologies are used in the curriculum transaction; students are trained to develop relevant skills that match globally accepted standards of excellence.

GIP CREATING ‘PROFESSIONAL VALUE’

Insolvency law education through GIP is both a ‘value education’ relating to human behaviour and also a ‘professional education’, thus creating ‘professional value’ for the ecosystem. In the fourth year of its running, the conduct of GIP at the IICA has been robust. Students from diverse professional backgrounds like law, chartered accountants, engineering, etc. joined the course and benefitted immensely by gaining a 360-degree view of the insolvency resolution arena, as envisaged by the WG constituted by the IBBI. For instilling flexibility and innovation in learning, focus was on inculcating an all-round imbibing of both the theory and the practice, with students being brought in contact to best experts nationally and internationally. To ensure that this did not become just a classroom pedagogy, some key initiatives were taken which included, *inter alia*, the following:

(a) ‘Expert Talk Series’ featuring eminent insolvency law experts from around the globe;

(b) ‘Building your Career Series’ discussing the emerging stream of opportunities for the students in the realm of insolvency and bankruptcy laws;

(c) Conferences, seminars, workshops, case studies and discussion on practical scenarios under IBC;

(d) A week with the legends;
(e) Integrated certification programme in mediation; and

(f) ‘Alumni Talk Series’- Engagement with the GIP alumni and mentorship from practitioners.

In essence, the IICA, under the guidance of the IBBI, has developed a holistic approach to professionalising insolvency law education within the larger context of society and the economy. The course provides students with a perspective on identifying and remediying turnaround business situations, that is, established businesses experiencing operational, financial, and managerial difficulties. Students learn, from different standpoints, how to distinguish between ‘troubled’ and ‘crisis’ companies and how to use both qualitative and quantitative tools to effect solutions.

Academic excellence, coupled with moral rectitude and intellectual integrity is the essence of the GIP delivered at the IICA. The young graduates are taught and mentored by industry professionals and academia equally, from India and overseas, resulting in a balanced mix of the theoretical and the practical. The programme has been delivered both by the faculty at the IICA and eminent guest faculty and experts like Dr. M. S. Sahoo, former Chairperson, IBBI, Mr. Abizer Diwanji, Head, Financial Services, EY, Prof. Bob Wessels, Emeritus Professor of International Insolvency Law, Leiden University, the Netherlands, etc.

The structural components of the programme delineated across the preparatory, specialisation, and the traineeship levels have been successful in training a young cadre of professionals in a competitive manner. The GIP course structure covers the entire spectrum of insolvency and turnaround policies, laws and regulations. It inculcates the requisite soft skills such as interpersonal and communication skills, people management, organisation management, entrepreneurship and emotional intelligence/quotient. The course is equally emphatic about developing thought leadership through interaction with and mentorship by thinkers, leaders, and role models from a variety of fields. Being a fully residential course, peer-interaction, learning, and feedback provide a cross-domain knowledge acquisition environment to the students. The students are trained in the field by professionals who provide theoretical and practical insights to help these professionals help build new career options in the field of insolvency, special situations, stressed assets and operational turnaround.

The course integrates the functional disciplines of the core curriculum. A basic understanding of accounting and corporate finance, cash flow and going concern projections, debt restructuring and liquidation analysis, credit relationships and managerial perspectives are central components of classwork. Assignments are group-oriented projects culminating in a final group analysis. The course enables an individual to not only study one or more specialised areas of interest from an insolvency law perspective at a deep level, but also develop capabilities across a range of disciplines.

After a campus recruitment and placement drive, the graduate professionals are successfully placed in the restructuring, turnaround and insolvency practices of top-tier consulting firms, law firms, banks and insolvency professionals’ entities. The industry today recognises the expertise and excellence of GIP students graduating from the IICA.
WAY FORWARD

Now that three years of the programme have been completed, and the fourth batch is now learning the ropes, it’s time to make an assessment of the programme and the need to make alterations based on the learning experience and the changing business environment.

One of the areas the IICA is planning to focus more in coming years is on making these GIP professionals expert turnaround professionals too. Turnarounds are no longer special cases but an all-too-familiar part of corporate life. The challenge for an IP would be to rescue a company from bankruptcy, turn it around and thus add value to and for all stakeholders in the company. And while addressing the issue of turnaround, there is a need to focus on all aspects of corporate turnarounds- from the early stages of recognising potentially distressed company- threatening problems, to diagnosing and implementing appropriate corrective market/ financial/ organisational/ legal solutions to such problems.

Going forward, the IICA will attempt to incorporate courses, in cooperation with the IBBI, that lay emphasis on diverse aspects of managing corporate turnarounds including the financial, legal, operational and cultural aspects of reviving an entity. Another area where the IICA is looking at is on learning from other jurisdictions, with new collaborations and international partnerships with institutes/universities of international repute. Apart from bilateral arrangements with other countries focus will also be on exploring possible avenues of collaboration with multilateral bodies such as INSOL International. It will enable the GIP professionals to get international placements by tapping the overseas market, especially the law and consultancy firms.

Operating a business in a challenging environment requires a different skillset and strategy than when the business is booming. In challenging times, it’s often helpful to get a fresh perspective and leverage the proven experience of insolvency, turnaround and restructuring professionals. The focus of GIP at the IICA has been on pushing the existing frontiers of knowledge and realising the vision of the WG Report to ‘...broaden the horizon of thinking; perspective and outlook so that the graduates of the programme are able to innovate, challenge and change the norms’.

1 World Economic Forum, “How to ensure the benefits of ‘creative destruction’ are shared by all”, August, 2021.
4 Supra Note 2.
ABOUT THE AUTHORS

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Dr. V. Anantha Nageswaran was appointed as Chief Economic Adviser in January, 2022. He is a writer, author, teacher and consultant. He was a part-time member of the Economic Advisory Council to the Prime Minister of India from 2019 to 2021. He has written a weekly Mint column for fifteen years on Tuesdays, since 2007. He has co-authored several books and has taught at several business schools and institutes of management in India and in Singapore. He was the Dean of the IFMR Graduate School of Business and a distinguished Visiting Professor of Economics at Krea University. In his corporate career from 1994 to 2011, he was a Currency Economist at the Union Bank of Switzerland, Head of Research and Investment Consulting in Credit Suisse Private Banking in Asia, Head of Asia Research and Global Chief Investment Officer at Bank Julius Baer. He was an independent Director on the Boards of TVS Supply Chain Solutions, Sundaram Fasteners, TVS Sri Chakra Tyres, Delphi TVS and Aparajitha Corporate Services.

In 1985, he received a Post-Graduate Diploma in Management from the Indian Institute of Management, Ahmedabad. He earned his doctoral degree from the University of Massachusetts in Amherst in 1994 for his work on exchange rate behaviour.

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Ms. Aakanksha Arora is an Indian Economic Service officer of 2013 batch and is currently posted as Deputy Director in the Economic Advisory Council to Prime Minister. Previously, she was working in Department of Economic Affairs, Ministry of Finance from December, 2014 and handled various units including Macro, Monetary etc. She worked closely with Chief Economic Adviser and Principal Economic Adviser on Economic Surveys from 2014-15 to 2021-22 and on various economic policy issues. She represented India in the exchange programme between India and UK’s Economic Service, where she worked with Office of Budget Responsibility of UK. She has represented India in OECD meetings in Paris on various occasions. Before joining Indian Economic Service, she worked as an Assistant Professor in Shri Ram College of Commerce, Delhi University.

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Over a career spanning 37 years, he has served in the areas of finance, accounting, information technology, human resources, education, corporate governance, social impact innovation, environmental conservation, policy formulation, heritage preservation, philanthropy, and the venture and startup ecosystem. He was awarded the Padma Shri in 2015 and the Karnataka Rajyotsava Award in 2008.
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Mr. Sanjeev Krishan is the Chairman of PwC in India. He has been with the firm for nearly 31 years. He has successfully led the Transactions, Private Equity and Deals businesses of the firm, getting the firm to a pre-eminent position amongst its Private Equity clients and their investee companies. He has served in diverse leadership and client service roles and has extensive India and overseas experience in Deals, working across a range of sectors, such as technology, consumer and industrial products.

He is also part of FICCI’s National Committee on Stressed Assets and a member of the Rotary Club of Delhi, South. He is a certified Chartered Accountant and an Associate Member of the Institute of Chartered Accountants of India. He graduated with First Class in Economics from the University of Delhi and remains an active and proud alumnus.

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Ms. Rabitah Khara is a Director with PwC, India and currently works as a part of the Chairman’s office. She is responsible for anchoring various strategic initiatives, including acquisitions for the firm. Prior to her current role, she was working in the Deals team at PwC. She has over 10 years of experience in investment banking supporting clients end to end in their M&A and fund-raising journeys. She has also worked on numerous corporate insolvency resolution processes from both sides, supporting the committee of creditors and the Insolvency Professionals or supporting the resolution applicant in achieving a successful resolution of the corporate debtor. She completed her graduation in engineering with a specialisation in computer science from Panjab University, Chandigarh. She went on to complete her post-graduation (MBA) from Faculty of Management Studies, University of Delhi.
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Dr. Binod Kumar Sinha is a post-graduate and doctorate in Philosophy and alumnus of Patna University. He is a superannuated officer of the 1987 batch of the Indian Revenue Service (IRS). A multifaceted officer, he has had both national and international work experience during his tenure with the IRS. His area of specialization ranges from tax audits, investigation of corporate frauds, intelligence gathering for widening and deepening of tax base, training to tax officers as well as dealing with grievance redressal and transparency and integrity issues in tax administration.

His international experience comprises tax research and publication work in IBFD, Amsterdam (1997-1998) as well as service on deputation as Principal Inspector of Taxes and Revenue Manager with the Government of Botswana and the Botswana Unified Revenue Service for a period of 5 years (2002-2007) dealing with tax policy and legislation, treaty negotiation, treaty interpretation, advance ruling and other international tax issues. He was appointed as Member Technical, National Company Law Tribunal in May, 2019. After serving for three years as Member Technical at NCLT, Hyderabad, he is currently serving as Member Technical at NCLT, Delhi Benches.

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Dr. Jai Deo Sharma is M.com, CAIIB, DIM, MBA, LLB and Ph.D. and has over 39+ years of experience in Indian Overseas Bank (IOB). He was a Part time Director on the Board of IOB from March, 2006 to December, 2009 and from May, 2013 to May, 2016. He gave presentation to Joint Parliamentary Committee on IBC along with President, ICAI (Cost). He was a Guest Lecturer in various Institutions of repute like ASCI Hyderabad, COD Hyderabad, ICAI (Cost), ICSI, NIBSCOM Noida, PNB Staff College, Bank of India Staff College, UGC Funded Programmes etc. He has been the Chief Guest, Guest of Honour and Panelist at various seminars and conferences of the University of Madras, ICAI, SRM University, AMET University, Amity University, Jain University. He has published more than 30 research papers and articles. He wrote thesis on ‘Post Globalisation motivational Dimensions amongst the officers of PSBs’ and evolved a new theory of motivation – ‘Skill Gap Theory of Motivation’ as a Post-Doctoral Study.

Mr. R. K. Bansal

Mr. R. K. Bansal is the MD & CEO of Edelweiss Asset Reconstruction Company Ltd.. He has over four decades of experience straddling both development banking and commercial banking. With multifaceted experience across all functional areas including institutional finance, corporate lending, retail banking, investments, treasury, operations, among others, his core area of expertise has been in resolving stressed assets. He has successfully managed several large resolution cases. A former Executive Director of IDBI Bank, he was also appointed as the Chairman of ARCIL and has served as a member of the IBA’s Standing Committee on Retail Banking, in addition to serving on the boards of IDBI Federal Life Insurance Co. Ltd., ISIL, J.K. Lakshmi Cement Ltd., Uttam Value Steels Ltd., SIDBI, IDBI Asset Management Ltd., NSDL, NSDL e-Governance Infrastructure Ltd., among others.

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Mr. Ashish Kumar

Mr. Ashish Kumar is currently Assistant General Manager, ERD, State Bank of India. Prior to joining SBI, he was working with Steel Authority of India Ltd. as a Management Trainee (Admin). In his two decades with SBI, he has worked across multiple domains, from handling branch operations to large Corporate Credits and has a seven plus years’ experience managing treasury operations of the bank, first in running equity investments portfolio and thereafter dealing in forex operations of the bank. He also has rich experience in training and learning development, having worked as a faculty at Bank’s training establishment. He is pursuing management from NMIMS, Mumbai.

Mr. Rajasekhar V. K.

Mr. Rajasekhar V. K. is a former Member (Judicial) of the National Company Law Tribunal. He is the youngest ever incumbent in the post. He served in Mumbai, Kolkata, Cuttack and Allahabad Benches of the Tribunal. He studied at Govt Victoria College, Palakkad, and obtained his law degree from Delhi University. He enrolled as an advocate in Chennai and practised in the field of company law, civil law, economic offences and IBC. He had worked in the Ministry of Corporate Affairs in various capacities earlier, and gained experience in administration, vigilance and competition law matters. He also had a brief stint in the Employees Provident Funds Organisation.

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Ms. Ajanta Gupta is currently a Research Associate in IBBI since 2018. She is a Chartered Accountant and received her undergraduate degree in Law from Faculty of Law, University of Delhi and LLM from O.P. Jindal Global University. She has cleared Limited Insolvency Exam in 2017 and Registered Valuer Exam in Securities and Financial Assets class in 2020. She has obtained her certificate in Forensic Accounting and Fraud Detection from ICAI, completed her training in commercial Mediation from IICA in collaboration with High Court of Delhi and registered as an Independent Director with IICA. She is a member of INSOL International.

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Mr. Akaant KM is a legal practitioner practising primarily in the High Court of Punjab and Haryana and the National Company Law Tribunals in Delhi and Chandigarh. He specialises in the subject of Insolvency and Bankruptcy Law and has been actively engaged in this area of law both as a practising advocate as well as a researcher. He has also represented various companies, banks and Resolution Professionals before the NCLTs and the DRTs. He is also an empaneled advocate with the Punjab National Bank and Legal Aid at National Company Law Tribunal, Ahmedabad. He is currently a visiting faculty at the National Law University, Mumbai, and the National University of Juridical Sciences, Kolkata, instructing courses on the Insolvency and Bankruptcy Code, 2016. He has written a legal commentary on the Insolvency and Bankruptcy Code, 2016 titled ‘Insolvency and Bankruptcy - Law and Practice’ foreworded by HMJ Suryakant, Judge Supreme Court of India and published by the EBC publishers and is working on the 2nd edition currently.

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Ms. Shreya Prakash is a restructuring and insolvency lawyer based out of Singapore. She was previously a Senior Associate at Shardul Amarchand Mangaldas & Co., in which role she advised creditors, resolution applicants and resolution professionals on matters under the IBC. She has previously advised the MCA, the Insolvency Law Committee, and the IBBI on the design and drafting of amendments to the Code and rules and regulations relating to the corporate insolvency and liquidation processes, insolvency professionals and information utilities including introduction of a Group Insolvency regime. She is an alumna of the National Law School of India University, Bangalore and the University of Oxford.

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Dr. Aparna Ravi is a Partner at Samvad Partners Advocates. Her practice areas include insolvency and restructuring, distressed M&A and general corporate transactions. She was a member of the Bankruptcy Law Reform Committee and continues to be actively involved in discussions on the development of the IBC. She edited the 6th edition of ‘Mulla The Law of Insolvency in India’, a treatise on personal insolvency law that was published by Lexis Nexis. She has also been a visiting faculty at the National Law School of India University, Bangalore and is an adjunct Faculty at the Indian Institute of Corporate Affairs.

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Ms. Sikha Bansal is an Associate Member of the Institute of Company Secretaries of India and had secured all India rank in examinations conducted by the Institute. Her core area of expertise include insolvency law, law on security interests, corporate laws and financial regulations. She is the co-author of the book ‘Law Relating to Insolvency and Bankruptcy Code 2016’ and has authored several articles on subjects pertaining to insolvency law. She has been engaged extensively in resolution/liquidation matters as well as advisory under the Code.
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Mr. Timothy Lopes is a Management Studies graduate and is an Associate Member of the Institute of Company Secretaries of India. His interests lie in the field of advisory and consultancy on corporate laws, financial regulations, securitisation and related matters. He has authored several articles on various subject matters including securitisation, leasing, corporate laws, etc.

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Mr. Unnikrishnan A., Principal Legal Adviser, Reserve Bank of India, is an ex-officio member of the Governing Board of the IBBI right from its inception. He holds post graduate degrees in both economics and law and started his career in RBI in the year 1995 as a Legal Officer. At different points of time, he advised the RBI on legal matters relating to regulation and supervision of commercial banks, RRBs, co-operative banks and NBFCs, foreign exchange management, financial markets, currency management, right to information and payment and settlement systems, and handled the litigation pertaining thereto. He was associated with the work of a number of committees and groups dealing with legislations in financial sector. He has published a number of articles on legal issues.

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Mr. Sudhaker Shukla

Mr. Sudhaker Shukla took charge as Whole-time Member, IBBI on November 14, 2019. He served as a member of the Indian Economic Service for over 34 years in various capacities across Ministries and Departments of the Government of India and represented India, in the Board of the African Development Bank. He is currently looking after Research and Regulation Wing comprising Corporate Insolvency, Corporate Liquidation (including Voluntary Liquidation), Individual Insolvency and Bankruptcy, Data Management & Dissemination, Legal Affairs, Adjudication, Prosecution and Court Proceedings. In addition, he is also handling IT, IBC-21, Vigilance, Board meetings, Strategy, Communications, Parliament and FSDC related matters in the IBBI.
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Dr. Kokila Jayaram is an Indian Economic Service Officer of 2011 batch. Currently she is posted as Deputy General Manager with the IBBI handling CIRP Division and assisting the Research Division. Prior to this, she has worked with the Ministry of Commerce and Industry, and the Ministry of Rural Development.

Dr. K. P. Krishnan

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Dr. Anuradha Guru

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Dr. Mamata Biswal is working as a Professor of Law at Gujarat National Law University. Her areas of expertise are Corporate Laws, International Trade Law (International Sales Law), Insolvency and Bankruptcy Laws. She is the Centre Director of the Centre for Corporate and Insolvency Laws at GNLU. She was awarded the ICSSR Senior Fellowship award in 2016-17 in the topic, ‘Legal Challenges before India to ratify the United Nation’s Convention on Contracts for the International Sale of Goods (CISG): A Critical Analysis’. She has published books on Company Law and Insolvency Laws by reputed publishers, her articles have been published in various International and National journals. She has presented research papers in various International and National Conferences. She has delivered expert lectures in various International and National Institutes on different areas of law. She has been inducted as an independent woman director in the Gujarat based PSUs i.e. GSPC Pipavav Power Company Ltd, Gujarat State Energy Generation Limited, GSPC LNG Limited., Gujarat Industrial Investment Corporation Ltd. and Gujarat Industries Power Company Limited.
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Mr. Vijaykumar V. Iyer is a registered Insolvency Professional. He is also a fellow member of the ICAI and an associate member of the ICMAI. He has 30+ years of professional experience and has worked on over 400 domestic and cross-border M&A transactions. He is currently a Partner in Deloitte India Insolvency Professionals LLP and has handled several cases under the IBC framework including Binani Cement Ltd., Bhushan Steel Ltd., SPS Steels Rolling Mills Ltd., Aircel Ltd., Aircel Cellular Ltd., Dishnet Wireless Ltd. and Murli Industries Ltd.

Mr. Abhishek Sood

Mr. Abhishek Sood has completed his B.Com (Hons) from University of Delhi, and holds a PGDM from IIM Bangalore. He has more than 12 years of experience which includes assignments in transaction advisory, business operations and corporate banking, including fund raising, loan sanctions and restructuring. He joined Deloitte in 2017 and has worked on several IBC cases in supporting the Resolution Professional including Bhushan Steel Ltd. and Gwalior Bypass Project Limited.

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Mr. Kuriakose P. Alex is an Electrical and Electronics Engineer from MG University, Kerala and has completed Graduate Insolvency Programme - a flagship programme of the Indian Institute of Corporate Affairs, Government of India. He is currently a part of the Financial Advisory - Restructuring Services Team of Deloitte in India and has actively supported on multiple IBC engagements.

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Mr. Rama Subramaniam Gandhi is currently a financial sector policy expert and adviser. He is an independent director on the boards of several entities like bank, financial market, account aggregator, information utility and fintech, among others. He is a prolific speaker and covers, including these areas, wide range of subjects. He was a Deputy Governor of the Reserve Bank of India for three years from 2014 to 2017. He had been a seasoned and accomplished central banker for 37 years. He had a three year secondment to the Securities and Exchange Board of India, the capital market regulator.
Mr. Debajyoti Ray Chaudhuri

Mr. Debajyoti Ray Chaudhuri is an MBA from the Faculty of Management Studies (Delhi) and Certified Associate of the Indian Institute of Bankers. Currently, he is serving as Managing Director and CEO of National E-Governance Services limited, which is an Information Utility regulated by IBBI. Immediately prior to joining NeSL, he was Chief General Manager in the State Bank of India on deputation to the Insolvency and Bankruptcy Board of India, where he took some path breaking initiatives like the implementation of the Companies (Registered Valuer and Valuation) Rules, 2017. His articles on issues related to insolvency have been published in reputed publications/national newspapers and he has been a speaker in numerous seminars/workshops related to corporate insolvency and also in educational institutions like the NLUs. He was conferred the ‘Business Excellence and Innovative Best Practices - Academia Awards-2020’ by the New Delhi Institute of Management.

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In 2019, she was selected as founding Head, Centre for Insolvency and Bankruptcy, Indian Institute of Corporate Affairs, Government of India. She has given several policy inputs to
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She has participated in several conferences and has published widely. She has three books to her credit and has published several research papers in leading national and international journals. Her research interest includes insolvency laws and corporate governance. She holds Ph.D. from National Law University Jodhpur and masters from University College London, UK.

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He has published several technical papers in many edited Books, Journals, News Magazines and Newspapers. He has formulated and piloted enactment of about 20 legislations by Parliament including many standalone Acts, and also formulated numerous subordinate legislations under the laws. He has also served on the governing board of many financial institutions and regulatory institutions in financial sector.

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Dr. Rajiv Mani

Dr. Rajiv Mani, Additional Secretary is an officer of the Indian Legal Service and is presently working in the Department of Legal Affairs, Ministry of Law and Justice, Government of India. He is presently looking after advisory work of various Ministries of the Government of India. He is also closely associated in carrying forward the legislative initiatives of the Government of India in strengthening the Ease of Doing Business environment and in
the efforts to promote institutional arbitration and making India a hub of International Commercial arbitration and developing an ADR ecosystem that facilitates easy resolution of disputes through minimal Court intervention. He has also dealt with proposals of legislative reforms to facilitate fast track adjudication of Commercial disputes under the Commercial Courts Act, 2015. He is a member of the Governing Board of the Insolvency and Bankruptcy Board of India and is also looking after the work of Law Commission of India as Additional Secretary.

**Ms. Avni Jain**

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Dr. Ashok Haldia is a Chartered Accountant, Management Accountant, Company Secretary, and Ph.D. by qualification. He is currently chairman of Governing Board of Indian Institute of Insolvency Professional of Institute of ICAI. His experience includes stress assets resolution; IBC; industrial finance and policy; enterprise and NBFC management; public sector and power sector policy; reforms and restructuring; infrastructure financing; accounting standard setting; company law and corporate governance; risk management; resource mobilisation including from multilaterals, and through IPO and private equity.

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**Mr. Praveen Kumar**

Mr. Praveen Kumar is the Director General and CEO of the Indian Institute of Corporate Affairs, Ministry of Corporate Affairs, Government of India. He is a 1987 batch retired IAS Officer of Tamil Nadu cadre and has headed various responsibilities in Government of Tamil Nadu and Government of India in multiple Departments such as Finance, Elections, Industries, Education, Corporate Affairs, New and Renewable Energy, etc. He retired from the Government of India as the Secretary, Ministry of Skill Development and Entrepreneurship in June, 2021. Apart from getting various awards from media and civil society organisations for his work as Chief Electoral Officer, Tamil Nadu, in the period 2010-2014, he was also awarded the ‘Prime Minister’s Award for Excellence in Public Administration’ for the year 2019, for his role in acting as Prabhari Officer of the Aspirational District Virudhunagar in Tamil Nadu, which saw the district attain number one position amongst all aspirational districts. He has also headed a number of State and Central Public Enterprises including TANMAG & TNSL (as MD), TNPFC (as CMD), SECI (as Chairperson) and IREDA (as CMD), apart from acting as Nominee Director in a number of State PSUs, and public private partnership companies.

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Dr. Surbhi Kapur is working as an Assistant Professor (Law) and Head, Centre for Insolvency and Bankruptcy at the Indian Institute of Corporate Affairs under the Ministry of Corporate Affairs, Government of India, steering the mandate of the Graduate Insolvency Programme. She is a trained legal professional, having more than seven years of professional experience, working as an academic and a legal researcher with the High Court of Delhi, Indian Institute of Foreign Trade, and the Insolvency and Bankruptcy Board of India. She is an alumnus of the National Academy of Legal Studies and Research (NALSAR) University of Law, Hyderabad, and Guru Gobind Singh Indraprastha University (GGSIPU), New Delhi, India. In 2019, she was selected to be a part of the first Indian Delegation of two at the INSOL Europe Academic Forum and Annual Congress, held in Copenhagen, Denmark. She has also been a Visiting Scholar at the Elisabeth Haub School of Law, Pace University, United States of America.