



भारतीय विवाला और शोधन अधिनियम बोर्ड
Insolvency and Bankruptcy Board of India



QUINQUENNIAL OF INSOLVENCY AND BANKRUPTCY CODE, 2016

Debtors'
Paradise Lost

Freedom from
Failure Redeemed

Balance of Rights
Restored

Insolvency Resolution
Professionalised

India's ranking in Resolving
Insolvency improved from 136 to 52

QUINQUENNIAL
OF
INSOLVENCY AND BANKRUPTCY CODE, 2016

2021

Insolvency and Bankruptcy Board of India
7th Floor, Mayur Bhawan, Connaught Circus, New Delhi - 110001
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The insolvency and bankruptcy reforms in the country, ushered in by the enactment of the Insolvency and Bankruptcy Code, 2016 (Code), completed five years on May 28, 2021. Along with it, IBBI, the regulator, too completes five years of its existence on October 1, 2021. It has been a remarkable, but challenging journey for the legislation, the Government, the regulator, and all stakeholders. The journey did not cease to surprise us. At every turn the journey met with new challenges and surprises that kindled renewed debate, discourse, leading to recasting of the path to stay focused on the objectives of the Code. While each milestone achieved imparted a sense of equilibrium, a shock wave would be right at the curb, ready to strike to test the resilience of this landmark legislation.

Many examples can be cited to make this point. As the Code yielded the first resolution plan, it uncovered a potential threat to the sanctity of the Code that unscrupulous people can take over a company while creditors take a huge haircut. As real estate companies came under resolution, it surfaced that there are companies which run mostly on the money of allottees, yet they did not have any explicit role in the Code. We were surprised when a successful resolution applicant did not want to implement its own resolution plan after it was approved. Such surprises were unique to the Indian experience and were addressed with alacrity by the Government and the regulator. There were surprises like the COVID-19 pandemic which crippled almost every business and every economy in the world and caught all of us off guard. In such an event of unprecedented setback to economic growth, the insolvency law had to rise to the occasion to save the lives of companies and livelihoods behind each company.

This annual publication of the IBBI, third in the series, traces these surprises and how the law adapted to them. It brings together experiences of experts and stakeholders who have been an integral part of this journey of the law and have plenty to share to entice discussions and debates. We are thankful to all the contributors for their insightful contributions, generosity and expertise to this publication, enriching the policy discourse around various aspects of the insolvency law and its ecosystem in the country.

We thank the team at IBBI comprising of Mr. Sudhaker Shukla, Dr. (Ms.) Anuradha Guru, Mr. Sushanta Kumar Das, Ms. Medha Shekar, Mr. Saram Santosh, Ms. Aditi Singhal, Ms. Prachi Apte and Ms. Namrata Nair for their commitment, enthusiasm, and exacting attention to detail in putting this publication together. We thank the printers 'Thinking Cap Creatives Pvt. Ltd.' for their creative and technical expertise towards designing and printing of this publication.

Confucius philosophy says: '*It does not matter how slowly you go as long as you do not stop.*' The journey of the Code, marked by many surprises, has progressed steadily over the last five years. What is important is that it continues to evolve and overcome the challenges that lie ahead. It is hoped that the next five years of the Code will be as enriching and fulfilling as the last five.

Dr. M. S. Sahoo

Chairperson - Insolvency and Bankruptcy Board of India

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FOREWORD

Among the several path breaking reforms unleashed by the Government; freedom to exit facilitated by the Insolvency and Bankruptcy Code, 2016 (Code/IBC), served as a glittering example in terms of efficiency of processes and several salubrious outcomes. More importantly, countering grave systemic challenges during its nascent journey of five years, it has redefined debtor-creditor relationship and practically ensured that debtors' paradise loses its sheen. The Code has been effective in tackling the vulnerabilities associated with financial stress caused by endogenous factors by way of resolution of the corporate debtor and vulnerabilities associated with economic stress caused by exogenous factors due to changes in business environment driven by innovation and policy shifts, by way of liquidation. However, the pandemic has included to this list a third overarching vulnerability caused by 'force majeure' conditions.

2. The unprecedented COVID-19 pandemic destabilised global economies, forcing Governments around the globe to rethink their response to tide over the crisis. The close of 2020 brought in a wave of optimism owing largely to the successful global containment of the spread of the virus. Global recovery set its stage, businesses resumed their operations and the wheels of commerce once again seemed to catch speed. Successful vaccine trials and rapid administration of vaccination in the early half 2021, proved to be an inflection point for the global and Indian economy. Rapid vaccination roll-out, easing of restrictions and several other fiscal and monetary policies to support businesses, brought back the lost confidence of investors and consumers. V-shaped recovery in economic growth was experienced across economies. The suspension of recourse to the Code under sections 7, 9 and 10, which was considered as an imperative to prevent viable firms from prematurely being pushed into insolvency, came to end in March, 2021 and with that began an attempt to recover, restructure and regrow.

3. The IBC has been a hallmark legislation in India's history of economic reforms. Its once nascent story has now transformed into an efficient, effective and preferred legislative framework to deal with insolvency resolution of corporates. Marking its fifth year of operation, the IBC, having faced a plethora of issues in its implementation and many legal challenges since its inception, has emerged as a dynamic law that answers to the calls of stakeholders in a time bound manner. It has helped to protect creditor's rights, increased the flow of credit and created a lucrative market for distressed assets in the economy. Recently approved resolution plans of some large corporates are a testament to the effectiveness and potential of IBC. This proactive approach has provided greater flexibility to businesses in case of honest failures and has reduced the overall pessimism and debt burden associated with the term 'insolvency and bankruptcy'. The law has proved that there are opportunities for successful resolutions and recoveries, holding up to its principle of preserving the value of businesses.

4. While the IBC has certainly helped in resolving companies with larger financial value, it faced limitations in addressing distress situations for smaller enterprises. The IBC (Amendment) Ordinance, 2021 was promulgated with a focused agenda for the corporate micro, small and medium enterprises (MSMEs) in the form of the pre-packaged insolvency resolution process (PPIRP/ pre-pack). The pandemic created multiple challenges for MSMEs, with several of them unable to continue operations. This pre-pack method, that involves very limited role of courts, is bound to provide a faster and efficient corporate rescue plan. Introduction of the pre-pack scheme has broadened 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.

5. The Code has undergone continuous changes, overcoming barriers and adapting to the growing corporate and economic needs of the country. Progress made under the Code and problems encountered now open up avenues for further refinements in the resolution processes. The Code, which established the Insolvency and Bankruptcy Board of India (IBBI) as the regulator, also assumed greater significance post COVID 19 pandemic. With many achievements and milestones reached, adapting to the 'new normal' would be another feather in its commendable journey so far.

6. With a view to promote enhanced visibility and charter a credible way forward with effective participation of academicians, policy makers, researchers, and other stakeholders alike, the IBBI has been making concerted efforts to build discourse around critical aspects and best practices webbed around the insolvency space in the country. Toward this end, it has been putting together thought-provoking articles by academicians, policy experts and subject experts in the form of its annual publication. since 2019. This publication titled '**Quinquennial of Insolvency and Bankruptcy Code, 2016**', is third in the series and contains insightful knowledge pieces assembled in five sections. I am confident that this year's publication will further the cause of igniting debate and building knowledge around the specialised area of insolvency and bankruptcy.

Rajesh Verma
Secretary to Government of India
Ministry of Corporate Affairs

PREFACE

Economic policy discourse often revolves around monetary policy, fiscal stimulus, social welfare programmes and other policy initiatives of the Government which are more visible forms of Government interventions for promoting economic growth. The other side of the coin are economic legislations that receive relatively less public attention but are the important nuts and bolts that hold the economy together and oil the wheels of economic activity. The underlying plumbing of an economy is structured around laws that make it easier to do business by easing the process of entry into business, survival of business and exit from business in case of failure. Unlike monetary and fiscal interventions that have relatively instantaneous impact on the economy, an economic legislation takes time to get engrained in the society and yield the envisaged results. Five years on, we celebrate the landmark Insolvency and Bankruptcy Code, 2016 (IBC/Code) which has come of age and borne fruits of economic transformation in the form of healthy outcomes in keeping with the enshrined objectives of the Code.

The history of evolution of insolvency laws shows how public perception of insolvency of business has changed over time. Historically, insolvency was considered to be highly personal to a debtor, wherein aspects of pride, vanity and an exaggerated tendency to speculate, were often considered as reasons for insolvency. The Roman notion of *fallitus ergo fraudator* (insolvent thus a swindler) became a common narrative for explaining insolvency of debtors. However, as bankruptcy systems slowly emerged with growth of prosperous medieval commercial towns in Europe, insolvency notions were depersonalised with corporal punishments for debtors slowly dying out. By the time joint stock companies emerged on the scene by mid-nineteenth century, varied reasons for insolvency came to fore like business cycle movements, changes in credit market etc. Thus, insolvencies came to be delinked from moral failure and linked to economic reasons for failure. It became easier for entrepreneurs to exit in case of honest business failure and come up with a new business.

Exit mechanisms for businesses play a pivotal role in promoting productivity growth which directly feeds into economic growth. An insolvency regime that can distinguish between successful ventures and unsuccessful ones give impetus to the process of 'creative destructions' in which obsolete businesses are replaced by new businesses. Productivity is magnified when scarce resources like labour, capital and assets locked up in inefficient firms get released for productive use by efficient firms. An effective insolvency regime strengthens the market selection process by disposing of non-viable firms and facilitating the restructuring of viable firms. It increases the scope and speed at which scarce resources consumed by failing firms can be reallocated to more productive uses by other firms. By incentivising creditors to extend credit and monitor performance of the firm and incentivising debtors and management to manage their business better, insolvency regimes can steer ex-ante efficient outcomes in the economy. Ex-post efficiency viz after insolvency occurs, maximising the value of assets of the corporate debtor, preserving going concern value of the

business, minimising the cost of insolvency by preventing hold outs or cramdowns by individual creditors and facilitating asset reallocation that maximises welfare.

In the Indian context, the enactment of the Code in May, 2016, ushered in a modern insolvency and bankruptcy regime in the country. The Code has been hailed as one of the most important economic legislation in recent times, having reformed the much-needed exit mechanism for corporates, to start with, and having addressed an important aspect of ease of doing business in the country. The law, being preventive in nature, is also being touted as having brought about a cultural shift in the dynamics between lenders and borrowers, and promoters and creditors. The Code has made an impact in the way repayment of debts are being viewed and treated by promoters and management of the defaulting firms. The first signs of distress now serve as early warnings for management to take corrective actions to avoid defaults. One can posit that the Code is emerging as a behavioural law aiming to draw various stakeholders of the entity in distress to work together, in a non-adversarial manner, towards laid down objectives of the law viz. ‘...*reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders...*’.

The IBC has been a game changer in the realm of economic legislations. By putting in place a comprehensive ‘one-stop-shop’ for insolvency resolution, it has paved the way for ease of exit in case of honest business failure. Five years into operation, the outcomes under it have been more than encouraging. The primary objective of the Code is rescuing lives of corporate debtors (CDs) in distress. The Code has rescued 396 CDs till June, 2021 through resolution plans, one third of which were in deep distress. However, it has referred 1349 CDs for liquidation. The CDs rescued had assets valued at ₹ 1.46 lakh crore, while the CDs referred for liquidation had assets valued at ₹ 0.49 lakh crore when they were admitted to CIRP. Thus, in value terms, around three fourth of distressed assets were rescued. Of the CDs sent for liquidation, three-fourth were either sick or defunct and of the firms rescued, one-third were either sick or defunct.

The outcomes of the Code have played out well in improving India’s ranking in ease of resolving insolvency indicators internationally. India’s rank moved up from 136 to 52 in terms of ‘resolving insolvency’ in the last three years in the World Bank Group’s Doing Business Reports. In the Global Innovation Index, India’s rank improved from 111 in 2017 to 47 in 2020 in ‘Ease of Resolving Insolvency’.

The onslaught of the COVID-19 pandemic had a devastating impact on lives and livelihoods. In keeping with the requirements of the times, the recourse to the IBC was suspended for a period of one year to the limited extent of disallowing firms being brought under insolvency resolution proceedings for COVID-19 related debts. This policy prescription was essential to help companies tide over the unprecedented financial stress caused by the pandemic by preventing them from being pushed into insolvency, leading to premature liquidation of viable firms due to unavailability of adequate number of resolution applicants to rescue them. Rescuing firms being the primary

objective of the Code, the rationale behind the suspension of the Code was to prevent the market from liquidating a viable firm rather than failing to liquidate an unviable firm.

The Code has so far witnessed six legislative interventions, five of which are by way of Ordinances, in view of urgencies, which demonstrate the keenness of the Government to continuously improve resolution framework. Each of these six amendments have strengthened the processes in sync with the emerging market realities and reinforced the primary objective of the Code, namely, revival of companies. In sync with this objective, the sixth amendment to the Code by way of an Ordinance in April, 2021 introduced pre-packaged insolvency resolution process for MSMEs in India. This Ordinance was replaced by the Insolvency and Bankruptcy Code (Amendment) Act, 2021 on August 12, 2021. This pre-pack process has been customised to the specific requirements of India’s insolvency resolution regime under the aegis of the Code. It is a unique blend of debtor-in-possession and creditor-in-control, informal up to a point and formal thereafter. The newly introduced pre-pack process has enriched the menu of options available to stakeholders for resolution of stress and taken the Indian insolvency journey to the next level.

This is the third annual publication of the IBBI, being released on the momentous occasion of the completion of fifth year of establishment of the IBBI and that of the IBC. It brings together experiences of some stakeholders on the way the law and the insolvency ecosystem has evolved till now, opinion of experts on the outcomes of the law and their advice on the way forward. It also strengthens the belief that this is a law which will, in the long run, be of immense value in ensuring best use of limited economic resources and facilitating ease of exit to entrepreneurs.

The Chairperson, IBBI, Dr. M. S. Sahoo, in his article in the publication presents his perspective on how the IBBI is different from other regulators in the country and amongst the insolvency regulators worldwide. It is insightful to understand and appreciate these differences.

The publication, has been divided into five Parts. Articles in Part I, titled ‘*Quantum Leap*’ present qualitative and quantitative achievements of the Code over the five years since its inception. Authors pen down their thoughts on the impact of the Code from the lens of policy makers, practitioners, and academicians, providing an overall view of the accomplishments of the insolvency reforms in the country.

Part II, ‘*Quintessence*’, goes on to list out various characteristic features of the Code which make it stand apart from the earlier insolvency and bankruptcy regimes in India. Rich and distinct viewpoints emerge from the pieces in this section. Part III, ‘*Quest for Excellence*’, carries articles suggesting ways to further strengthen the existing IBC mechanisms in terms of streamlined or revised processes and strengthening various market players in an insolvency process.

While the Code has several achievements to its credit, there are challenges and there is scope for improvements. In Part IV, ‘*Quelling Qualm*’, authors list some of these challenges and present their thoughts on how IBC has, in the past, and can, going forward, overcome these. Out of crises emerge new and incredible opportunities that have driven legislative changes. Transforming challenges into

opportunities, the authors discuss the recently introduced PPIRP, among other issues.

The last Part, titled '*Quick Steps*' is futuristic with authors listing the next steps that the insolvency law reforms should take in terms of adding exotic features such as resolution of group insolvency and cross border insolvency; use of mediation in insolvency resolution and implementing the remaining provisions of the Code viz. individual insolvency.

We are indeed grateful to all the authors, carrying with them a wealth of experience and expertise, for their insightful contributions. We are hopeful that this publication will deepen the comprehension of the readers in the evolving area of insolvency and bankruptcy in the country.

Dr. Navrang Saini
Whole Time Member
Insolvency and Bankruptcy Board of India

1

INSOLVENCY AND BANKRUPTCY BOARD OF INDIA: A REGULATOR LIKE NO OTHER

M. S. Sahoo

A good regulatory environment is an essential foundation for high performing nations to make their country a great place to work and live and to protect their environment. High performing regulators are a key lever to encourage innovation across the economy and foster productivity growth, through timely approval processes, flexible approaches to new issues and a service focus.

-OECD, Principles for the Governance of Regulators, 2012.

The traditional statecraft has certain limitations in governing markets. To effectively address the issues that arise in a dynamic market economy, Governments across jurisdictions have been setting up regulators and equipping them with the necessary powers, expertise, and resources commensurate with their tasks. Governance through regulators probably constitutes the most significant governance reforms in the recent decades.

Regulators are generally a class of body corporates, mostly a product of statutes. Like Government, they work in public interest and provide public goods. They have responsibilities - consumer protection, development, and regulation - akin to those of Government. They exercise quasi-legislative, executive, and quasi-judicial powers as Government does. Yet they are not the 'Government'. They are, in a sense, Governments within a Government, *imperium in imperio*, carrying out governance on behalf of Government in a defined framework.

India has a track record of establishing credible regulators¹ and delivering effective governance through them. It has created² a good and comprehensive regulatory system, tailored to her own market and societal needs. Regulators are broadly present in three spaces, namely, regulation of professions like the Bar Council of India, the Institute of Company Secretaries of India (ICSI) and the National Medical Commission; regulation of markets like the Securities and Exchange Board of India (SEBI), the Insurance Regulatory and Development Authority of India, and the Competition Commission of India; and regulation of utilities like the Central Electricity Regulatory Commission, the Telecom Regulatory Authority of India, and the Petroleum and Natural Gas Regulatory Board (PNGRB). Further, there are regulators both at Central and State level created under central legislations such as the Water (Prevention and Control of Pollution) Act, 1974, the Electricity Act, 2003, and the Real Estate (Regulation and Development) Act, 2016. The Insolvency and Bankruptcy Board of India (IBBI), established under the Insolvency and Bankruptcy Code, 2016 (Code / IBC), is a recent addition to the regulatory landscape.

The IBBI is a novel experiment, having no parallel either in the Indian regulatory milieu or in the insolvency space elsewhere. In this article, I dwell upon a few facets of IBBI's role and its functioning which make it a regulator like no other. In doing so, I draw comparison mostly with SEBI, which is considered as one of the most evolved regulators in India. I illustrate the peculiar challenges IBBI encountered in its infancy, many of which have largely subsided, with the growing maturity of the ecosystem. Mine is an insider's perspective, having been with the organisation since its inception. A disclaimer, therefore, is in order.

IDIOSYNCRATICITY OF IBBI

The IBBI has regulatory oversight over professionals and related institutions - Insolvency Professionals (IPs), Insolvency Professional Agencies (IPAs), Insolvency Professional Entities (IPEs) and Information Utilities (IUs) - in the insolvency space. It has the responsibility to make regulations and guidelines on matters relating to insolvency processes - corporate insolvency resolution process (CIRP), pre-packaged insolvency resolution process (PPIRP), corporate liquidation process, voluntary liquidation process, fresh start process (FSP), individual insolvency resolution process and individual bankruptcy process - under the Code. For the time being, it also acts as the authority for valuation profession.

Three-in-one regulator

A regulator of a profession (example, the ICSI) develops and regulates the profession. It does not develop or regulate markets where these professionals serve. Nor does it specify the rules to be followed by them in the market / for transactions, which are specified under the relevant legislations (example, the Companies Act, 2013) and rules made thereunder. A regulator of markets (example, the SEBI), assisted at times by a set of front-line regulators, promotes the development of, and regulates, markets. It does not develop and regulate the professionals, who render services in these

markets. A regulator of a utility (example, the PNGRB) regulates productions, distribution, and sale of products/services to protect the interests of consumers and foster fair trade and competition amongst the entities. It lays down technical standards, including safety standards.

The IBBI is different from other regulators as not only does it develop and regulate the insolvency profession, it also specifies the regulations to be followed by IPs in the market / for transactions, and regulates the markets where the IPs serve. In regulation of professions, it is assisted by a set of front-line regulators, namely, IPAs and Registered Valuers Organisations (RVOs). It sets standards to ensure quality of services and endeavours to provide a competitive environment. Differently put, the IBBI blends the duties of a regulator of professions, a regulator of markets, and a regulator of utilities, though its role is vastly different from that of any of them.

Ambit of authority

The Securities and Exchange Board of India Act, 1992 establishes SEBI. The entire Act is devoted to SEBI and the securities markets. The SEBI has *statutory objectives* to protect the interests of the investors in securities and to promote the development of, and to regulate, the securities market. It has mandate to *undertake any measure* in furtherance of its objectives. It has authority to make regulations to *carry out the purposes* of the Act. Its jurisdiction extends over all intermediaries and participants in securities markets, including issuers of securities in relation to issue and trading of their securities.

The Code provides for insolvency resolution processes of corporate persons and individuals. It provides for an ecosystem, comprising the Adjudicating Authority (AA), IPs, IPAs, IUs and IBBI for implementation of the Code. One of the objectives of the Code is the establishment of IBBI. A few sections of the Code are devoted to the IBBI and the insolvency profession. The IBBI does not have *explicit statutory objectives*, as SEBI has. It has specific statutory functions in the insolvency and bankruptcy space, subject to *general direction of the Government*. It has authority to make regulations to *carry out the provisions* of the Code. Its jurisdiction extends over service providers (IPs, IPAs, and IUs) only.

The SEBI Act, 1992 earmarks matters relating to establishment of the regulator and the Securities Appellate Tribunal to be prescribed by Rules and the matters relating to markets/ transactions to be specified by Regulations. The IBC lists 46 matters to be prescribed by Rules - five of these relate to establishment of the IBBI and the rest 41 relate to markets/ transactions. Thus, the ambit of authority of IBBI seems narrow as compared to that of a market regulator.

Regulator *vis-à-vis* Tribunal

A regulator makes subordinate legislation and enforces them in respect of relevant market participants. For example, the SEBI enforces the SEBI (Prohibition of Insider Trading) Regulations, 2015 on the company, promoters, board of directors, shareholders, investors, merchant bankers, auditors, IPs, and any other insider. It applies and interprets the regulations it has made, through its

enforcement and adjudicatory actions. A person aggrieved by such actions and interpretations may prefer an appeal before a tribunal. A decision of the tribunal is binding on the regulator until it is reversed. A tribunal is typically the appellate authority for the quasi-judicial functions of a regulator. However, it has no role as regards quasi-legislative and executive functions of the regulator.

The IBBI is not required to apply and interpret the regulations it has made, except in relation to service providers. The AA applies and interprets the law, including regulations, at the first instance, through its decisions, which are appealable before the National Company Law Appellate Tribunal (NCLAT). The Code lays down the roles of the AA and IBBI. The IBBI makes IPs available, and the AA appoints them to conduct various processes. It makes regulations relating to processes. The stakeholders and IPs conduct processes in accordance with regulations. Many of these are submitted to the AA for approval. Since no ecosystem, either in India or elsewhere, has two parallel institutions like IBBI and AA, it required significant efforts to develop mutual appreciation of each other's role in the initial years.³

Statutory features

Some examples of statutory features that make the IBBI distinct from other regulators are:

(a) Most legislations do not mandate any mechanism for making regulations, though many regulators have evolved standard operating procedures for making regulations, including public consultation. The Code, however, requires the IBBI to specify a mechanism for issuing regulations, including the conduct of public consultation process.

(b) Most statutes do not have specific provision for advisory committees, though many regulators, as a matter of practice, constitute advisory committees to serve as sounding boards for emerging ideas and to lend professional wisdom and market knowledge to the decision-making process. The Code, however, provides that the IBBI may constitute advisory committees in accordance with regulations.

(c) Many regulators have laid down the process to collect and disseminate information and data and conduct research and bring out publications, though respective statutes do not have detailed provisions in this regard. The Code has several provisions, such as, requiring the IBBI to publish information, data, research studies and other information; maintain websites and such other universally accessible repositories of electronic information; collect and maintain records relating to insolvency and bankruptcy cases and disseminate information relating to such cases; etc.

(d) In case of most other regulators, respective legislations provide for an appellate authority for appeals against their orders and credit of penalties to Consolidated Fund of India (CFI). The Code does not provide for either of these. The IBBI has sought an amendment to the Code to provide for these, while it credits penalties to CFI as a matter of good governance.

(e) In the interest of autonomy, respective legislations provide for sustenance of the regulator. A

regulator typically funds itself from the fees collected from its regulated entities and/or markets or transactions. The Code initially provided for levy of fee or other charges for registration of IPs, IPAs, and IUs. To partially address inadequacy of resources, an Amendment Act in 2018 allowed the IBBI to levy fee or other charges for carrying out the purposes of the Code. Notwithstanding this, the IBBI depends primarily on grants from Government for its sustenance, unlike most other regulators.

Of its own kind

Most insolvency jurisdictions have two layers in the hierarchy of regulation, namely, the government department dealing with insolvency, and membership organisations regulating insolvency practitioners. Wherever there is another agency in between, such agency is not dedicated to insolvency. For example, the responsibilities of the Australian Securities Investment Commission or the Australian Financial Security Authority include regulation of some aspects of insolvency. In contrast, the Indian jurisdiction has three layers in the hierarchy wherein the IBBI is interspersed between the Government and the IPAs. The IBBI is entrusted with tasks, some of which are either in the realm of Government or professional bodies in other jurisdictions. With no comparable regulator to learn from, either in India or elsewhere, IBBI is an evolving experiment in terms of its role.

The insolvency regime in the UK is probably the closest to that in India. The Insolvency Service, an executive agency of the Department for Business, Energy and Industrial Strategy, authorises and regulates the insolvency profession.⁴ The insolvency practitioners are required to be members of one of the five recognised professional bodies and the Insolvency Service exercises the general oversight over these bodies on behalf of the Secretary of State. It advises its parent department on policy matters related to insolvency and disseminates information to stakeholders on insolvency and investigation matters. The Insolvency Service employs Official Receivers who act as Trustee or Liquidator in cases where no private IP is appointed. It provides estate accounting and investment services for bankruptcy and liquidation estate funds. It conducts investigations into companies in public interest and deals with the disqualification of directors in corporate failures. It administers and investigates the affairs of bankrupts, individuals subject to debt relief orders, companies, and partnerships wound up by the court, and establish why they became insolvent. Unlike IBBI, it performs a range of functions and delivers many services under multiple legislations, namely, the Insolvency Acts 1986 and 2000, the Company Directors Disqualifications Act, 1986, the Employment Rights Act, 1996 and the Companies Acts 1985 and 2006.

FUNCTIONS OF IBBI: AN EXPOSITION OF EVOLUTION

Like every other regulator, the IBBI is a mini-State, having a mix of quasi-legislative, executive, and quasi-judicial functions. Since it is a new kid on the block, as also other elements of the insolvency ecosystem, full clarity of its role vis-à-vis the AA is yet to emerge as regards the statutory provisions.

Quasi-legislative functions

Section 11 of the SEBI Act, 1992 empowers SEBI to take any measure to achieve its objectives. Section 30(1) empowers it to make regulations to carry out the purposes of the Act. Without prejudice to this general power, section 30(2) lists out eight matters on which regulations may be made. The provisions of section 30 of the SEBI Act, 1992 read with SEBI's functions under section 11 make the scope of regulations very wide and flexible. This probably explains why regulations made by SEBI are rarely challenged on the ground of its authority to make regulations on any matter. On the other hand, section 240(1) of the Code empowers the IBBI to make regulations to carry out provisions of the Code. Without prejudice to this general power, section 240(2) lists out 111 matters on which regulations may be made, creating an impression that the list is exhaustive. Regulations made by IBBI face challenge on the ground of its competence, in addition to its *vires* or constitutional validity.

It is settled that the legality and propriety of any regulation cannot be considered by tribunals, in this case, the AA or NCLAT.⁵ In some cases, the AA, however, has expressed a view that tribunals are competent to test the *vires* of subordinate legislation.⁶ It is of the view that the IBBI may make regulations to carry out the 'provisions of the Code', and not the 'purpose of the Code'. Some regulations were struck down in collateral proceedings, without notice to IBBI, adding ambiguity and uncertainty to the regulations. A few examples are:

(a) While considering an application for extension of time in a CIRP, the AA struck down⁷ regulation 36A of the CIRP Regulations, which provides for issue of invitation of express of interest (EoI), being *ultra vires* of section 240(1) of the Code. The IBBI has contested this in a writ petition.

(b) While considering an application for closure of liquidation process, the AA found⁸ regulation 45(3)(a) of the Liquidation Process Regulations, which provides for sale of the corporate debtor (CD) as a going concern, beyond the competence of IBBI under section 240(2)(y). On appeal, however, the said finding was set aside.⁹ In the meantime, the Supreme Court reiterated¹⁰ that the Code envisages three modes of revival, one of which is sale of the CD as a going concern.

(c) Regulation 30A specifically provides¹¹ the procedure to affect a withdrawal before the constitution of CoC. The AA, however, exercised its inherent jurisdiction under rule 11 of the NCLT Rules under the Companies Act, 2013 to allow a withdrawal before the constitution of CoC, as such withdrawal is not covered under any provision of the Code.¹² It held that regulation 30A of the CIRP Regulations, being inconsistent with the provisions of section 12A, cannot be used in this case.

(d) While considering payment to dissenting financial creditors (FCs) under a resolution plan, the NCLAT held¹³ that regulation 38(1)(c) of the CIRP Regulations is inconsistent with section 240(1) of the Code. In deference to this, the IBBI deleted the said regulation. However, this provision subsequently found place in the Code.

On the other hand, as difficulties arise, the AA or the NCLAT calls upon the IBBI to make regulations

/ guidelines to address the gaps noticed by them. The IBBI makes best effort to address them, expeditiously. For example, while considering an application for approval of a resolution plan, the AA advised¹⁴ the IBBI to incorporate a specific regulation and specify a standard format for certificate to be provided by resolution professional (RP) certifying that all provisions of the Code, and Rules and Regulations made thereunder have been complied with and there has not been any contravention of the law. It considered that such a certificate is a vital necessity for expeditious disposal. The IBBI noted that the AA is not considering a *lis* involving adversarial litigation and there may not be any party in some cases to bring up deficiency in the process. The approval of resolution plans would be expeditious, if such a certificate is available, as the AA need not go through the bulky documents to verify compliance with every provision of law. The IBBI amended the CIRP Regulations to provide for a comprehensive compliance certificate and devised Form H for this purpose.

Recently, in a CIRP, the AA noticed that 20+ people accompanied the RP to the meetings of the committee of creditors (CoC), indicating either the RP is not fully prepared or giving fees (monetary benefit) to them. It requested¹⁵ the IBBI to examine this issue and issue appropriate guidelines. In a liquidation process, the AA advised¹⁶ the IBBI, to notify guidelines regarding criteria and process of nominating representatives of stakeholders to the stakeholders' consultation committee under the Liquidation Process Regulations. Similarly, the NCLAT, in a CIRP, noticed that in a contract of guarantee, the creditors, who receive some amount in a CIRP (borrower / guarantor), need to adjust their claims in another CIRP. It advised¹⁷ the IBBI to lay down regulations to guide interim resolution professional (IRPs) / RPs in this regard.

The regulations have been challenged also before Courts. A few examples are:

(a) The IP Regulations require an IP to pay fee calculated at the rate of 0.25% of the turnover from the services rendered by him under the Code. On challenge on the ground of competence, the High Court noted that section 240 is the general regulation making power of IBBI and it does not impose any restraint on its powers, except that the regulations should be consistent with the Code and the rules thereunder and should be for the purposes of carrying out the provisions of the Code. It held¹⁸ that there can be no question whatsoever about the powers of IBBI to frame regulations regarding the fee payable by IPs and IPAs.

(b) The Liquidation Process Regulations stipulate that a person, who is not eligible under the Code to submit a resolution plan in a CIRP of a CD, shall not be a party in any manner to a compromise or arrangement of the CD. This was challenged before the Apex Court on the ground that the said regulation transgressed the authority of IBBI. The Apex Court observed that the power to frame regulations under section 240(1) is conditioned by two requirements: first, the regulations must be consistent with the provisions of the Code and the rules made thereunder; and second, the regulations must be to carry out the provisions of the Code. It found¹⁹ that impugned regulation meets both the requirements.

With the rulings of the Supreme Court, High Court and NCLAT regards the scope of regulations under section 240 read with scope of functions under section 196(1)(t) of the Code, greater clarity will continue to emerge on the powers of IBBI to make regulations.

Executive functions

Most of the processes under the Code are like an orchestra where many constituents have specific roles. For example, a CIRP requires cooperation of the CD and its erstwhile management, creditors and the CoC, resolution applicants, and the IP and professionals appointed by him to assist him. If any of them does not co-operate or resorts to active non-cooperation or *malafide* actions, the process may not either conclude in time or yield the optimum outcome. A CIRP may be completely frustrated if, for example, the successful resolution applicant (SRA) does not implement the resolution plan, after its approval by the AA.

Actions in respect of market participants

Several CIRPs have witnessed a variety of contraventions of provisions of law by market participants. Since the participants are not within its regulatory domain, the IBBI has tried three options to deal with such contraventions, with varying degrees of success. The options are: (a) Directions to IPs, (b) Filing of complaints, and (c) Filing of appeals.

Directions to IPs: The CoC acts through its meetings chaired by the IP. It can influence the IP to act in the manner which may not be permissible. While the IBBI does not have mandate to discipline the CoC or its members directly, the IBBI typically issues directions to the IP in case of contraventions by the CoC. This has limitations as an IP can be replaced by the CoC without assigning any reason. A few examples of IBBI's response are:

(a) The AA expressed a concern²⁰ that the FCs do not send representatives to meetings of the CoC, who are competent to take decisions. This causes delay in process and contributes to depletion of value of the CD. The IBBI directed²¹ that the RP shall, in every notice of meeting of the CoC and any other communication addressed to FCs, require that they must be represented in the CoC or in any meeting of the CoC by such persons who are competent and are authorised to take decisions on the spot, without deferring decisions for want of any internal approval from the FCs.

(b) The law provides that the insolvency resolution process cost (IRPC) shall not include any expense incurred by a creditor. However, in a CIRP, the CoC insisted on inclusion of expenses incurred on fee payable to lenders' legal counsel for services rendered during CIRP and even before it commenced. It decided to include it in IRPC, after minuting that if IBBI objects to such inclusion, the amount would be reimbursed to the CD by FCs in proportion to their voting shares. The IBBI happened to notice it and initiated a disciplinary proceeding. The Disciplinary Committee (DC) directed²² the RP to make good the loss by securing reimbursement from FCs, as it could not direct the CoC to reimburse the amount.

(c) It is the duty of the IRP/ RP to decide as to who is an FC. His decision may be contested before

the AA. In a CIRP, the AA passed an order declaring a creditor as an FC. However, the CoC sat in appeal²³ over the order of the AA and passed resolutions to the contrary. It recorded: '*despite the Order passed by Hon'ble NCLT Allahabad the CoC is of the view that they no longer wish to continue M/s BVN Traders in the category of the "Financial Creditor" in the CoC....*'. Since the RP had a hand in facilitating the CoC to take such decisions, the IBBI, through a disciplinary proceeding, suspended²⁴ the registration of the IP for one year.

Filing of complaints: There are contraventions by promoters and resolution applicants as well. In such situations, the IBBI files a complaint, suo moto or on a reference from the AA, before the special court against the recalcitrant market participant. The complaint may not always succeed for want of adequate evidence (beyond all reasonable doubts) which the IBBI may not be able to gather for want of jurisdiction. Even if it succeeds, it may not serve the cause of the CIRP. A few examples of references from AA are:

(a) The AA *inter alia* referred²⁵ the matter to IBBI for initiating prosecution against the promoter and director of the CD, who had contravened the provisions of the Code and its directions. In another matter, it directed²⁶ the IBBI to proceed against the directors of the CD under section 70 of the Code for non-co-operation.

(b) The AA granted²⁷ liberty to the petitioner to file a complaint with IBBI claiming that the SRA intentionally and wilfully contravened the terms of resolution plan. In another matter, the AA held²⁸ that the SRA breached the terms of approved resolution plan in contravention of section 74(3) of the Code.

Filing of appeals: Another option for the IBBI is to file an appeal with the NCLAT in case of non-compliance with law. In a CIRP, the IBBI noticed that an ineligible resolution applicant, the sole FC and the IP colluded to ensure²⁹ that the people responsible for insolvency of the CD paid a fraction (33%) of the claim amount to the FC and wrested the control and management of the CD. They misused the CIRP to pass on a one-time settlement as resolution plan and to wipe off claims of creditors, which was not possible otherwise. They did this against the explicit mandate of the statute and judicial pronouncements and in contravention of the Code and regulations relating to CIRP. The IBBI, following due procedure, cancelled the registration of the IP. Further, since the resolution plan was in contravention of the law, the IBBI appealed against the order of the AA approving the resolution plan. The NCLAT lamented that it is very unfortunate that IBBI has preferred an appeal, though it cannot be held to be an aggrieved person. It observed³⁰ that the IBBI having no *locus standi* cannot challenge the finding of the AA. However, at the direction of the IBBI, the IP filed an appeal against the order of the AA approving resolution plan and the NCLAT set aside³¹ the impugned order.

Successful implementation of the Code requires all the constituents to play by the rule book and they are subject to regulatory discipline, with quick consequences for contraventions. A parallel may elucidate the point. In its early days, the SEBI was not being perceived as very effective in protecting

the interest of investors, essentially because it did not have jurisdiction over the issuers of securities. This infirmity was addressed by the Securities Laws (Amendment) Act, 1995, which incorporated section 11A (which has been further strengthened in 2002) in the SEBI Act, 1992 to expand SEBI's regulatory jurisdiction over corporates in the issuance of capital, transfer of securities and other related matters.

Actions in respect of IPs

The IBBI enforces regulations that cast obligations on IPs, IPAs, and IUs. However, it often faces pushback, as the insolvency processes are conducted under the oversight of the AA. If IBBI finds something irregular in an ongoing process, it may advise or direct the IP to take certain actions. On noticing certain deficiencies in the invitation of EoI in a CIRP, the IBBI directed the RP concerned to issue a fresh advertisement that addresses the deficiencies, and the cost of such advertisement shall not be part of the IRPC. The RP filed a petition contesting the direction of IBBI before the AA, which directed³² the RP to continue to function in normal course and to provide a copy of the petition to the IBBI, with an advice that if IBBI's actions are sustained, remedial measures can be taken at a later stage. In due course, the AA disposed of the petition³³ with certain direction and observations. Thus, the IBBI needs to defend its administrative actions. If it is not sustained, the market may not get clear signals. Even if it is sustained, the disposal by AA may take some time, impacting the timelines of CIRP.

To avoid such situations, the IBBI now-a-days files an application with the AA seeking replacement of the RP in cases where integrity of the process is threatened. It came across a few instances where the IP has prevented his replacement either by not constituting CoC or not allowing agenda for his replacement to be considered by CoC. This deprived the CoC of its legitimate right to have an IP of its choice. When IBBI filed an application for replacement of the RP, the maintainability of such application was intensely contested. Noting that an IBC proceeding is *in rem*, the AA held³⁴ the application to be maintainable. After considering the application on merits, it replaced the IP. It even issued a show cause notice (SCN) to the IP as to why contempt proceedings shall not be initiated against him. The IBBI now seeks replacement of the IP, and the AA allows³⁵ such replacement in deserving cases. In other cases, it initiates disciplinary proceedings to penalise the IP.

The IBBI has a policy in place for conducting trigger based and routine inspections to ensure that the IPs comply with the law. Since inspection entails infringement on the freedom of service providers besides imposing a cost on them and the outcome of such inspection could be an enforcement action, there should be clear governance principles to minimise the pains of inspection on the concerned stakeholders and to avoid unwarranted enforcement actions. Accordingly, IBBI's Inspection Regulations govern initiation, conduct and closure of inspections and investigations. There are also regulations to deal with grievances and complaints.

Quasi-judicial functions

The IBBI has certain quasi-judicial responsibilities. It includes disciplining the IPs in case of deviant behaviour. In a CIRP, the AA clarified³⁶ that if *there is any complaint against an IP, the IBBI shall have the same investigated. If it finds, after investigation, that a criminal case is made out against the IP, it shall file a complaint in respect of the offences committed by him before the special court. A complaint by any other person with police is not maintainable.* There is a bar on trial of offences in the absence of filing of a complaint by the IBBI. In a liquidation process, the AA clarified³⁷ that IBBI is the only authority to look into and enquire into any allegation against the Liquidator.

However, interested parties routinely file FIRs against IPs and threaten them with criminal action so that the IP toes their line under duress. The threat of criminal prosecution and police investigation may prevent an IP from conducting CIRP without fear and favour. The AA observed³⁸ that for lawful discharge of duty as IP, accelerating criminal charges, and using police to register a complaint of criminal nature is not appropriate and if there are any irregularities on the part of the IP or his team, the applications could be filed before it or a complaint could be registered with IBBI. In a recent case, the Supreme Court observed that it was appalled³⁹ with the developments leading to arrest of an IP. It observed that the police official dealing with the case was not familiar with the provision of privilege of an IP appointed by the Court in terms of section 233 of the Code. While directing immediate release of the IP, the Supreme Court directed the Investigation Officer not to take any coercive action against him.

The AA has at times taken up the task on themselves to discipline IPs. In one CIRP, it held the IP to be an unfit person for any assignment under the Code and imposed⁴⁰ a fine of ₹ 20,000 on him. It directed the IBBI to remove him from the panel. There are instances where the AA directs IBBI to initiate enquiry or drop an enquiry against an IP. Recently, the AA referred⁴¹ a matter to IBBI to make an enquiry and take appropriate action against an IP. After a few days in the same matter, it directed⁴² the IBBI not to initiate any enquiry till further orders, and if any enquiry is initiated, the same be halted till its further direction. This may adversely impact the effectiveness of the disciplinary role of IBBI.

In a CIRP, the AA found⁴³ inexplicable lackadaisical attitude of an IP and felt expedient to bring it to the notice of IBBI for an appropriate action. The IBBI took note of this advice of the AA, undertook due diligence, and issued a SCN to the IP. However, considering an application of the IP, the AA observed⁴⁴ that under such circumstances, the SCN deserves to be recalled. The IBBI filed an application to the AA with a prayer that the SCN be allowed to be disposed of on merits in accordance with the law. After hearing the parties, the AA directed⁴⁵ that all disciplinary proceedings initiated by the IBBI be quashed. Aggrieved by the order of the AA, the IBBI filed an appeal before the NCLAT, which held⁴⁶ that once a disciplinary proceeding is initiated by IBBI based on evidence on record, it is for the IBBI to close it or pass appropriate orders in accordance with law. Such power having been vested with IBBI and in absence of any power with the AA, the latter cannot quash the proceeding, even if it was initiated at its instance and recommendation. With the ruling of the

Supreme Court and the NCLAT, the clarity is emerging about role of IBBI in relation to deviant conduct of IPs.

IBBI'S JOURNEY: DIFFERENT FROM OTHERS

While discharging its statutory duties and functions, the IBBI has charted a slightly different path, as compared to most other regulators, albeit within the permissible boundaries of the statute.

Responsiveness

Speed is the essence of the processes under the Code. The IBBI, being a creation of the Code, imbibed speed from day one. It was established on October 1, 2016 and instructed to commence corporate insolvency by December 1, 2016. This required nothing short of a miracle. The immediate tasks included: market volunteering to set up IPAs; individuals with right calibre to enrol with IPAs and seek registration with the IBBI as IPs; regulations relating to IPs, IPAs, CIRP and Liquidation Process to be in place; advocacy to spread the message of the Code and make the stakeholders aware of their role, and the IBBI to have the capacity to work on these. With active support of the Government, the IBBI delivered all these, making roll out of corporate insolvency possible on December 1, 2016. Promptitude has been a part of its work culture since then.

Regulators are created to address the concerns proactively or at least immediately after a concern has surfaced. A few illustrations of such response by IBBI are presented here:

(a) In the CIRP of Jaypee Infratech Limited, public announcement was made on August 10, 2017 seeking claims by August 24, 2017. It was not clear whether an allottee of a real estate project would submit claims as an FC or OC. To ensure that claims are submitted by August 24, 2017, the IBBI amended the CIRP Regulations on August 16, 2017 to enable submission of claims by allottees. In course of time, the Code was amended on June 6, 2018 to explicitly consider such allottees as FCs.

(b) The first resolution plan under the Code was approved on August 2, 2017, whereby the CD got amalgamated with a group company, while the creditors took a haircut of 94%. This appeared like rewarding the promoters, who probably drove the company to the ground, at the expense of the creditors. To maintain integrity of CIRP, the IBBI amended the CIRP Regulations on November 7, 2017 requiring disclosure of the antecedents - convictions, criminal proceedings, wilful defaults, debarments - of the resolution applicant and its connected persons to enable an assessment of the credibility of such applicant. Subsequently, the Code was amended on November 23, 2017, prohibiting persons with such antecedents and the connected persons from submitting resolution plans.

(c) It was noticed that some IPs were not paying adequate attention to compliance with provisions of the applicable laws. The IBBI, vide a circular dated January 3, 2018, directed that the IP shall exercise reasonable care and diligence and take all necessary steps to ensure that the CD undergoing any process under the Code complies with the applicable laws. It clarified that if a corporate person

suffers any loss, including penalty, if any, on account of non-compliance of any provision of the applicable laws, such loss shall not form part of IRPC or liquidation process cost. Subsequently on June 6, 2018, the Code was amended to the effect that the IP, acting as IRP or RP, shall be responsible for complying with the requirements under any law for the time being in force, on behalf of the CD.

(d) When the stakeholders have proposed an IP, the AA needs to verify his credentials from the IBBI before appointing him for a process. This requires the AA to make a reference to IBBI and the IBBI to respond. To save time, the IBBI makes available the database of all eligible IPs with the AA in advance so that it can appoint the IP instantaneously. Similarly, where the stakeholders have not proposed an IP, the AA needs to make a reference to the IBBI for recommendation of an IP. To expedite the process, the IBBI makes available a Panel of recommended IPs for appointment as IRPs/ RPs/ Liquidators/ Bankruptcy Trustees, with the AA. The Panel provides⁴⁷ instant solution to the AA to pick up a name and make the appointment. The NCLAT has held⁴⁸ that an IP appointed out of the list of IPs should be treated as an appointment on the recommendation of the IBBI. The Code initially envisaged 14 days for appointment of an IRP. This innovative solution, however, made appointments instantaneous. In recognition of this, the Insolvency Law Committee (ILC) recommended⁴⁹ doing away with 14 days for appointment of an IRP and section 16(1) of the Code was accordingly amended in December 2019.

(e) Regulation 37 of the CIRP Regulations provides that a resolution plan shall provide for the measures, as may be necessary, for insolvency resolution of the CD for maximisation of value of its assets. It provides much more flexibility in developing a resolution plan and a list of inclusive measures that a resolution plan may provide for. The Standing Committee of Finance has recently recommended⁵⁰ that the Code may be amended to clarify that the resolution plan can be achieved through any of the means specified in regulation 37.

Governance

There have been concerns emanating from integration of powers in a regulator. Highlighting the concern, the Supreme Court observed⁵¹ that integration of power by vesting legislative, executive, and judicial powers in the same body, in future, may raise several public law concerns as the principle of control of one body over the other was the central theme underlying the doctrine of separation of powers. Recognising the concern, the IBBI structured itself, within 100 days of its existence, into three separate wings, namely, Research and Regulation Wing, Registration and Monitoring Wing, and Administrative Law Wing and each of these wings is headed by a separate Whole-time Member, to minimise intra-institutional and public law concern.

The Code does not distinguish between the IBBI and its Governing Board (GB). It is, however, useful to distinguish between the body of regulator (an office, employees, assets, and other resources) and its head, the GB which provides leadership, determines strategy, ensures risk management, scrutinises performance, and challenges itself for excellence. In its first meeting held on October 7, 2016, the GB identified the businesses which it alone should transact, pending formal regulations. The formal

regulations were notified on January 31, 2017, earmarking the businesses to be transacted by the GB. The GB broadly carries out quasi-legislative functions and approves major policy initiatives and standing operating procedures for important executive functions. The regulations provide for a Charter of Conduct for Members of GB to ensure that the GB conducts in a manner that does not compromise its ability to accomplish its mandate or undermine public confidence in the ability of members to discharge their responsibilities.

Conceptually, the GB's primary responsibility is to act as a hands-on principal to hold the management accountable. To play this role effectively, non-executive members of the GB have been meeting stakeholders and officers of the IBBI periodically. Further, a regulator is created to serve the society and the economy, not just the stakeholders or direct beneficiaries. This requires an external perspective in governance of the regulator.⁵² There is a thinking to commence interaction of the non-executive directors with representatives of the society, other than direct stakeholders.

The GB has been conscious of its performance from the very beginning. It has been evaluating itself since 2018-19 to assess if it is meeting the expectations of external scrutiny and improving both organisational and board performance and to identify the strengths, weaknesses, and opportunities to improve its performance. The evaluation covers broadly three dimensions, namely: (a) Board Composition and Quality, which cover aspects such as expertise and experience of Board Members, strategy to achieve laid down objectives, quality of debate and discussion in its meetings and its engagement with stakeholders; (b) Board Meetings and Procedures, which cover aspects such as regularity and frequency of Board meetings, accuracy of minutes, amount of time spent on strategic and important matters and follow-up on actions arising from Board meetings; and (c) Board Functions and Development, which include aspects such as integrity of accounting and financial reporting, promoting transparency and good governance and open channels of communication with the top management. The outcome of evaluation is being reported in the annual report.

The IBBI also evaluates its performance independent of evaluation of the GB. Keeping in view the inadequacy of self-evaluation, the GB directed evaluation of the performance of IBBI, as distinct from that of the Code, by an external agency. The National Council of Applied Economic Research (NCAER) has been commissioned recently to undertake an evaluation covering different aspects, including determination of continued regulatory relevance of IBBI and to develop a framework for assessment of IBBI as a regulator going forward.

The GB is now seized with a desire to reimagine IBBI and IBC with changing times and challenges ahead. It is examining afresh the *raison d'être* of IBBI as to whether its continued existence is warranted in the light of the outcomes of the processes being overseen by IBBI and whether these are eventually leading to enhanced economic performance. In the reimagined IBC, GB is considering administrative processes under IBBI's supervision, in place of adjudicatory process, in respect of voluntary liquidation and FSP.

There is no standard framework available to track outcomes of insolvency reforms, other than the

World Bank Ease of Doing Business indicators. The World Bank indicators, which is designed in the context of ease of doing business in nearly 200 countries, have limitations to track or measure the outcome of an insolvency regime. Hence, it is important to design a framework for assessment of performance of the insolvency regime in the country in terms of its effectiveness, efficiency, and efficacy. Such a framework would inform various stakeholders, in a structured manner, of the outcomes of the new regime, and enable organisation and availability of information required for the framework. Keeping this in view, the IBBI set up a Working Group to develop a framework for tracking outcomes of the Code vis-à-vis its objectives.

In the interest of transparency and accountability, the IBBI has suggested several amendments to provisions relating to its working, powers, and functions. These include a mechanism for appeal against the orders of IBBI, credit of penalties imposed by the IBBI to CFI, streamlining provisions relating to inspection and investigation, etc. The ILC has decided⁵³ that the suggested amendments would be addressed by the Government in consultation with the IBBI at a later stage.

Making regulations

Generally, regulations try to resolve 'polycentric' problems. Such problems involve many interested parties interacting with one another in a fluid situation. A small trigger in one variable creates tensions all around, with an incalculable series of interdependent changes. It is not possible either to identify the stakeholders likely to be impacted by a change, and factor in the series of interdependent changes, nor to organise them to participate in the decision making. Yet, the regulators must have 'second sight' to see the entire play in an evolving environment before any regulatory intervention to ensure that it addresses the identified market failure and does no more. This makes regulation making more of an art: it is difficult to derive regulations from mathematical formulations or rely on a standard 'one-size-fits-all' formulation. A responsive regulator designs and modifies regulations, proactively with changing needs of the market.

The Supreme Court has observed⁵⁴ that it would be a healthy functioning of our democracy if all subordinate legislation were to be transparent. It exhorted Parliament to frame a legislation along the lines of the US Administrative Procedure Act, 1946 (with certain well-defined exceptions) by which every subordinate legislation is subject to a transparent process. It requires that due consultations are held with all stakeholders, and the rule or regulation making power is exercised after due consideration of all stakeholders' submissions, together with an explanatory memorandum which broadly considers what they have said and the reasons for agreeing or disagreeing with them.

While it is not possible to have standard regulations to address a market failure, it is possible to standardise process for making regulations to ensure that the regulations are effective as well as responsive, yet not excessive. The IBBI (Mechanism for Issuing Regulations) Regulations, 2018 (Issuing Regulations) provide a standard mechanism and process for making or amending any regulations. Due to ever evolving nature of markets, a subordinate legislation, over time, may

become obsolete. The Issuing Regulations require the IBBI to review each regulation every three years unless a review is warranted earlier. The IBBI has been making regulations in accordance with these Regulations, although it falls short to an extent in the quality of economic analysis.

The IBBI has always endeavoured to engage with stakeholders in every possible format in the regulation making process, to ensure acceptable degree of legitimacy. The engagement factors in ground realities, secures ownership of regulations and produces regulations which are robust and precise, relevant to the market needs of the time. The IBBI discusses the draft regulations in several roundtables with the stakeholders to revalidate the understanding of the issues the said regulations seek to address, and the appropriateness of such regulations to address the issues. After considering comments of public on draft regulations and the advice of the relevant Working Group and Advisory Committee, the GB approves regulations. The IBBI also organises roundtables to convey the intent of regulations so made to stakeholders and facilitate implementation of the regulations.

The IBBI has a standing arrangement to enable any stakeholder to seek any new regulation or any change in any of the existing regulations, throughout the year. This puts every stakeholder into the shoes of a regulator and crowdsources ideas and perspectives. Consequently, the universe of ideas available with the regulator is much larger and the possibility of a more conducive regulatory framework much higher. The IBBI invites comments from stakeholders on the existing regulations in April every year. It has been the endeavour to process the comments received till December and following the due process, modify the regulations, to the extent necessary, by March.

Use of technology

The IBBI has laid emphasis on using information technology (IT) for delivery of its services since its inception. It made a functional website available by middle of November, 2016, and the submission of online applications for registration of IPs commenced by end of November, 2016. An online limited insolvency examination was available by the end of December, 2016. Gradually, the facilities were enhanced, IP registration module was redeveloped to make it fully online, and Content Management System improved the capability of the website, which is now a repository of matters relating to insolvency and bankruptcy in the country. The IBBI conducts four online examinations (Valuation Examinations for three Asset Classes and Insolvency Examination) in four sessions every day from about 100 locations. It has a mechanism for stakeholders to file complaints and grievances online and track their status. It has an electronic platform that enables seeking and processing comments and suggestions on each section / regulation and sub-section / sub-regulation of the proposed legislation/subordinate legislation. This platform has also been used by Government a few times to seek comments on draft legislations.

The IBBI disseminates a variety of information about professionals and processes. IPs, IPAs, Registered Valuers, RVOs, AA and stakeholders submitting complaints have role-based login IDs. IPs have been filing process related Forms online. While work is on to expand coverage, add analytics and make data available in machine readable form, the following data are presently

available on IBBI's website:

(a) *Insolvency Professionals*: The available information includes profile of the IP, including professional qualifications, work experience, details of authorisation for assignment (AFA), details of continuous professional education (CPE), Orders of the DC, if any, detail of assignments handled in various capacities (IRP, RP, and Liquidator), etc.

(b) *Corporate insolvency resolution process*: It disseminates: (i) profile of the CD, public announcement, invitation of EoI, details of claims of creditors, and related orders of AA, in respect of each CIRP, (ii) outcomes in terms of liquidation value, claims, realisations by FCs and OCs, and timelines, in respect of each CIRP ending with resolution plans, and (iii) outcomes in terms of number of resolution plans received, highest value offered through resolution plan, details of claims, and timelines in respect of each CIRP ending with order of liquidation.

(c) *Liquidation process*: The details available are: (i) profile of the CD, public announcement, details of claims of stakeholders, and related orders of AA, in respect of each liquidation process, and (ii) outcomes in terms of sale proceeds, claims, liquidation value, distribution of sale proceeds among stakeholders, and timelines in respect of each closed liquidation process.

(d) *Voluntary liquidation process*: The details available are: (i) profile of the CD, public announcement, and related orders of AA, in respect of each voluntary liquidation process, and (ii) outcomes in terms of amount due to creditors, the realisation of assets, distribution of sale proceeds among creditors, liquidation expenses, and timelines in respect of each closed voluntary liquidation process.

The IBBI has a paperless office that ensures transparency and accountability and assures data security and integrity. In times of COVID-19, e-Office and e-Meetings helped the officials to dispose the office work from the safety of their respective homes and the office was fully functional even during the nationwide lockdown or peak of second wave of the pandemic. Going forward, the IBBI is working on a single comprehensive IT system, IBC-21 which will be a 'one-stop-shop' for all data pertaining to processes under the Code and service providers registered with the IBBI and for all interactions with stakeholders.

Building profession

The IBBI has been shepherding two emerging professions, namely, insolvency profession and valuation profession. While using the standard toolbox to build professions, it has made some innovations as discussed below.

Graduate Insolvency Programme: The IBBI led an industry initiative to conceptualise Graduate Insolvency Programme (GIP) to take the insolvency profession to the next level. It is a one of its kind programme in the world to produce top-quality IPs who can deliver world-class services. It provides an avenue for young professionals, having talent but lacking experience, to take up the insolvency profession. It is a 24-month programme consisting of an intensive residential classroom

component of 12 months and a hands-on internship component at the cutting edge of the practice for 12 months. The Indian Institute of Corporate Affairs commenced GIP in 2019-20. The National Law Institute University, Bhopal is scheduled to commence GIP in 2021-22. A few pass outs of the first batch have recently joined the profession.

Fit and Proper Person: A distinct requirement of the insolvency profession (also valuation profession), as compared to most other professions in the country, is that it lets only those individuals in, who the profession would feel proud of, and prevents entry of those individuals, whose antecedents are doubtful or questionable. The IBBI allows entry of only those individuals who are fit and proper person and requires them to remain ‘fit and proper’ as a condition of continued registration. For determining whether a person is ‘fit and proper’ or not, it considers various aspects, including but not limited to (a) integrity, reputation, and character, (b) absence of convictions and restraint orders, and (c) competence and financial solvency.

Valuation Profession: Valuations serve as reference for evaluation of choices, including liquidation, and selection of the choices that decides the fate of the CD and consequently its stakeholders. If valuation is not right, a viable CD could be liquidated and an unviable CD could be rehabilitated, which are disastrous for the economy. The Code read with regulations assign valuation to RVs, which did not exist as such. As an interim arrangement, a framework was created under the Companies Act, 2013 enabling IBBI to groom valuation profession. To take the profession to the next level, a Committee of Experts has recommended establishment of National Institute of Valuers to steer regulation and development of valuation profession.

Knowledge organisation: The IBBI strives to be a knowledge organisation given its role in respect of two new professions. In association with IPAs, it has been engaging with researchers, academia, and practitioners to produce and capture emerging knowledge and build capacity of professionals at the time of entry and on a continuing basis. The IBBI and IPAs bring out several publications, and research studies, and actively encourage and support academia to do so. The IBBI has made available study material, developed by experts, to help the candidates appearing for insolvency and valuation examinations. Of these, the study materials for plant and machinery, and land and building, developed by Centre for Valuation Studies, Research and Training Association, are used by many valuer organisations across the world.

Innovative solutions

The IBBI has played a pioneering role from conceptualisation to implementation of several innovative products, including insolvency framework for resolution of stress of financial service providers, PPIRP, and institutional framework for valuation profession. It has conceptualised several innovative solutions to improve outcomes of processes and taken up with appropriate authorities. Some of them are as follows.

Insolvency professional entity: An individual IP may not always have adequate resources of his own

to handle a large and complicated CIRP. It would help him if he has access to a developed pool of resources which he can draw in case of need. The IP Regulations provide for such a pool in the form of IPE to provide support services. An IP may use the services of a recognised IPE subject to the condition that the entity as well as the IP shall be jointly and severally liable for all acts of omission or commission of its partners or directors as IPs.

Resolvability: The Code has shifted the focus of creditors, in case of default, from the possibility of recovery to the possibility of resolution. The success of resolution process depends on how resolvable the company is. The likelihood is more if the company has value, and such value is free from encumbrances, is visible to a discerning eye, and easily realisable by any resolution applicant. It is less if value resides in informal, off-the record arrangements; personal relationships of promoters; disputed titles, complicated structures, and contingent contracts; or avoidance transactions. To improve the likelihood of resolution, a company should consider having a sort of ‘living will’ that provides a guided path for resolution. The IBBI is advocating companies to always remain resolvable, should the need arise. In the days to come, market would prefer to deal with a company which is resolvable and a resolvable company would obtain a competitive advantage *vis-à-vis* non-resolvable company.

Automation of contracts: It often takes time and effort for an IU to receive the information from one of the parties to a loan agreement and then seek authentication from the other party before the information is usable. Automation (standardisation, dematerialisation, and electronic execution) of loan agreements will obviate the need for authentication, facilitating seamless insolvency proceedings, while making the process of contracting efficient. An IU or some other repository could facilitate automation of loan contracts and serve as comprehensive utility for all the financial information required for insolvency proceedings. The IBBI has been advocating automation of loan contracts. A beginning has been made whereby the National e-Governance Services Limited (NeSL) facilitates digital execution of loan agreements. The Secondary Loan Market Association, a self-regulatory body, has been set up by banks to specify standard documentation and covenants for loans and ensure standardisation of practices to promote secondary market for corporate loans.

Fresh Start Process: The Code envisages an FSP which allows an indebted individual to restart his life afresh, where the chances of recovery are so low that the cost of resolving the insolvency becomes an additional burden to either the debtor or the creditor or the State. It, however, provides for a court supervised and IP assisted FSP. The IBBI, based on advice of the advisory committee, has suggested a redesign of the process to make it accessible, simpler, quick, and cost effective. It has recommended: (a) Shift from quasi-judicial process to an administrative process, whereby dedicated Debt Relief Officers of IBBI will oversee the FSP and issue debt relief orders; (b) Shift from sophisticated IPs to Insolvency Advisers, who will assist and guide eligible debtors; and (c) Implementation of the entire process on an online platform accessible from anywhere. The ILC⁵⁵ found this feasible and has recommended an amendment to the Code to this effect.

Platform for distressed assets: India is one of the fastest-growing, trillion-dollar economies. In the face of competition and innovation, it is natural that some firms will have stress. Given the size of the economy and its growth potential, there will be a continuous flow of stressed assets into market. They would need to be resolved, not necessarily through IBC. The resolution would happen even before the assets become stressed. It is necessary to have robust and liquid market for stressed assets that enables realisation of best value by the stakeholders and rescue of viable firms. The IBBI has empanelled two vendors, namely, NeSL and Mjunction, for providing platforms for distressed assets, with four elements: (a) Market for Interim Finance, (b) Virtual Data Room, (c) Invitation and Evaluation of Resolution Plans, and (d) Auctions for Liquidation Assets. As participation increases, the platforms would prove to be a gamechanger, providing cost efficient resolutions.

The IBBI has recommended redesign of several other elements in the Code to make them operational and effective. These relate to avoidance transactions, Insolvency and Bankruptcy Fund, IU, AA, group insolvency, cross border insolvency, corporate liquidation, voluntary liquidation, etc. These are at various stages of consideration.

BUILDING LEGITIMACY

What distinguishes an organisation from an institution is its legitimacy. An organisation needs to be accepted by the stakeholders for what it does and how it does, rather than only for its statutory mandate. What sets apart an institution from others is the perception that its actions are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions.⁵⁶ In a regulatory context, a regulator can be said to be ‘legitimate’ if it is perceived as having a right to govern both by those it seeks to govern and those on behalf of whom it purports to govern.⁵⁷ This requires the regulator to build its social capital by consistent conduct and performance over years or even decades. To my understanding, the IBBI began the journey of legitimacy from its very inception.

The kind of pro-active engagement IBBI has with stakeholders, including through hundreds of roundtables every year, has been unprecedented in many ways. The active role stakeholders have played has been commendable, turning out to be the most valuable resource of the IBC ecosystem. Many believe that IBC has been a reform by the stakeholders, for the stakeholders and of the stakeholders. Further, the statutory process of making regulations and an organisational structure that houses the quasi-legislative, executive, and quasi-judicial wings at arm’s length distance, help build credibility of each regulatory action of IBBI.

The IBBI is constantly learning and upgrading the skills of its officers. Every interaction with constituents of the insolvency ecosystem brings new learnings and understanding. The IBBI is also making efforts to encourage research in insolvency to help make better and informed policy decisions going forward. It has recently set up a Research Guidance Group comprising of eminent policy makers, subject experts, and academicians to guide research in this evolving area and promote academic research.

END NOTE

The IBC saga has been unfolding. The IBBI has been playing its role as a key pillar of the ecosystem. The performance of the insolvency ecosystem has earned due recognition. India won the prestigious Global Restructuring Review (GRR) Award for the ‘Most Improved Jurisdiction’ in 2018. While shortlisting India for this award in 2018, the GRR observed⁵⁸:

It has been all change in India since it enacted its first ever Insolvency and Bankruptcy Code in 2016, bringing in greater empowerment for creditors, registered insolvency professionals and a whole new network of National Company Law Tribunals (NCLTs). An almost constant stream of improvements and updates has followed in response to feedback and practical experience: for example, in early 2018, new regulator the Insolvency and Bankruptcy Board of India (IBBI) introduced additional rules defining how to calculate the fair value of debtors’ assets requiring registered valuers to do the maths. Case law is now beginning to build up on the interpretation of the new rules too.

India’s efforts at making resolving insolvency easier have been recognised by the World Bank’s Doing Business Report (DBR). In the latest DBR 2020 released in October 2019, which takes into account the progress in insolvency legal system till April, 2019, India made a giant leap in its ranking in resolving insolvency parameter to 52nd position (from 136th rank three years ago). The DBR noted⁵⁹:

The case of India provides an example of successful implementation of reorganization procedures. India established an insolvency regime in 2016..... With the reorganization procedure available, companies have effective tools to restore financial viability, and creditors have access to better tools to successfully negotiate and have greater chances to revert the money loaned at the end of insolvency proceedings.

Insolvency reforms very quickly attracted talented and aspirational employees to IBBI, the best professionals to insolvency and valuation professions and capable and empowered market participants to undertake transactions. Many eminent citizens joined Working Groups and Advisory Committees of the IBBI and provided their precious time to guide IBBI in laying down an appropriate regulatory framework in a virgin area. The IBBI owes its uniqueness entirely to its GB, which moved away from playing the traditional role. They motivated out-of-box thinking, lent their expertise, and extended firm support for successful implementation of the IBC. I am personally indebted to all those whose contribution ensured that IBC was up and running in shortest time, unprecedented in the history of any economic legislation in the country and that of the insolvency laws around the world.

Perhaps in recognition of its role and performance, the IBBI finds a place in important fora such as Financial Stability and Development Council, Forum of Indian Regulators, Competition Law Review Committee, Insolvency Law Committee, and International Association of Insolvency Regulators. It provided leadership to important committees in insolvency space such as Sub-Committee of the ILC on Resolution of Financial Service Providers;⁶⁰ Committee of Experts on Institutional Framework for Regulation and Development of Valuation Professionals;⁶¹ and Sub-Committee of the ILC on PPIRP.⁶² It has partnership with World Bank, International Finance Corporation, International

Monetary Fund, Foreign, Commonwealth & Development Office, and International Insolvency Institute for building capacity of the insolvency ecosystem.

In this quinquennial year of the Code and IBBI, I look at the outcomes, the journey of IBBI and my personal journey with IBBI, with a sense of satisfaction and contentment. It has been a well begun reform in the insolvency space in the country and as the proverb goes, ‘well begun is half done’. Many milestones have been crossed, but many more lie ahead.

A distinguished visitor to IBBI once described it as a ‘start-up’. I quite tend to agree and wish it remains so. The IBBI has all the features of a start-up, namely, it is young; it is innovating; it is flexible, and it is focussed on outcome. Team IBBI, led by its GB, is ever vigilant and available to any stakeholder with a legitimate concern to help address it within the four walls of the legal framework in place.

NOTES

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⁷ *State Bank of India v. Su Kam Power Systems Ltd.*, (IB)-540 (PB)/2017, September 5, 2018.

⁸ Ibid 5.

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PART I QUANTUM LEAP

2

IBC : THE CHALLENGE OF LEGAL REFORMS

T. K. Viswanathan

So far legal reforms in India revolved around doctrinal research and depended upon the accidents of litigation. ‘Law in action’ studies, empirical research and impact analysis are largely absent. This shortcoming has been a subject matter of academic discussion amongst legal scholars for the past four decades. According to Gibson (1982)¹-

It is becoming increasingly recognised that within the modern complex state the effectiveness of the law is too important a matter to chance or conjecture. Informed knowledge upon the working of past laws and possible consequences of proposed new legislation provides a setting against which both the legislature and the executive can have greater confidence that the proposed statute’s purpose will be achieved. The belief that reform is most effectively undertaken upon bedrock of knowledge rather than the quicksands of ignorance is the major justification for studying the effect of the law upon our society. Legal impact analysis is a tool for such endeavours.

Legal impact analysis has two components. First is the study of impact and effectiveness of Acts of legislatures in operation and second the study of empirical data on the impact of judicial decisions.² The Governments have attempted to address this shortcoming by undertaking the exercise of repealing obsolete laws from the statute book.³ But in the absence of empirical data, ‘law in action’ studies and impact analysis, merely cleaning the statute book of obsolete laws is a cosmetic exercise which does not help in addressing the ills plaguing our legal system.

Till the enactment of the Insolvency and Bankruptcy Code, 2016 (Code/IBC) there was no systematic and continuous law reform based on empirical and socio-legal research reflecting what Eugen Ehrlich calls as the living law⁴ of the people. The IBC is changing this trend and introducing a new wave of legal reforms which uses data and market indicators extensively to keep the law in

tune with current economic and social realities. Thus, enactment of IBC is a precursor to a new class of legal reform which reflects the living law of the people.

The Indian legal framework lacked a robust and comprehensive insolvency and bankruptcy mechanism for many years. But with the enactment of the IBC, this long felt need for reforming the credit market has been addressed. The Code represents the current market realities in the financial sector and is supplemented by a very rich ecosystem which enables policy makers and legal researchers to monitor the effectiveness of its implementation which other Acts of the Parliament hitherto lacked.

The Code is a piece of economic legislation and is the result of Government's response to meet the economic challenges faced by our country in a fast paced globalised economy. The Code is futuristic in design and can accommodate fast changing technological developments which has a lightening impact on the financial markets. The Code has been enacted at a time when lawmakers and members of the legal profession are encountering new challenges and opportunities hitherto not experienced by the legal fraternity. Justice Holmes' prophecy, more than hundred years ago, that '*for the rational study of the law the black-letter man may be the man of the present, but the man of the future is the man of statistics and the master of economics*'⁵, is going to be tested through the provisions of IBC since the decision as to the revival of a firm will be a decision based on sound economic principles in tune with market realities and not on the dry bones of the black letter law. Accordingly, the Code reposes great faith in the wisdom of the market players in the credit market by empowering the financial creditors to take the final decision on the prospects of revival or winding up of a business enterprise.

The Central Government followed up the enactment of IBC with a continuous monitoring mechanism by constituting a Standing Committee, the Insolvency Law Committee (ILC), to respond to the challenges arising in the operation of the Code. This has given a great force to the Code by energising it to realise its stated objectives. No other Act of the Parliament or State legislature has attracted so much importance in matters of operationalising and implementation of the provisions of any law enacted by it. Perhaps the only exception may be the direct and indirect tax laws which use extensive empirical data and feedback to initiate legislative reform. Thus, IBC is set to change current legal framework where there is no systematic and periodic review of Acts of Parliament and State legislatures on a continuous basis and amendments to Acts are triggered due to some difficulty arising from a judgement or due to some public demand.

To understand the importance of IBC in the current legal framework, it is necessary to have a glimpse of the challenges being faced by the legal profession and judges today due to the impact of technology and information deluge and the traditional judicial conservatism. Lee Loewinger, the founder of the Jurimetric research lamented in 1949 that the only area of human activity which has developed no significant new methods in the last few centuries is law. The next step forward in the path of man's progress according to him must be from jurisprudence (which is mere speculation about law) to Jurimetrics (which is scientific investigation of legal problems).⁶ As a result people

of all backgrounds— particularly those without legal education— are questioning the time-honoured ways of delivering legal services. We live in a time when a traditional, conservative legal profession is increasingly being forced to justify its methods— and perhaps even its existence; a time when dissent against the old order is becoming normalised and circulated globally; a time when newcomers are rewriting the script and challenging the old ways.⁷

Latest innovations in the areas of technology and law triggered by digital revolution and communication networks, like digital technology, Big Data, data analytics, algorithms, artificial intelligence, Internet of Things, Blockchain technology, judicial statistics⁸ and virtual court rooms and online court hearings etc. have already entered the legal discourse. A brief overview of the innovations in technology and its implications for law and law reform will enable us to understand the new trend set in motion by the Government by the enactment of the Code and the series of measures undertaken by the Government for its effective implementation as part of the larger law reform movement.

VIRTUAL COURT ROOMS AND ONLINE COURT PROCEEDINGS

Digital technology and communication networks have made it feasible for the judiciary to migrate to the digital environment and conduct online trial and proceedings. Tele-immersion can create a virtual court room where all the parties including the judges can be brought together in a telelinked digital environment cutting across continents. Tele-immersion also facilitates creation of virtual court room where courts of different jurisdictions can hold joint sittings cutting across distances and time differences to decide cases. Electronic communication through video, multimedia and other virtual mode is gaining importance in the implementation of IBC for the following reasons:

(a) When the provisions relating to Part III of the Code (relating to individuals and partnership firms) will be brought into force it will be a boon to individuals seeking redress under the IBC to participate in online hearings instead of wasting their time and energy in travelling to tribunals situated at far off places. This is all the more important because unlike corporate insolvency where companies can afford to file and defend cases before National Company Law Tribunals (NCLTs) which are located only in select cities, individual insolvency will have a far wider reach with individuals located in every remote corner of the country. They will be subject to the IBC and will need to engage with the concerned Debt Recovery Tribunals (DRTs) which are the Adjudication Authorities (AAs) for individual insolvency. Since the IBC replaces the jurisdiction of the district courts under the Provincial Insolvency Act, 1920 and the Presidency Towns Insolvency Act, 1909, the IBC has amended the Recovery of Debts and Bankruptcy Act, 1993 (RDB Act), empowering the DRTs to sit in circuit sittings at district headquarters to provide easy access to litigants.⁹ Yet litigants will have to travel from remote places to the district headquarters to gain access to the tribunal. Online filings and submissions and hearings by DRTs will address this hardship and facilitate easy access to justice as part of e-governance. Moreover, where the stakes are not high, intervention of lawyers can also be dispensed with and provisions for online mediation can be incorporated into the Act. Already, DRTs are empowered under the RDB Act to accept electronic filing of documents etc., and are digitally

compliant to accommodate online hearings with minor amendments to the Act.

(b) Cross-border insolvency matters will require bankruptcy judges of different national jurisdictions to jointly collaborate and hold sittings. A joint hearing requires that either court can also question a person who has appeared before the other court or allow one or more persons to speak. The United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (Model Law) provides effective mechanisms for dealing with cases of cross-border insolvency so as to promote *inter alia* the objective of cooperation between the courts and other competent authorities of the enacting State. The Model Law contains detailed provisions relating to how concurrent proceedings will be dealt with by the courts of different jurisdictions which requires direct communication between two courts. It also provides for joint hearings between the two courts. The relevant articles which deal with communication between bankruptcy courts are 25 to 27. To supplement the requirements of these articles, guidelines for communication and cooperation between courts in cross-border insolvency matters has been adopted by the Judicial Insolvency Network Conference in 2016. An interesting part of the guidelines is Annexure A which relate to guidelines on the Conduct of Joint Hearings by courts of different jurisdictions.¹⁰ The ILC constituted by the Ministry of Corporate Affairs (MCA) submitted its report in October, 2018 which recommended the Government on adoption of the Model Law and the matter is under consideration of the Government. The Model Law when adopted, will require the IBC to be suitably amended to provide for joint hearings in cross border matters between the NCLTs and bankruptcy courts of other jurisdictions.

(c) Another crisis which has hastened the popularity of online court hearings is COVID-19. The pandemic has forced the members of the legal profession to accept virtual court proceedings without much resistance. The Hon'ble Supreme Court (SC) addressed the issue of delivery of justice in the form of order during the COVID-19 lockdown. A bench consisting of Chief Justice of India Sharad Arvind Bobde, Justices D. Y. Chandrachud and Justice L. Nageswara Rao issued a direction in *In Re: Guidelines for Court Functioning Through Video Conferencing During COVID-19 Pandemic*¹¹, regarding measures to be taken by courts to reduce the physical presence of all litigants within court premises by adapting to the social distancing guidelines. These guidelines were issued by invoking Article 142 of the Constitution of India as an extra-ordinary jurisdiction. The SC also issued a press note addressing criticism against the continuation of virtual court hearings post-lockdown stating that the aim of both the system of adjudication through the open court system and the court system being conducted via video conferencing is delivery of justice. The press notes further state that '*Open Court hearings cannot be claimed as a matter of absolute right and process of adjudication itself does not demand an Open Court*'. However, in the present era when we are reliant on technology for every aspect of our lives, virtual court rooms cannot be 'antithetical' to the open court system in any manner. It also issued instructions for joining video-conferencing/tele-conferencing for hearing of listed matters.¹² The National Company Law Appellate Tribunal (NCLAT) also issued a statement that:

In order to contain the spread of coronavirus (COVID-19), and after considering the various instructions and advisories relating to coronavirus control and lockdown issued by the government, Hon'ble Acting Chairperson, NCLAT has decided that all urgent cases will be heard through video conferencing mode from June 1, 2020.

Accordingly, the NCLAT has issued Revised Standard Operating Procedure for Advocates/ Authorised Representatives/Party-in-Person for mentioning the matter for hearing through virtual mode (Cisco Webex meeting platform) from August 4, 2020 till further orders. The Delhi High Court in *Deepak Kholsa v. National Company Law Appellate Tribunal and Ors.*¹³, opined that the NCLT and the NCLAT are free to regulate their own procedure for virtual hearings as long as they ensure that requests for links were considered in a fair, transparent and non-arbitrary manner.

Viewed in this light, online and virtual court hearings will be the normal mode of conducting the judicial proceedings in the near future and provisions of the Code are flexible enough with minimum amendments to address these futuristic developments.

BIG DATA, ALGORITHMS, ARTIFICIAL INTELLIGENCE AND DATA ANALYTICS IN JUDICIAL PROCESS-DATAFICATION OF INFORMATION

'Datafication' of information refers to transforming words into data which unleashes numerous uses and possibilities. It is not merely digitisation of information from analog to digital medium. It is much more. To 'datafy' a phenomenon is to put it in a quantified format so it can be tabulated and analysed and made actionable.¹⁴ In order to capture quantifiable information *viz.* to datafy, we need to know how to measure and how to record what we measure. This requires the right set of tools. It also necessitates a desire to quantify and to record. Both are prerequisites of datafication, and there is already a large amount of legal literature available on methods of data collection, scaling techniques in socio-legal research, analysis of aggregate data, interpretation of data which facilitates measuring the impact of law and legislation.¹⁵ Emergence of judicial statistics¹⁶ as a separate expertise like medical statistics coupled with latest advancement in information processing tools will give a great momentum to law reform in the new millennium

As we move towards datafication of the information sub-structure of the society, the principal way that information is captured, shared, and disseminated and the systems for the same, can be used to improve, refine, streamline, optimise, and turbo-charge our traditional ways of working. Moreover, our systems are becoming increasingly pervasive where the handhelds, tablets and laptops have come to dominate our lives, giving birth to the 'Internet of Things', a term that refers to the presence of chips in everyday objects, so that they are directly controllable by humans and are connected to one another across the internet at all times.¹⁷ All these new developments have an enormous impact on law, courts and the legal profession. because it is possible through data analytics and artificial intelligence to process such information to address legal problems previously not thought of in human history.

The IBC recognises that asymmetry of information is a critical barrier to fair negotiations, or ensuring swiftness of the resolution process and thus provides for a regulated information utility (IU) that will make available all relevant credit information to all stakeholders in resolving insolvency and bankruptcy. This role is performed by the Information Utilities which are repositories of all credit history of debtors. In addition, the Central Government has undertaken a slew of measures to take forward the datafication process in order to rectify the information asymmetry by amending the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002¹⁸ (SARFAESI Act) establishing a Central Registry which will maintain records of transactions related to secured assets and a central database to integrate records of property registered under various registration systems with this Central Registry. This includes integration of registrations made under Companies Act, 2013, Registration Act, 1908 and Motor Vehicles Act, 1988. The Central Government may, by notification, extend the provisions of Chapter IV relating to Central Registry to all creditors other than secured creditors as defined in clause (zd) of sub-section (i) of section 2, for creation, modification or satisfaction of any security interest over any property of the borrower for the purpose of securing due repayment of any financial assistance granted by such creditor to the borrower. This is sought to be expanded by providing in the legislation a provision requiring all security interests to be registered with a Central Registry. Ultimately there is a need to create a Public Credit Records Authority which can capture ancillary credit information available outside the banking system from designated service providers and making it available in a central data base for facilitating efficient credit decision making by credit institutions. The proposed Authority should have access / data feed from the following sources: –

- (a) Tax defaulters / overdue status data from tax authorities such as Income Tax, GSTN, EPFO, municipal corporations, etc.
- (b) from GSTN platform in respect of customer's turnover, tax filing status, over tax status, etc., which are critical data inputs for customer due diligence, loan appraisal and monitoring process.
- (c) enforcement actions under SARFAESI Act or IBC, all court orders, regulatory action issued by Securities and Exchange Board of India, Reserve Bank of India, the Insurance Regulatory and Development Authority of India, etc. by respective regulators/judiciary, other economic law enforcement agencies like Enforcement Directorate, Department of Revenue Intelligence, Economic Offences Wing etc.
- (d) from various regulatory websites and databases to have consolidated view of customers on tax compliances, regulatory orders and sanctions, credit defaults etc.

For the purpose of capturing ancillary information, the Central Government can be empowered to notify (a) statutory, regulatory and other authorities under its control, and (b) in consultation with the State Governments, the local bodies, statutory, regulatory and other authorities under their control. This Big Data would serve as early alert/warning system to financing entities in the process of their loan appraisal/loan monitoring. Availability of such database will facilitate efficient credit decision

making by credit institutions. This is further augmented by the interlinking of the websites of the NCLT and NCLAT to other government websites enabling researchers and policy framers to get first-hand information about the credit market on a real time basis.

According to Dru Stevenson & Nicholas J. Wagoner,

Big data . . . invites lawyers to make a fundamental change in their approach to the law itself by looking to statistical patterns, predictors, and correlations, in addition to the legal rules that purportedly control outcomes—case law, statutory law, procedural rules, and administrative regulations.¹⁹

New techniques melding traditional statistics and computer science make it increasingly feasible to analyse large sets of data. These techniques and algorithms developed by statisticians and computer scientists search for patterns in data have the potential to provide a wealth of useful information if we can develop ways to extract it.²⁰

The use of data to fortify legal argument before a court was successfully demonstrated in the famous U.S Supreme Court case *Muller v. Oregon* (208 US 412), by Brandeis.²¹ The issue before the Supreme Court involved the constitutionality of limiting hours for female laundry workers in the State of Oregon. Brandeis, who later became the US Supreme Court Judge, adopted a novel technique to drive home his argument that overwork was inimical to the workers' health, compiled a number of statistics from medical and sociological journals and listed citations to the articles in his brief. The brief was significant in that it was the first one submitted to the Supreme Court that relied primarily on extra-legal data to prove its argument. Not only did the brief help Brandeis win the case, but it also became a legal landmark in its own right. Briefs that cited non-legal data quickly became commonplace and became known as 'Brandeis Briefs'. Big Data supplemented by Brandeis Brief is going to play a crucial role in the committee of creditors meetings and in the litigation landscape of IBC.

Thus, Big Data about the players in the credit market is readily available for the purposes of the IBC. The ecosystems accompanying the IBC and the implementation of its provisions making use of modern technology and information tools, serve as an example of how legal reform will shape future legislations. Not only can the impact of the provisions of IBC be measured and calibrated by the Government and Parliament, the impact of the decisions of NCLT and NCLAT are also available to take remedial action as may be considered necessary. Viewed in light of the above background, the IBC is a state-of-the-art legislation which is drafted to leverage and capitalise on the benefits of modern technology and also is a precursor to the new breed of legislation which will adorn the statute book. Today every department of the Government is sponsoring legislations impacting the lives of citizens in many ways. Many of them have enormous impact on the liberties and rights of the citizens. Once enacted there is no mechanism to assess the effect of the laws so enacted unless litigated in courts. Only when an affected person challenges the provisions in a court of law the Department is put on notice and the Government response is merely confined to addressing the individual case and not to review the overall Act itself. To achieve this, it is necessary that each

Ministry/Department, entrusted with administering the Acts of Parliament under the Government of India Allocation of Business Rules, 1961, should be directed to undertake this exercise and make it part of its annual report submitted to Parliament every year. The MCA has already set the trend by constituting a standing committee to review the Acts under its purview and other Ministries should follow this practice.²²

CONCLUSION

The IBC was enacted in 2016 and has been amended many times and subjected to many judicial interpretations, yielding a rich body of insolvency and bankruptcy jurisprudence which speaks volumes about the vitality of the Code. There have been criticisms about the functioning of the IBC, casting doubts on the law itself. However, that should not dishearten us because no Act of the legislature is perfect and can ensure 100% success within a short span of five or ten years. The reason for this is twofold. First the IBC represents transition from old legal order to a new legal order and the tension between new legal order and old legal order is always high at moments of such transition. We are in the middle of such a transition. Most of the cases which are clogging the NCLT and for which the Code is being unfairly criticised as not being effective, are legacy cases which arose before the enactment of the IBC and were caused by the ills plaguing the credit market prior to its enactment. Since the IBC has addressed all those concerns, once the backlog is cleared, the credit market will be restored to its health. Second, since Big Data about the functioning of the Code is readily available it is possible to measure and evaluate the effectiveness of its provisions and level criticism. It may not be an exaggeration to state that no other law is as transparent as the IBC, under which its effectiveness is readily measurable, subject to evaluation by all the stakeholders due to the availability of Big Data.

All reform movements in history have met with resistance and the IBC is not an exception. In this context it is worth recalling the words of wisdom of Machiavelli who said-

It ought to be remembered that there is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things. Because the innovator has for enemies all those who have done well under the old conditions, and lukewarm defenders in those who may do well under the new. This coolness arises partly from fear of the opponents, who have the laws on their side, and partly from the incredulity of men, who do not readily believe in new things until they have had a long experience of them.²³

The IBC is a jewel in the Indian statute book and is a historic legal reform legislation undertaken by the Government of India which is likely to usher a new wave of law reform movement which will extensively use Big Data, data analytics and market indicators to keep the law in tune with current economic and social realities and enable India to emerge as a major restructuring hub of Asia, rivalling Singapore.

NOTES

¹ Gibson C. (1982), “Legal Impact Analysis: The Ideal and the Practicable”, *Journal of the Indian Law Institute*, Vol. 24, no. 4, pp. 837-847.

² Baxi U. (1982), “Who Bothers About the Supreme Court-The Problem of Impact”, *Journal of the Indian Law Institute*, Vol 24, p. 854. Till now no one has raised the need for studying the effectiveness of Acts of legislatures as part of the law reform movement.

³ Reports of the Law Commission of India, 96th Report (1984), 248th and 249th Report (2014). Report of the Commission on Review of Administrative Laws - P.C Jain Committee (1998). Report of the Committee to identify the Central Acts which are not relevant or no longer needed or require repeal/re-enactment in the present socio-economic context - R. Ramanujam Committee (2014).

⁴ The central point in Ehrlich’s theory is that ‘the law of a community is to be found in social facts and not in formal sources of law’. He says: ‘At present as well as at any other time the centre of gravity of legal development lies not in legislation nor in juristic science, nor in judicial decision, but in society itself.’ The living law is the law which dominates life itself even though it has not been posited in legal propositions. The source of our knowledge of this law is, first, the modern legal document; secondly, direct observation of life, of commerce, of customs and usages and of all associations, not only those that the law has recognised but also of those that it has over looked and passed by, indeed even of those that it has disapproved. Ziegert. K.(1936), *Introduction to Eugen Ehrlich, Fundamental Principles of Sociology of Law*, Transaction Publishers.

⁵ Holmes O. (1897), “The Path of the Law”, *Harvard Law Review*, Vol. 10, no. 8, pp. 457-478.

⁶ Loevinger L. (1949), “Jurimetrics-The Next Step Forward”, *Minnesota Law Review*. Loevinger L. (1963), “Jurimetrics: The Methodology of Legal Inquiry”, *Law and Contemporary Problems*, pp. 5-35.

⁷ Mitchell K. (2017), *The Great Legal Reformation: Notes from the Field*, Kindle Edition.

⁸ Numbers cannot talk, but they can reveal. Mathematicians have developed an entire field namely statistics which is dedicated to getting answers out of numbers. It facilitates collection of data and projection of future demands which may be made upon any system. Medical statistics has evolved as a science of its own which gives an insight into the prevalence of diseases and the measures which can be taken to prevent them. Similarly, judicial statistics can help us discover patterns in litigation both quantitatively and qualitatively and it will also help us to effectively address the problem of judicial arrears. The websites of High Courts and Supreme Court contain upto date information on institution, pendency and disposal of cases.

⁹ Section 17(1A)(b), Amendment to Recovery of Debts due to Banks and Financial Institutions Act, 1993

¹⁰ Guidelines for Communication and Cooperation Between Courts in Cross-Border Insolvency Matters. The judicial insolvency network (JIN) is a network of insolvency judges from across the world and was established in October, 2016 by a group of judges from England and Wales, Australia, Bermuda, British Virgin Islands, Canada, Cayman Islands, Singapore and the USA. The JIN held its inaugural conference in Singapore on October 10-11, 2016 which concluded with the issuance of a set of guidelines titled ‘Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters’ also known as the JIN Guidelines. The JIN Guidelines were incorporated into law in England and Wales on May 5, 2017 through an amendment to the Chancery Guide. Other countries have also adopted it.

¹¹ *Re: Guidelines For Court Functioning Through Video Conferencing During Covid-19 Pandemic; Suo moto Writ Petition (Civil) No. 5/2020;*

¹² SOP for Ld. Advocate/ party in person for e-filing, mentioning, listing and video conferencing hearing, Supreme Court of India, May 16, 2020.

¹³ W.P(C) 7108, March 8, 2021.

¹⁴ Schönberger V. and Cukier K (2014), *Big Data: A Revolution That Will Transform How We Live, Work, and Think*, Houghton Mifflin Harcourt, Kindle Edition, p. 78.

¹⁵ Gangrade K. D. (1982), “Methods of Data Collection: Questionnaire and Schedule”, *Journal of the Indian Law Institute*, Vol. 24, no. 4, pp. 713–722. Ghosh B. N. (1982), “Scaling Techniques in Socio-legal Research”, *Journal of the Indian Law Institute*, Vol. 24, no. 4, pp. 739–750. Shukla K. S. (1982), “Analysis of Aggregate Data”, *Journal of the Indian Law Institute*, Vol. 24, no. 4, 1982, pp. 756–762. Raj H. (1982), “Interpretation of Data.” *Journal of the*

Indian Law Institute, Vol. 24, no. 4, pp. 763–771. Agrawala Raj (1982), “Experiments of a Law Teacher in Empirical Research”, Journal of the Indian Law Institute, Vol. 24, no. 4, pp. 863–874. Ghosh B. N. (1982), “Collection and Analysis of Data”, Journal of the Indian Law Institute, Vol. 24, no. 4, pp. 785–836.

¹⁶ Thiel O. (1960), “Judicial Statistics”, The Annals of the American Academy of Political and Social Science, Vol. 328, pp. 94–104.

¹⁷ Susskind R. (2019), Online Courts and the Future of Justice, OUP Oxford, Kindle Edition.

¹⁸ The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016.

¹⁹ Dru Stevenson and Nicholas J. Wagoner (2015), “Bargaining in the Shadow of Big Data”, 67 FLA. L. REV. 1337, pp. 1340–42.

²⁰ Holmes Dawn E. (2017), Big Data: A Very Short Introduction (Very Short Introductions), OUP Oxford, Kindle Edition, Kindle Locations 931–933.

²¹ The Brandeis Brief, Louis D. Brandeis School of Law Library.

²² Since Ministries may not have the manpower and expertise to undertake this sort of annual exercise it will be necessary to engage the National Law Schools, law firms, judicial academies, Bar Councils and other professional bodies to undertake this task for which Ministry must provide adequate funds in their Annual Budget.

²³ Machiavelli N. (1532), The Prince, Dante University Press, Boston.

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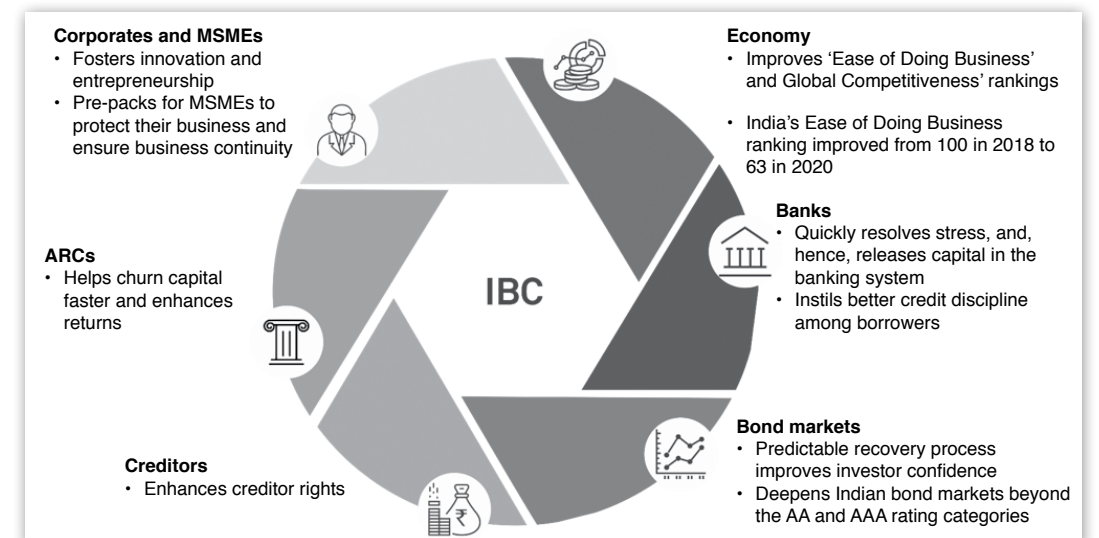
IBC: CODING A SEISMIC SHIFT

Ashu Suyash

The Insolvency and Bankruptcy Code, 2016 (Code/IBC) is aimed at protecting the interests of all stakeholders, including banks and financial institutions (FIs), secured and unsecured creditors, and employees. Even asset reconstruction companies (ARCs) stand to benefit from speedy recovery, and stakeholders would gain clarity on their share of dues. Besides, if implemented well, it can help deepen the corporate bond market by facilitating lower-rated issuances as well as further improve India’s Ease of Doing Business (EoDB) ranking.

The following chart depicts the benefits of IBC for each set of stakeholders.

Figure 1: Gains for stakeholders under IBC



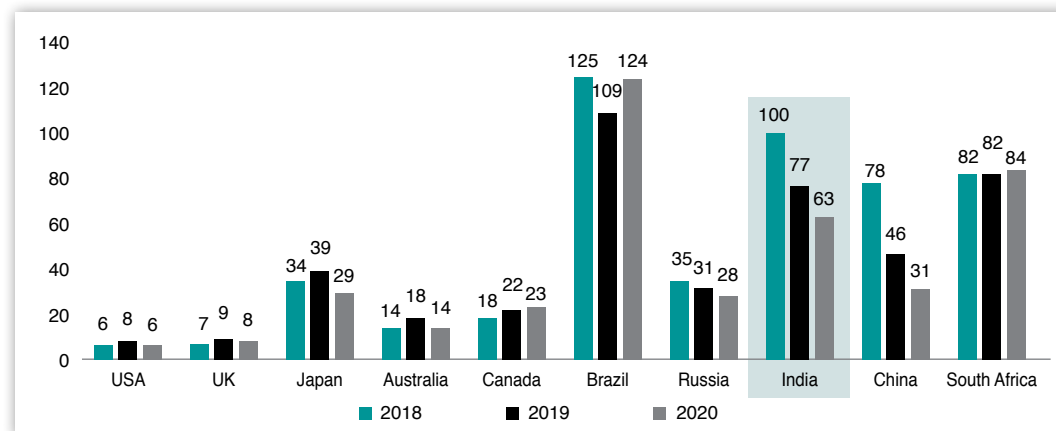
Let us examine the impact of IBC on each stakeholder in greater detail.

Impact of IBC on the economy

Ease of Doing Business ranking has improved: Implementation of the IBC has helped improve India's position in the World Bank's EoDB ranking, and attract more foreign investors.

In 2020, the ranking weighed 190 countries on 10 areas of reforms. India's rank improved to 63 from 100 in 2018, mainly because of IBC implementation.

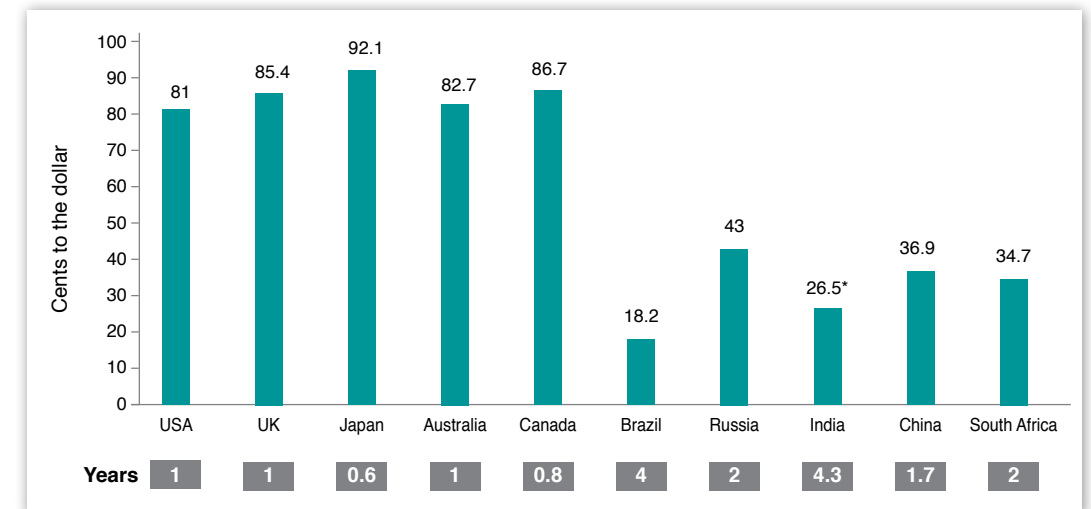
Figure 2: Ease of Doing Business rankings, 2020



Source: Doing Business, World Bank report

Strengthening insolvency framework: World Bank's EoDB ranking is based on 11 parameters. One of the parameters is linked to insolvency framework. The Doing Business 2020 report puts the ease of resolving insolvency score and rank of India at 62.0 (improved from 40.8 in 2019) and 52 (improved from 108 in 2019), respectively, citing the strengthening insolvency resolution framework. The significant jump in India's score can be attributed to the IBC, which prescribes clear timelines for the resolution process.

Figure 3: Recovery rates and timelines in developed and emerging nations



*Data as per Doing Business 2019 report. The Doing Business 2020 report has not been considered as the recovery rate of 71.6% and resolution timeline of 1.6 years could be one-off events, and as the data pertained to just two cities of India.

Source: Doing Business 2019, World Bank report

Banks and financial institutions

Indian banks, especially Public Sector Banks (PSBs), have in the past few years been burdened with a huge pile of non-performing assets (NPAs), which eroded their profitability and capitalisation. As on March 31, 2021, gross NPAs were estimated at 7.5%-8% of gross advances.¹ Though that represents a decline from 11.2% as of March 31, 2018, these are expected to increase to 8.5-9.0% by end of fiscal 2022.

Recent regulatory changes are instilling better credit discipline in borrowers: The risk management practices of Indian banks, especially PSBs, remain weak. Moreover, laws were not in favour of lenders and, hence, erring promoters exploited the tedious recovery procedure. This is borne out by the high and rising number of wilful defaulters of banks. However, the Reserve Bank India (RBI) has tightened norms for such defaulters and made stressed asset resolution norms more stringent. That, coupled with increased resolution of large-ticket NPAs under the IBC framework, have contributed to better recovery of NPAs.

IBC amendments are hastening this process: Introduction of an amendment - section 29 A - has rendered the promoters of insolvent companies (except micro, small, medium enterprises (MSME)) ineligible to bid for their own entity, significantly enhancing credit discipline. This resulted in resolution of cases at the pre-admission stage in the IBC, as the fear of promoters losing their

companies started looming. As per press release by Ministry of Corporate Affairs (MCA) dated December 15, 2019, ~9,600 cases involving ₹ 3.75 lakh crore were disposed of under the IBC at the pre-admission stage.²

It is releasing capital for banks: Banks deploy substantial capital as provisions against stressed assets. Faster resolution will help release capital that can be used for credit expansion.

Unsecured loans market is getting a boost: The IBC will promote unsecured financing as the distribution waterfall of recoveries following liquidation gives unsecured financial creditors (FCs) (apart from all secured creditors) precedence over government dues.

Bond markets and investors

India's corporate bond market is still small but developing: The corporate bond market forms only ~23% of India's gross domestic product (GDP), compared with ~146% in the United States (US) and ~85% in South Korea, on account of lack of investor confidence and the 'newness' of the insolvency regime.

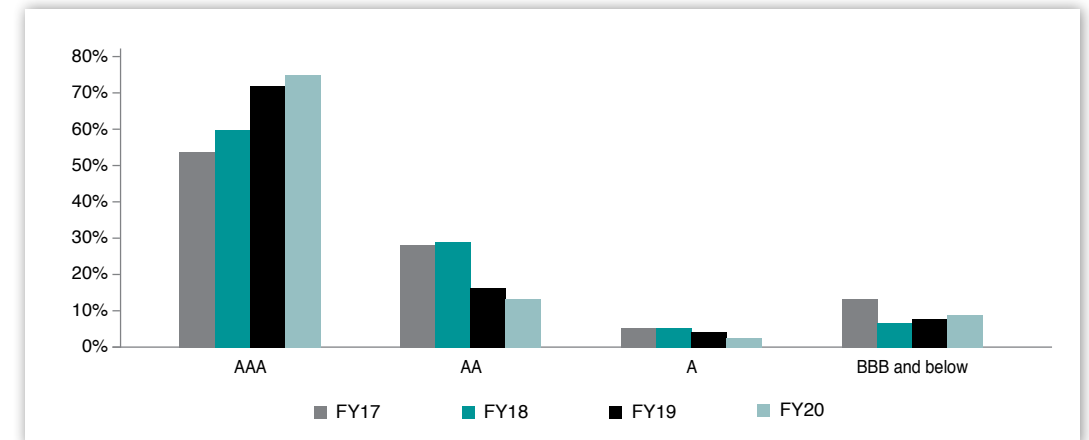
Table 1: Recovery rate, resolution timeline vis-à-vis bond market penetration

Country	Doing Business score*	Recovery rate* (%)	Time* (years)	Corporate bonds / GDP ratio^ (%)
China	77.9	36.9	1.7	35
Singapore	86.2	88.7	0.8	36
Malaysia	81.5	81.0	1	54
South Korea	84.0	84.3	1.5	85
US	84.0	81.0	1	146
India	67.2#	26.5#	4.3#	23

Source: *Doing Business report 2020; #Data as per Doing Business 2019 report - The Doing Business 2020 report has not been considered as the recovery rate of 71.6% and resolution timeline of 1.6 years could be one-off events and as data pertained to just two cities of India, Hence, CRISIL Ratings has used the 2019 data for a better comparison. CRISIL Research

Low investor interest is also clearly reflected in India's corporate bond market, which is skewed towards highly rated bonds. About 90% of trading is restricted to AAA and AA rating categories. The primary reason for the aversion to lower-rated paper (below AA category) is poor recovery in case of a default.

Figure 4: Distribution of bond issuances by rating category



Source: Prime Database, CRISIL Research

Better and faster resolution will deepen the bond markets: With a robust IBC ecosystem, and the expectation of greater sustenance in the certainty of resolution outcomes and adherence to timelines under the IBC, the interest of both domestic and foreign investors in lower-rated paper is expected to increase over time. Hence, a gradual shift of investor confidence would lead to higher penetration of bond markets in India.

The RBI has also implemented norms for limiting individual/group exposures in banks and encouraging large corporate borrowers to access the bond markets for funds. This, along with the IBC, will boost the Indian corporate bond market.

Creditors

For the first time, operational creditors (OCs), too, can initiate insolvency proceedings. The IBC has uplifted the rights of the creditor (irrespective of type, that is, FC or OC), and sharpened identification of bankruptcies and initiation of resolution proceedings. It has especially empowered OCs such as trade suppliers, employees, and workmen to initiate the insolvency resolution process. The provision was not available in earlier and even other current restructuring mechanisms, such as the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act) and the Recovery of Debts and Bankruptcy Act, 1993 (RDB Act). OCs are now initiating more corporate insolvency resolution processes (CIRPs) than FCs. As of March, 2021, out of 4,376 cases admitted under CIRP, ~51% were initiated by OCs, ~43% by FCs and the remaining by corporate debtors (CDs). While OCs initiated 80% of the CIRPs with underlying default amount of less than ₹ 1 crore, FCs initiated 80% of CIRPs with underlying default amount of more than ₹ 10 crore.

Asset Reconstruction Companies

IBC has further strengthened ongoing ARC reforms: Till 2013, though ARCs successfully reconstructed a few large accounts and demonstrated the ability to recover through asset sales. The recovery rate was not up to potential due to pending legal issues, delay in debt aggregation and acquisition of high vintage assets. From fiscals 2014-17, there were several policy amendments and the shift to the 15:85 acquisition structure from the 5:95 structure, wherein minimum security receipts subscription by ARCs was increased to 15% from 5% since the regulator wanted ARCs to have more skin in the game. This paved the way for improvement in recovery prospects. The IBC was enacted in this period.

In fiscal 2018 and beyond, implementation of the IBC took off and new provisioning norms for banks to hold security receipts were brought in. Hence, ARCs have started looking at a structural shift in their business model with higher cash deals backed by investors with deep pockets.

With IBC-induced borrower discipline improving, recoveries could climb: Nonetheless, ARCs have a long way to go in terms of recovery. Access to capital sources is a critical aspect because the collective net worth of ARCs is pegged at just ₹ 9,500-10,000 crore (CRISIL Ratings' estimate; as on March 31, 2021), and they have limited room to tackle mounting NPAs. However, they have been trying to implement strategies to improve recovery rates backed by positive changes in the regulatory framework, improved credit discipline among borrowers because of the IBC, and acquisition of lower vintage assets.

Corporates and MSMEs

To be sure, the IBC has instilled better credit discipline among borrowers, that is, corporates including MSMEs. This has led to faster resolution and better recovery in and outside the IBC platform. The Code also provides some respite for start-ups, which, if insolvent, can be wound up on a fast-track basis within 90 days. Thus, creditor interest can be protected and capital can be reallocated to efficient businesses. This may also help entrepreneurs initiate insolvency proceedings voluntarily. Over a period of time, the Code is expected to promote entrepreneurship and increase the role of professionals from various fields such as law, accountancy and finance.

While the IBC fosters innovation and entrepreneurship, the recently introduced insolvency pre-pack is a step in the right direction to protect and ensure business continuity for MSMEs.

According to the Ministry of MSME's report for fiscal year 2021, India's MSME sector is dominated by micro-enterprises. Of an estimated total of 6.33 crore MSMEs, 6.30 crore (99.47%) are micro-enterprises³, 3.31 lakh (0.52%) are small⁴, and 5,000 (0.01%) are mid-sized⁵. Rural areas have 51% of the MSMEs in the country.

Given their crucial role as a catalyst for economic growth, the MSME Development Act, 2006 gave MSMEs special status by way of relaxations, exemptions and relief under various government

schemes, and several laws including the IBC.

The IBC provides relaxations to MSMEs through section 240A, wherein if the CD is an MSME, section 29A of the IBC, is exempted. The exemption has allowed a window to promoter-directors of MSMEs to submit resolution plans under the Code, thereby increasing the chances of revival of these firms.

It is pertinent here to look at how the pandemic has led to changes in the provisions of the IBC, to the further benefit of corporates, especially MSMEs.

Changes in the IBC in response to the pandemic will mainly benefit MSMEs

The intensifying pandemic and the consequent recession have cast a cloud over business sentiment across the globe. Banks and non-banking financial companies (NBFCs) saw subdued growth in fiscal year 2021 and the credit quality of corporates was hit in the first half of the fiscal as the economy decelerated sharply. The second COVID-19 wave has thrown cold water over Indian economy that was beginning to warm up after the most severe contraction since independence. Consequently, CRISIL has lowered its GDP growth forecast for India to 9.5% for the current fiscal, compared with 11% expected earlier. However, the central government announced a slew of measures to boost the economy in the wake of the pandemic. Of these, the following (made on May 17, 2020 under the economic package) pertained to the IBC.

- a) Minimum threshold to initiate insolvency proceedings raised to ₹ 1 crore from ₹ 1 lakh.
- b) Special insolvency resolution framework for MSMEs.
- c) Suspension of fresh initiation of insolvency proceedings up to one year till March 24, 2021.
- d) Exclusion of pandemic-related debt from the definition of 'default' under the code for the purpose of triggering insolvency proceedings.

The intention of IBC relaxations was to provide a breather to corporates, including the MSMEs, to sustain during the pandemic. That said, MSMEs would have been the first to gain, since they do not have the wherewithal to sustain for long if referred to the IBC. This would also have shielded MSMEs from value erosion of their business because there would not be any takers under the IBC due to the unique nature of their business.

The lifting of the suspension of initiation of fresh insolvency process under the IBC, which ended on March 24, 2021, may also lead to a surge in cases under the IBC which is a key monitorable.

Introduction of 'pre-packaged' resolution option augurs well for MSMEs too

On April 4, 2021, the President of India promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 to allow pre-packaged insolvency resolution process (PPIRP) for CDs classified as MSMEs with minimum default of ₹ 10 lakh. This new regime under the IBC aims to provide MSMEs quicker, more cost-effective resolution than the traditional CIRP route.

The PPIRP for MSMEs is based on the ‘debtor-in-possession’ model, wherein the CD proposes a resolution plan to the secured creditors before the initiation of CIRP and the entity continues to be controlled by the existing management rather than coming under the control of the Resolution Professional (RP). Once the proposal is approved by 66% of the creditors, it comes under CIRP wherein the timeline for resolution is 120 days vis-à-vis 330 days for corporates referred directly under CIRP (see Annexure 1 for details of PPIRP working).

Benefits of PPIRP

PPIRP is expected to be an informal process compared to the CIRP. It should result in quicker resolution and maximise the underlying value on a going concern basis. CDs and lenders can arrive at a mutually agreed effective resolution plan that saves a lot of time before the commencement of the CIRP process and manages to save cost during the course of resolution – a breather for small borrowers, many of whom do not have the wherewithal to incur the CIRP costs resulting in the firm being referred for liquidation. This arrangement also provides flexibility to obtain a better resolution plan compared with the base resolution plan (BRP) submitted by the CD, which would help in better price discovery.

Challenges

Since most of the negotiation under PPIRP is expected to take place before the CIRP starts, creditors may opt for other legal mechanisms for recovery as well. This defeats the purpose of PPIRP. Also, Insolvency Professionals (IPs) are evolving even under the pre-existing IBC ecosystem and may require more expertise to deal with pre-packed deals.

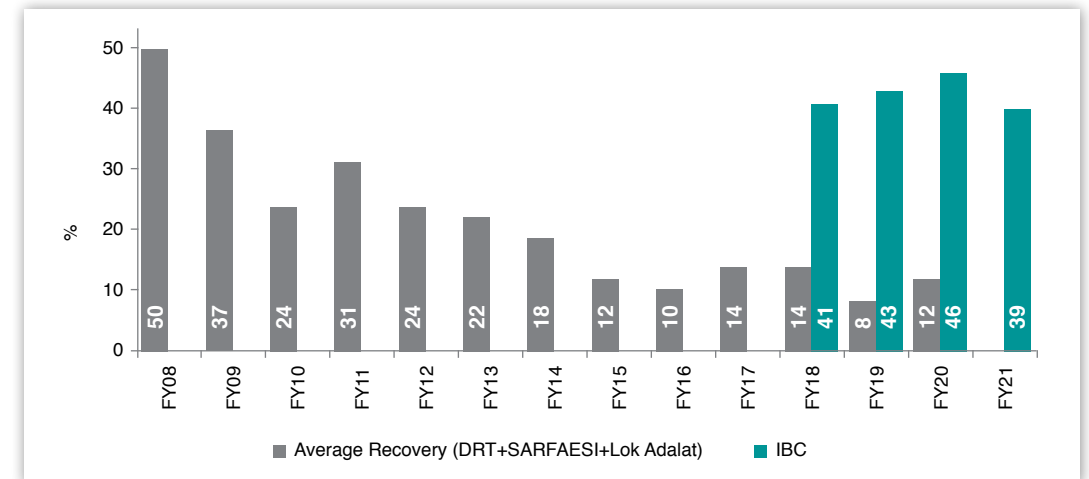
IBC Vs. OTHER MECHANISMS: HITS AND MISSES

The IBC has shown better recovery rates

The ‘seismic shift’ IBC has brought about in insolvency resolution in India moves the bargaining power to creditors from debtors. The focus is on optimum debt reduction, including through potential transfer of assets to a new management that can bring in the resources needed to scale-up cash flows.

The recovery rate under IBC has been better than that through other channels such as debt recovery tribunals (DRTs), the SARFAESI Act and Lok Adalats, which are burdened by pending legal issues and infrastructure constraints.

Figure 5: Recovery rates across mechanisms

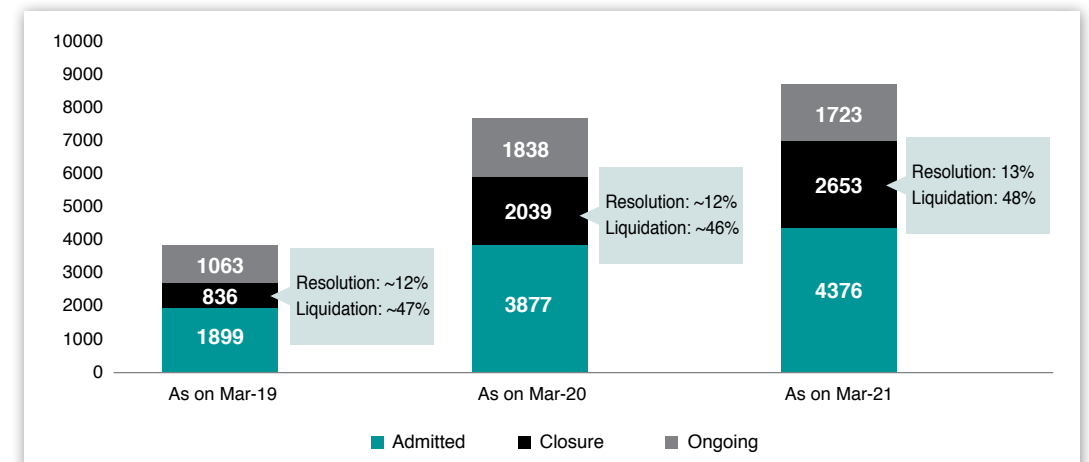


Source: RBI, IBBI; For IBC, the recovery rate is calculated on aggregate figures

As on March 31, 2021, the National Company Law Tribunal (NCLT) had approved resolution plan for 348 stressed assets under CIRP – this is 13% of the cases closed till March, 2021. Of these, resolution has been reached for around ₹ 2.03 lakh crore as against total claims of FCs of around ₹ 5.16 lakh crore, translating into a recovery rate of 39%. Had these 348 cases undergone the liquidation process, the recovery rate for the FCs would have been 22% (liquidation value upon claims of FCs).

Liquidation cases increased by more than three times to 1,277 as of March, 2021 (this is 48% of the total cases closed till March, 2021) from ~400 as of March, 2019.

Figure 6: Cases admitted to NCLT over the past three fiscals (aggregate basis)

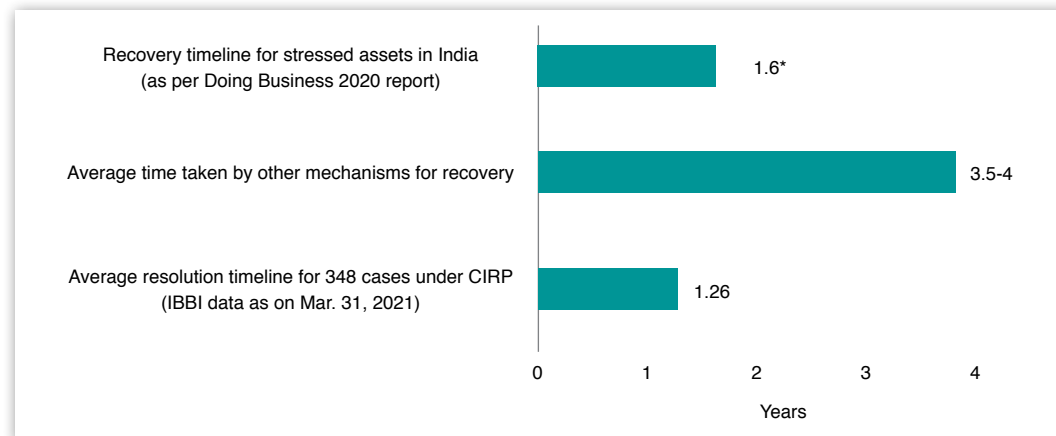


Source: IBBI

It is also quicker, though adherence to own timeline remains a challenge

Resolutions under the IBC are undoubtedly faster compared with other mechanisms such as ARCs/ DRT/ SARFAESI Act, at 1.26 years (459 days) for resolved cases (348) as of March, 2021, compared with 3.5-4.0 years through other routes. This corroborates with the resolution timeline of 1.6 years mentioned in the World Bank's Doing Business 2020 report.

Figure 7: Recovery timeline comparison



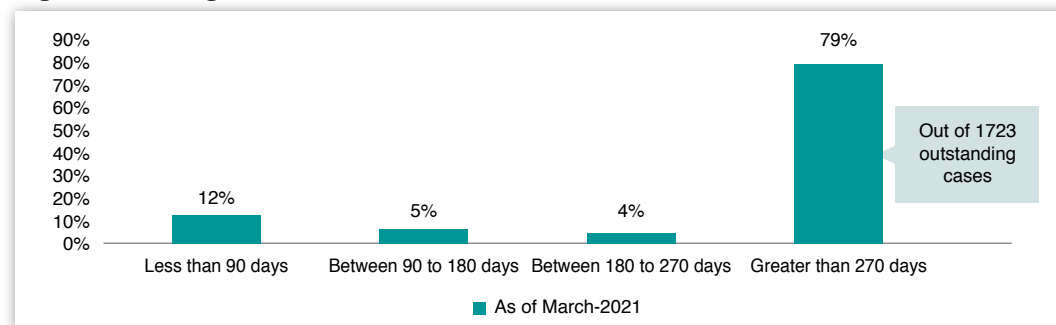
*Recovery timeline for major cities in India (Delhi & Mumbai)

Source: World Bank Ease of Doing Business Report 2020 and IBBI

Though the average resolution timeline for the 348 resolved cases under IBC as of March, 2021 as compared to other mechanisms is faster, it has crossed the 330 days timeline prescribed in the Code itself. Also, the average timeline across categories i.e. FCs, OCs and CDs was also more than prescribed.

Further, 79% of the outstanding 1,723 cases as of March, 2021 are pending beyond 270 days. Hence, adherence to IBC's own timeline remains a challenge.

Figure 8: Pending Cases



Source: IBBI Newsletter

For 2019 and 2020, outstanding cases pending for more than 270 days were at 30-35%

Infrastructure bottlenecks, varying judgments by different NCLT benches, and administrative issues are some of the reasons for the significant delays in the resolution of CIRP applications.

MIND THE GAP: A ROUTE MAP FOR QUICKER, BETTER RESOLUTIONS

Work towards achieving time-bound resolution

Stakeholders are failing to formulate a resolution plan within the prescribed 330 days, especially in complex/large cases.

Of the first 12 large cases in the IBC referred by the RBI, the majority crossed 270 days for resolution. As on March 31, 2021, there were 1,723 cases under CIRP, of which 79% were pending for resolution for more than 270 days.

Stakeholders need to work together constructively. The development of IPs with integrity and the necessary skills to undertake the onerous tasks in insolvency and bankruptcy cases is critical.

Delays also raise the threat of liquidation, so time-bound resolution is key to maximise asset value

Delay in the initiation of the insolvency process affects the liquidation value of the underlying assets, which depreciates with time. Many corporates ending up with liquidation had long pending defaults, and were left with inadequate organisational capital.

The major reasons for failure to arrive at a proper resolution plan include valuation mismatch, lack of clarity on payment of statutory liabilities, conflict among lenders, and high cost involved in submitting such plans.

In most cases leading to liquidation, the resolution value offered is lower than the liquidation value, the plan comes from ineligible parties, or there is no resolution plan at all. Liquidation also leads to job losses, even if the firm is liquidated on a going-concern basis.

Strengthen judicial infrastructure

Currently, there are only 15 benches with 19 judicial members and 21 technical members at the NCLT.⁶

This may not be sufficient to deal with a large number of pending cases as the NCLT is required to resolve cases earlier filed under the Company Law Board and the Board for Industrial and Financial Reconstruction (BIFR) in addition to insolvency cases.

Winding up and amalgamation cases with High Courts and corporate cases in DRTs are also transferred to the NCLT.

To address this, the MCA is contemplating doubling the NCLT benches. An immediate ramp-up of infrastructure at the NCLT and the National Company Law Appellate Tribunal (NCLAT), digitisation of the platform, proactive training/on-boarding of judges, lawyers and other intermediaries will be helpful for more effective implementation of the code.

Give Committee of Creditors (CoC) more powers, autonomy

Members of the CoC hold several responsibilities including invitation, receipt, consideration and approval of resolution plans under the IBC. Their conduct has serious implications for continued business of a CD, and consequently, the economy.

In a number of cases, the Adjudicating Authority (AA) has observed that the members of the CoC nominated by lenders are not given the authority to take decisions upfront, thereby delaying the process. Moreover, conflicts are common even among secured creditors.

These aspects can result in increased conflicts of interest in agreeing to a revival plan within a stipulated period. The provision for automatic liquidation means the end of the road for companies that could otherwise have been revived.

The CoC must work dynamically with the RP to revive the company and should be trained to handle professional challenges. Logistical challenges need to be addressed to deal with the large number of participants attending CoC meetings to have a constructive decision-oriented discussion.

Set up robust information utilities (IUs) to provide credible information on claims

IUs provide access to credible and transparent evidence of default, which helps expedite the initiation of the resolution process. They also facilitate quick formation of the CoC by providing information regarding creditors' claims required to form the committee.

In the absence of IUs, the formation of a CoC may take longer, making it difficult to adhere to the timeline for completing the resolution process. It also becomes time-consuming for NCLT to evaluate whether a default has taken place.

India has only one IU, National e-Governance Services Ltd (NeSL), which was registered with the Insolvency and Bankruptcy Board of India (IBBI) on September 25, 2017. Moreover, the financial information available with NeSL needs scrutiny. Technological infrastructure has to be strengthened to avoid data loss and maintain confidentiality.

Develop a viable secondary market for stressed assets

Unlike the US, India does not have an active organised market for secondary/used industrial assets, such as plant and machinery. This limits the lender's ability to take possession of secured assets in case of insolvency, as they do not have buyers. Moreover, banks are sceptical about funding these assets.

An active secondary market and funding from banks could foster entrepreneurial interest, helping in faster redeployment of these assets and ensuring better price discovery.

Implement group/cross-border insolvency on a fast-track basis

With the current amendments in the code, group/cross-border insolvencies in the current context should be prioritised as they are complex and entangled with legal complications. Learnings from recent transactions such as resolution of Videocon and its 13 group companies should be taken on-board to lay down a comprehensive framework. The ecosystem needs to be strengthened by increasing NCLT capacities and developing technical expertise of judges with efficient administrative functionaries.

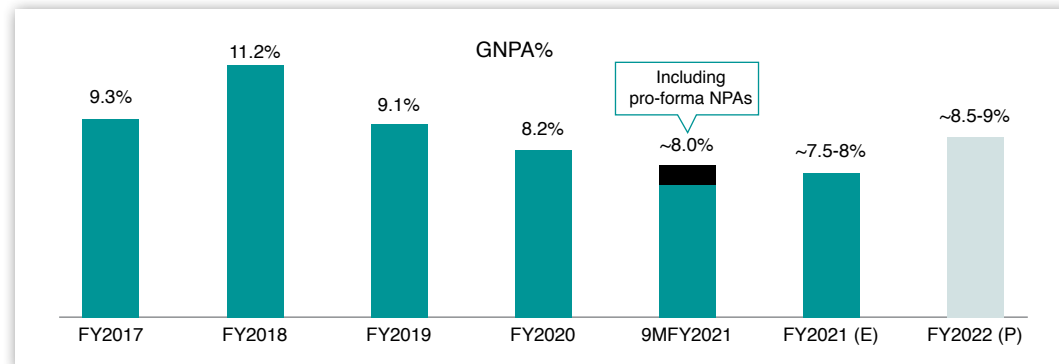
Develop comprehensive bankruptcy framework for financial service providers (FISPs)

With the rise in stress in the non-banking financial sector, rules were notified by the MCA providing a framework for insolvency resolution of systemically important FiSPs⁷, excluding banks. These rules are under the powers given to the government in section 227 of the IBC and are only applicable to NBFCs (including housing finance companies) with asset size of ₹ 500 crore or more as per the last audited balance sheet. RBI as the FiSP regulator is allowed to file an application. Similar to the corporate resolution framework under the IBC, a comprehensive framework for FiSPs, including banks, needs to be developed as this is one of the most critical areas of the IBC.

CRISIL RATINGS' ESTIMATE OF THE MARKET FOR STRESSED ASSETS

The expected increase in gross NPAs (GNPAs) of both banks and non-banks this fiscal as a repercussion of the pandemic will provide a significant opportunity for players in the stressed assets market.

Interestingly, the proportion of acquisition of smaller and medium-sized accounts has increased in the last couple of years, in contrast with the focus on large corporate accounts previously. Moreover, ARCs are increasingly acquiring stressed assets from non-banks, though this proportion remains small.

Figure 9: Banking GNPA's to cross ~₹ 10 lakh crore by March, 2022

Source: CRISIL Ratings analysis

GNPAs of banks have declined from the peak seen in March, 2018 and were lower as of March, 2021 vis-à-vis March, 2020 on account of supportive measures, including the six-month debt moratorium, Emergency Credit Line Guarantee Scheme (ECLGS) loans and restructuring measures.

However, with the second wave hitting the country, NPAs are expected to rise to 8.5-9.0% by March, 2022. The current asset quality stress cycle will be different than that witnessed a few years back. NPAs then came primarily from bigger, chunkier accounts. This time, smaller accounts, especially the MSME and retail segments, are expected to be more vulnerable than large corporates, as the latter have consolidated and deleveraged their balance sheets considerably in the past few years. While restructuring scheme announced for MSME segment and small borrowers should prevent the NPAs from rising too much, there is, nevertheless, opportunity for stressed asset investors with expertise and interest in these asset classes.

Figure 10: Unsecured loans and MSME Finance worst impacted

AUM share		90+ dpd		Restructuring	Stressed Assets (Mar'21)
		March 2020	March 2021		
4%	Gold loans	1.9%	1.1-1.3%	Nil	1.1-1.3%
38%	Home loans	1.2%	1.3-1.5%	0.5-0.75%	1.8-2.0%
22%	Vehicle finance	6.0%	5.5-6.0%	1.5-2.0%	7.5-8.0%
4%	Unsecured loans	2.2%	3.5-4.0%	2.5-3.0%	10.5-11.0%*
11%	MSME finance	3.4%	4.5-5.0%	1.5-2.0%	6.5-7.0%

AUM: Asset under management; MSME: Micro, small, and medium enterprise

Note: AUM share is estimated as of March 31, 2021

Source: Company reports, CRISIL Ratings' estimates

Delinquencies are expected to rise for NBFCs too, though the extent of increase will vary across asset classes. Stressed assets of NBFCs were estimated at ₹ 1.5 lakh crore as of March, 2021.

While gold and home loans are expected to be affected the least, MSME, unsecured and wholesale loans will take a bigger hit as these borrower segments have been affected more by the pandemic. For vehicle loans, where asset quality is closely linked to economic activity, delinquencies will see a temporary increase and should decline over the medium term as economic activity picks up. Similar to the corporate segment, MSMEs too present an opportunity for stressed asset players focussed on the retail and MSME segments.

As the containment measures are gradually eased in the next couple of months and the vaccination programme gathers pace, the upside to NPA estimates may be limited. However, another surge in COVID-19 cases leading to localised or partial lockdowns pose downside risks.

PRE-PACK INSOLVENCY, A SHOT IN THE ARM FOR MSMEs

A summary of PPIRP⁸ for MSMEs: The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021

Preliminary information memorandum	Information submitted by the CD
Pre-packed insolvency date	Date of initiating PPIRP by the AA
PPIRP cost	<ul style="list-style-type: none"> Interim finance cost and cost incurred to raise it RP's fees Cost incurred by the RP for running the business of the CD Cost incurred by the government to facilitate the PPIRP Any other cost specified by IBBI
PPIRP period	Period beginning from the admission of an application for initiating PPIRP by the AA and ending when an order for approval of the resolution plan or termination of PPIRP or initiation of CIRP is passed by the AA.
Base resolution plan	Initial resolution plan provided by the CD

CD eligible and other conditions for initiating PPIRP

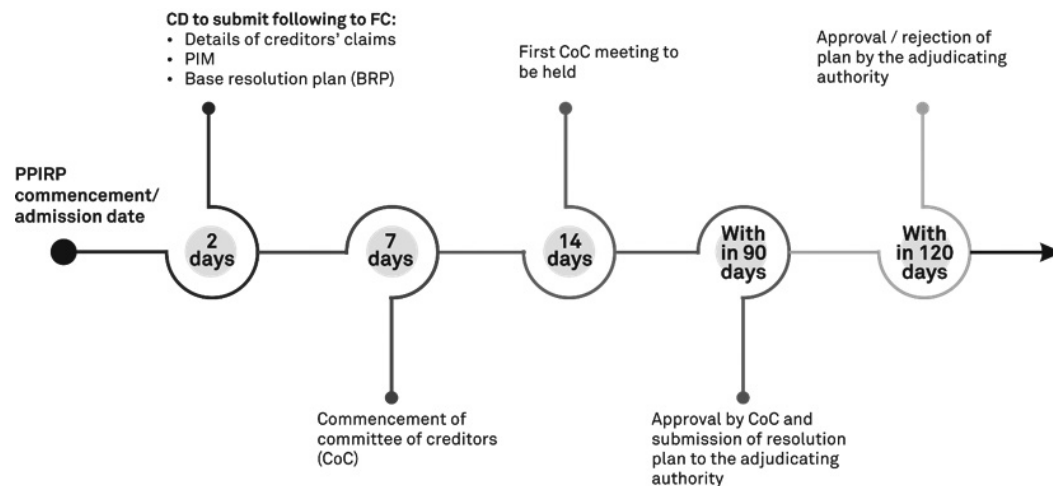
- CD classified as a MSME under section 7(1) of Micro, Small and Medium Enterprise Development Act, 2006
- Not undergoing a CIRP process
- Not undergone CIRP and PPIRP process for three years preceding initiation date
- No order passed under section 33 of the IBC for liquidating the CD
- Eligible to submit a resolution plan under section 29A
- FCs to propose the appointment of RP
- FCs with a 66% voting share by value must approve the resolution plan
- Majority of directors or partners of the CD to declare:
 - CD to file an application for initiating PPIRP within 90 days
 - The initiation is not to defraud any person
 - Name of the IP proposed and approved to be appointed as RP
- Special resolution passed by members of the CD; or three-fourths of the partners approving the initiation of PPIRP
- Approval of at least 66% of the FCs by value required for initiating the PPIRP
- Prior to approval, FC must be provided with declaration, special resolution and base resolution plan

- CoC does not approve the plan selected after competing with BRP in the manner specified by IBBI
- The AA rejects the resolution plan, as it does not conform to requirements under section 30(2).
- The AA orders vesting of management of CD with the RP, after which the CoC approves a resolution plan which does not result in change in management or control of CD (the AA shall also order for liquidation)
- In the event of termination, CD shall bear the PPIRP costs, if any.

COMPARISON OF BANKRUPTCY MECHANISMS WORLDWIDE

Details	US	UK	India	Other countries
Bankruptcy initiation	A creditor may file for restructuring and liquidation and does not need to provide evidence	A creditor may file for restructuring and liquidation, but needs to produce clear evidence	In India, an FC, an OC or the CD itself can initiate on default of ₹1 crore and above	In some countries, such as Australia, Canada, Greece, Brazil and Russia, creditors may file only for liquidation
Management change	Debtor retains management control of the company and proposes a plan of reorganisation	An Administrator takes over management of the company and plays a central role in the rescue process	The management of the affairs of the CD vests in the interim RP appointed by the AA and approved by the CoC	
Pre-packaged rescue	Debtor company and its creditors conclude an agreement for sale of the company's business prior to initiation of formal insolvency proceedings	Same as in the US	Framework for MSMEs introduced	
Consent of resolution proposal	Each class of creditors needs to consent to the resolution plan through a vote of two-thirds of that class in volume and half the allowed claims. Provision available for 'cram-down' of dissenting creditors	Acceptance of the proposal requires a simple majority (by value) of the creditors present and voting	66% consent of CoC for key decisions, and 51% for routine decisions	In Germany, the proposal needs to be approved by each class of creditors. In France, two committees of creditors plus a committee of bond holders are established

Figure 11: Timelines for approval for resolution plan



Termination of PPIRP

- No resolution approved until 90 days of PPIRP commencement
- CoC decides to terminate the plan with a minimum 66% of the voting share
- CoC decides to initiate CIRP process against the CD with a minimum 66% of the voting share

Details	US	UK	India	Other countries
Waterfall mechanism	In case of liquidation, costs associated with insolvency proceedings have the first claim	In case of liquidation, secured creditors have the first claim	In case of liquidation, costs associated with insolvency proceedings have the first claim followed by dues of workmen and secured creditors on a pari passu basis	In Australia, Norway, Greece, Mexico and Colombia, employees' salaries have the first claim in the order of priority
Moratorium	Law provides for an automatic moratorium on the enforcement of claims against the company and its property upon filing of a Chapter 11 petition	Law provides for an interim moratorium for the period between the filing of an application to appoint an Administrator and the actual appointment	The IBC provides for an automatic moratorium of 180 days against any debt recovery action by the creditors, extendable by 90 days in exceptional cases	In Singapore and Brazil, the moratorium holds till the entire resolution plan is approved

Source: RBI, CRISIL Ratings

NOTES

¹ Financial Stability Report, July 2021

² Year End Review (2019), Ministry of Corporate Affairs.

³ Micro investment upto ₹ 1 crore and sales.

⁴ Small: Investment up to ₹ 10 crore and sales up to ₹ 50 crore.

⁵ Medium: Investment up to ₹ 50 crore and sales up to ₹ 250 crore.

⁶ National Company Law Tribunal

⁷ Ministry of Corporate Affairs Notification, November 18, 2019.

⁸ A pre-pack is the resolution of the debt of a distressed company (corporate debtor) through an agreement between secured creditors and investors instead of a public bidding process. Under the pre-pack system, financial creditors will agree to terms with a potential investor and seek approval of the resolution plan from the NCLT.

4

IBC : A BANKING REGULATOR'S PERSPECTIVE

Saurav Sinha

Corporate bankruptcy law is undoubtedly a key element in any market economy. Bankruptcy laws serve the greater public good by providing an avenue for recycling capital tied up in inefficient or obsolete firms thereby realigning the deployment of resources as per the present requirements of society. By acting as a conveyor for capital deployed with less efficiency elsewhere, bankruptcy laws also promote entrepreneurship and innovation in the economy, thereby reducing the overall opportunity cost of capital deployment by the entire economy. Equally importantly, bankruptcy laws also provide a means for distressed borrowers to renegotiate their debt with the creditors and for creditors to exercise their rights over borrowers in default. It is this last aspect of bankruptcy laws that is of special interest to the Reserve Bank of India (RBI) as the regulator of the banks and non-banking financial companies (NBFCs) in the country. In this article, the author describes the special interest that the RBI has and how it has leveraged the Insolvency and Bankruptcy Code, 2016 (Code/IBC) in the regulatory approach towards resolution of stressed assets in the banking system.

WHY IS THE BANKING REGULATOR INTERESTED IN BANKRUPTCY LAW?

Firms grow by successively investing in new viable projects. If the project succeeds, the firm enjoys windfall gains that can be passed on to the owners – the equity holders. The upside enjoyed by the creditors in such cases is limited to the timely servicing of their debt. However, if the project fails, the liability of the equity holders is limited to their respective shareholding. Once the shareholders are wiped out, all further losses are to be borne by the creditors. Thus, equity holders would prefer

more financing by debt since generally, it would be cheaper, and it would increase the return on equity by increasing the leverage of the firm.

Since the Indian debt market is dominated by banks, unresolved corporate defaults have a major debilitating effect on the health of banking companies. Unresolved corporate defaults increase the level of expected losses for the banks, leading to higher provisions which eats into the capital of the banks. Lower capital constraints their ability to lend to more productive borrowers thereby affecting the growth prospects of the economy. Unresolved defaults, if these are allowed to permeate through forbearances, such as suboptimal loan restructurings, preserve inefficiencies at the cost of additional fresh investments, which get crowded out.

Moreover, since the manifestation of expected losses leads to higher provisions for the banks, there are perverse incentives for the banks to evergreen the bad exposures by diverting more and more fresh credit to these inefficient borrowers, resulting in gross misallocation of resources in the economy. The longer corporate defaults remain unresolved, the more intense such perverse incentives will be. Therefore, a wait and watch approach for resolution of corporate defaults is not the ideal approach for a banking regulator to adopt.

At the same time, even if there is intent to resolve corporate defaults, the absence of a credible mechanism for resolution hampers the scope of resolution. Financial liabilities of a corporate debtor (CD) are a web of contracts accumulated over years with varying degrees of rights to the various creditors. Therefore, effective resolution of corporate distress requires unravelling this complex web of financial contracts and rewriting them in line with the revised expectations of the income-generating ability of the borrower in distress. Regulator-led resolution efforts inherently suffer from the limitations of the statutory power conferred upon the respective regulator. In an increasingly complex world of financial intermediation, where debt financing is done not just by banks, also by collective investment vehicles, insurance companies etc., absence of a comprehensive bankruptcy law proves detrimental. Moreover, absence of a comprehensive bankruptcy law and the consequent lack of a credible mechanism to enforce creditor rights increases the risk premium charged by the lenders to borrowers, in a bid to at least partially offset the high loss given default in such situations, through higher interest rates charged.

All the above demonstrate how bankruptcy law is a natural complement to effective banking regulation in any country.

EFFORTS OF RBI TOWARDS RESOLUTION OF STRESSED ASSETS

The share of non-performing assets (NPAs) to the gross loans of the banks, which had declined steadily for almost a decade until 2011, started inching up since 2011-12 due to various factors. The macroeconomic context in the years immediately preceding the NPA build-up was marked by the post-global financial crisis policy imperatives of ample liquidity and high credit growth, particularly

in certain high-risk sectors, which eventually reflected in lower lending standards and accumulating stress on bank balance sheets. It was in this context that the RBI initiated concerted steps towards strengthening the prudential regime and recognising the true stress in banks' balance sheets. The decision to do away with regulatory forbearance regarding asset classification on restructuring of loans, effective April, 2015, was a significant step from the perspective of aligning the regulatory norms with international best practices.

The asset quality review exercise undertaken in 2015-16 was a critical first step in recognising the aggregate stock of NPAs across the banking system. In tandem, a series of measures were put in place to provide a mechanism for coordinated resolution of stressed assets. Over time, additional tools to deal with problem assets were also introduced, given the absence of an effective bankruptcy law. These tools were primarily aimed at facilitating restructuring of credit facilities and/or change in ownership/management. The essential features of a bankruptcy law were sought to be incorporated into these designs. For instance, the Joint Lenders' Forum under the restructuring schemes was akin to the committee of creditors (CoC) where collective decision making could be facilitated. Further, the asset classification standstill permitted in respect of invocation of the restructuring schemes was equivalent to the moratorium under IBC – the borrower and its lenders could proceed with designing and implementing a restructuring plan without worrying about enforcement actions from lenders as well as without having immediate repayment pressures on the borrowers.

However, these efforts suffered from the absence of an effective, time-bound statutory framework for resolution of stressed assets. Stressed assets in the corporate portfolio of banks, which were the focus of the regulatory initiatives of the RBI, continued to rise at a rapid pace. Further, recovery rates of bad debts under the earlier regimes were observed to be lower due to weak creditor enforcement.

The enactment of the IBC in 2016 bridged the missing link for resolution of stressed bank assets and presented an opportunity to overhaul the existing framework. The enactment of the Banking Regulation (Amendment) Act, 2017, vested powers in the RBI to issue directions for pushing specific default cases for resolution under IBC and signalled the strong policy intent to leverage IBC for resolution of stressed assets. Under these powers, as is now widely known, the RBI issued directions in June, 2017, to the banks to initiate insolvency proceedings under IBC in respect of 12 largest CDs which were classified as NPA. These were followed by another set of directions in August, 2017, where the banks were directed to implement resolution plans in respect of another 29 corporate borrowers in default by December 13, 2017, failing which insolvency proceedings had to be initiated against them.

The enactment of IBC also obviated the need for rule-based regulations on resolution of stressed assets. Moreover, the default by the CD being the trigger for initiating insolvency proceedings under the statute forced a rethink of the regulatory trigger for mandatory resolution as well. The then prevailing schemes for restructuring were replaced by a simple and harmonised framework for resolution under a circular dated February 12, 2018 (February 12 circular). This revised framework provided near total discretion to lenders for designing and implementing a resolution plan in respect

of a borrower in default subject to bright line outcome tests. In respect of borrowers where the aggregate exposure to all banks were ₹ 2000 crore and above, non-implementation of a resolution plan within 180 days from the date of default required lenders to file insolvency application under IBC. As is now widely known, the revised framework was a subject of multiple litigations which culminated in the judgment of the Hon'ble Supreme Court of India on April 2, 2019¹, which found that the framework was *ultra vires* to section 35AA of the Banking Regulation Act, 1949. The judgment found that once a specific method for directing banks to initiate insolvency proceedings against the borrowers in default was prescribed in the statute, the same outcome could not be achieved through a general regulation such as the revised framework.

Consequently, the RBI issued the circular dated June 7, 2019 on Prudential Framework for Resolution of Stressed Assets (Prudential Framework), where the disincentive for delayed implementation was additional provisions required to be made by the lenders. The Prudential Framework also prescribed that half of these additional provisions could be reversed if an insolvency application was filed, and the other half could be reversed once the application was admitted. Thus, even though not directly, IBC is leveraged under the Prudential Framework as well.

IBC was the preferred route for RBI for resolution of Dewan Housing Finance Corporation Ltd. (DHFL) as well when the attempts to resolve the borrower under the Prudential Framework appeared not to deliver the desired results. At the same time, RBI has been fully cognisant of the fact that IBC is designed to suit the resolution of non-financial firms and resolution of financial service providers through IBC is only a temporary arrangement till a comprehensive law for resolution of financial service providers is enacted.

HOW EFFECTIVE HAS THE IBC LEVERAGE BY RBI BEEN?

An internal study was conducted to assess the impact of enactment of IBC and the resolution frameworks issued by the RBI (including the erstwhile February 12 circular) leveraging the IBC. The study was done using the sample of borrowers to whom banks/all India financial institutions have aggregate exposure of ₹ 5 crore or above as reported in Central Repository of Information on Large Credits (CRILC), which is a supervisory database managed by the RBI. The period of study was from March, 2015 to December, 2019. The CRILC databases used for the period have been adjusted to factor in the impact of bank mergers that happened subsequently.²

The reporting to CRILC happened on a quarterly basis till March, 2018 and monthly from April, 2018. Even though reporting to CRILC has been happening since 2014, it has been assumed that the reporting stabilised only by March, 2015. Further, the period after December, 2019 has been excluded because the outbreak of the pandemic in January, 2020 and the subsequent suspension of fresh insolvency proceedings for a year, which would affect the integrity of the assessment.

Using the asset classification reported in CRILC by the lenders, the one quarter transition matrices were calculated for the 20 cohorts between March, 2015 and December, 2019. The transition matrices have been computed based on the proportion of funded outstanding belonging to a

particular asset classification during a quarter that remained in the same category or moved to other asset classification categories in the ensuing three-month period. The asset classification movement across every three-month cohort was tracked for every combination of bank and borrower reported in CRILC. The exposures which did not remain with a particular lender at the end of the one-quarter period was tagged as #N/A.

Even though CRILC reporting has been happening on a monthly basis since April, 2018, the transition matrices have been calculated on a quarterly basis for quarters ending March, June, September and December even after that for the sake of comparability with prior period.

From the transition matrices calculated for the 20 cohorts between March, 2015 and December, 2019, the following average transition matrices were computed as simple average, separated by various milestones, as mentioned below:

a) Till notification of IBC in December, 2016.

(percent of total)

1-Q Transition	Non-SMA	SMA-0	SMA-1	SMA-2	NPA	#N/A
Non-SMA	88.95	2.36	2.84	2.06	0.79	3.00
SMA-0	35.62	38.94	9.26	9.66	4.55	1.96
SMA-1	33.91	8.05	25.91	24.15	6.50	1.47
SMA-2	19.88	6.10	11.95	48.50	11.94	1.63
NPA	1.80	0.15	0.34	0.25	93.43	4.04

b) After notification of IBC till the first list of 12 accounts in June, 2017.

(percent of total)

1-Q Transition	Non-SMA	SMA-0	SMA-1	SMA-2	NPA	#N/A
Non-SMA	91.01	1.53	2.29	0.98	0.58	3.61
SMA-0	45.36	31.92	7.12	9.92	4.60	1.08
SMA-1	35.94	7.27	25.47	22.16	7.69	1.46
SMA-2	17.13	3.86	13.92	44.43	19.12	1.54
NPA	0.94	0.10	0.09	0.10	92.88	5.89

c) After the first list till February 12 circular.

(percent of total)

1-Q Transition	Non-SMA	SMA-0	SMA-1	SMA-2	NPA	#N/A
Non-SMA	91.54	1.66	1.96	1.20	0.63	3.01
SMA-0	45.55	32.45	7.87	6.74	4.01	3.37
SMA-1	49.60	4.36	22.24	15.68	5.95	2.17
SMA-2	16.79	3.03	6.75	58.08	13.86	1.48
NPA	1.10	0.03	0.07	0.25	94.75	3.81

d) After the erstwhile February 12 circular till the judgment of Supreme Court dated April 2, 2020

(percent of total)

1-Q Transition	Non-SMA	SMA-0	SMA-1	SMA-2	NPA	#N/A
Non-SMA	92.24	3.41	0.87	0.51	0.34	2.62
SMA-0	58.71	27.04	6.62	3.73	1.97	1.93
SMA-1	38.18	18.66	19.14	13.46	8.35	2.21
SMA-2	19.67	14.39	13.97	31.02	17.49	3.45
NPA	1.21	0.09	0.04	0.07	93.70	4.88

e) Period since the Prudential Framework.

(percent of total)

1-Q Transition	Non-SMA	SMA-0	SMA-1	SMA-2	NPA	#N/A
Non-SMA	94.00	1.89	0.75	0.56	0.45	2.34
SMA-0	47.98	26.22	9.78	9.15	5.50	1.37
SMA-1	29.75	9.71	25.21	14.07	19.84	1.42
SMA-2	15.92	6.96	8.75	44.31	22.84	1.23
NPA	1.04	0.08	0.04	0.03	93.53	5.27

From the above transition matrices, the following can be surmised:

- Notification of IBC alone did not result in any material change in the behavior of borrowers. In fact, the proportion of special mention account (SMA)-2 and NPA accounts where default was cured in three months, came down slightly to 17.13% and 0.94% respectively, post notification of IBC as compared to 19.88% and 1.80% respectively prior to that. The curing of defaults in accounts classified as SMA-1 went up slightly after the notification of IBC to 35.94% from 33.91% prior to that.
- The directions issued by RBI to banks in respect of 12 defaulters had a significant impact on the behavior of accounts classified as SMA-1. For such accounts, the proportion of accounts in which default was cured increased to 49.60%.
- The most positive impact on the credit culture was by the erstwhile February 12 circular. It resulted in increases in curing of defaults from NPA, SMA-2 and SMA-0 to 1.21%, 19.67% and 58.71% respectively as against 1.02%, 16.96% and 45.46% respectively in the period between notification of IBC and February 12, 2018 ((ii)+ (iii)/2). Even though the curing of default in respect of SMA-1 exposures reduced from 42.77% in the period between notification of IBC and February 12, 2018 to 38.18% after the release of the erstwhile February 12 circular, the movement from SMA-1 to SMA-0 showed a significant jump (18.66% as against 5.82% previously).

- The upgrades came down significantly after the Hon'ble Supreme Court declared that the erstwhile February 12 circular was *ultra vires* to section 35AA of the Banking Regulation Act, 1949 even though it has partly recovered since the Prudential Framework was issued.

Similar findings have been reported in Kulkarni *et al.* (2021)³ who studied the effect of IBC and the erstwhile February 12 circular on recognition of zombie borrowers as non-performing. They used data from CRILC and CMIE Prowess for the study and concluded that improvements in the bankruptcy framework alone are not sufficient to nudge undercapitalised lenders to recognise losses stemming from insolvent borrowers. However, erstwhile February 12 circular, through the advanced reporting of borrower defaults, restrictions on lenders' ability to engage in regulatory forbearance, and the elimination of lender discretion in initiating bankruptcy proceedings against borrowers in default were successful in pushing even the most undercapitalised banks to recognise zombies as NPAs.

Thus, it can be surmised that while IBC undeniably had a positive impact on the credit culture, the impact was amplified when the RBI was able to leverage IBC in its resolution framework. The impact has weakened once the strength of the leverage reduced. It is important to recognise that such regulatory reforms were only possible on account of the paradigm shift in approach towards resolution brought about by the enactment of the IBC.

A WISHLIST FROM THE BANKING REGULATOR

The RBI firmly believes that a modern insolvency law such as the IBC deserves support and patience from all stakeholders and the attitude towards the new piece of law should not be coloured by losses materialised in respect of resolution of assets that have been stressed for decades. In fact, it is a disconcerting notion that IBC is seen as a last resort of resolution by many stakeholders including various banks – something that has to be thought about only after all other avenues have been extinguished. The RBI believes in the well-used analogy of a stressed borrower being similar to an ice cube taken out of the refrigerator – the longer it remains unprotected, the more ice melts into water and is lost. Similarly, the longer it takes for a collective resolution effort to start, the greater will be the value deterioration in the underlying company and consequently, the greater will be the haircuts for the lenders. The average time spent by a corporate borrower in default before insolvency proceedings commence against them would be a topic on which more research may be required.

Another disquieting aspect for the RBI is the time elapsed between the filing of an application for commencement of the corporate insolvency resolution process and the eventual admission of such an application. More research may be required to pinpoint the exact reasons that lead to such delays and to plug them since it could turn into a major impediment in ease of exit for bankrupt borrowers and enforcement of creditor rights.

Nevertheless, the RBI has been welcoming about the new dimensions being introduced to the IBC such as the new module of the pre-packaged insolvency resolution process (PPIRP/pre-packs) which combines the best of the out-of-court resolution efforts and the judicial finality of a resolution

plan approved by an Adjudicating Authority. Even though PPIRP has been presently allowed only for micro, small and medium enterprises' borrowers, the RBI envisions pre-packs as a natural complement to the Prudential Framework in respect of all borrowers in that difficult resolution involving non-cooperative lenders can be resolved using such pre-packaged plans. RBI is hopeful that PPIRP will soon be extended to all borrowers.

The RBI will continue to watch closely the changes in incentives to various stakeholders, especially the borrowers, that would be brought about by the developments in IBC.

NOTES

¹ *Dharani Sugar and Chemicals Ltd. v. Union of India & Ors.*, 2019 SCC Online SC 460

² Merger of ING Vysya Bank with Kotak Mahindra Bank Limited; merger of the associate banks and Bharatiya Mahila Bank with the State Bank of India; and merger of Dena Bank and Vijaya Bank with Bank of Baroda.

³ Kulkarni N. et. al. (2021), "Unearthing Zombies", Working Papers 59, Ashoka University, Department of Economics.

5

MY JOURNEY WITH IBC

B. S. V. Prakash Kumar

It was on June 1, 2016 that the National Companies Law Tribunal (NCLT) was constituted under the Companies Act, 2013 by conferring encompassing jurisdiction upon it to deal with all company matters. Parallely, the Company Law Board (CLB) was dissolved following the birth of NCLT. The then Chairman of CLB, Justice M. M. Kumar and me joined NCLT on the orders of the Central Government. Other selected Members too joined within a period of one month. In the process of bringing NCLT into operation, I was posted to NCLT Mumbai. When I proceeded to Mumbai, not even a steno was available there. But somehow, we managed without steno for some time. Later with the help of a retired employee of Ministry of Corporate Affairs (MCA), I got hold of a steno, who, on her terms joined as contract employee. This Tribunal, which is now considered as premium Tribunal, had come into existence calmly and quietly, not knowing to itself that it would become the most happening Tribunal soon. It had started its journey without wherewithal to kick-start. However, all the Members who initially joined NCLT at various places, remained tenacious and kept adding value to the institution with their prowess. Here, I recall that without the relentless work of the founder President and founder Members of NCLT, this institution would not have stood at where it is now.

Even before NCLT could come out of its teething issues, such as staff requirement, infrastructural needs, cases relating to merger and amalgamation (M&A) and reduction of share capital cases were transferred to NCLT by notification dated December 15, 2016. By that time the Insolvency and Bankruptcy Code, 2016 (Code/IBC) had also come into force on May 28, 2016. NCLT was notified as the Adjudicating Authority (AA) under the IBC provisions on corporate insolvency resolution process (CIRP) which came into effect in December 1, 2016. Thereafter, various provisions of the IBC relating to corporate insolvency and liquidation have come into effect, in a phased manner, making NCLT work twenty-four into seven. I shall mention that not only Members of NCLT, but its staff also worked day and night to cope with flooding of IBC cases into NCLT.

In the saga of it, first section 7 matter (CP (IBC) 1/2016)¹ was filed on December 22, 2021, in NCLT Mumbai. Incidentally it came before the bench comprising Technical Member Mr. Nallasenapathi and me. Since rush of filing cases by then did not start, on January 17, 2017, we admitted this first case within one month after considering the detailed arguments of a senior counsel on behalf of the corporate debtor (CD). It was informed to the Tribunal that the debt is in seizin of a Tribunal governed by the Maharashtra Relief Undertaking (Special Provisions) Act, 1958 (MRUA), but we held that the *non-obstante* clause present in the IBC will prevail over other jurisdictions, inconsistent with IBC. Since it was first of its kind matter, there was lack of understanding on how relief portion was to be framed. The reliefs were ultimately framed taking clue from the mandate given under section 14 of the Code. This very first case travelled up to the Hon'ble Supreme Court of India, which upheld the order passed by the NCLT, setting a precedent that IBC will prevail over all other laws inconsistent with IBC.²

In the formative days another experience I came across is, one Company called Kirusa Software Private Limited (Operational Creditor), on December 30, 2016 filed section 9³ Petition against a company called Mobilox Innovations Private Limited, the CD, on December 30, 2016, stating that the CD defaulted in paying debt in relation to payment of rentals for toll free numbers as well as primary rate interface rental to telecom operators. The point for consideration in the matter was whether section 9 petition could be admitted if reply to section 8 notice⁴ is not given within 10 days after receipt of section 8 Notice. It was also first of its kind for no order under section 9 was available to take a clue. Moreover, the dichotomy in the case was by that time neither suit nor arbitration proceeding had been initiated by the CD against the operational creditor (OC), but there was ample material reflecting dispute between the parties even before issuance of section 8 notice. Another sticking point was that reply as per section 8 is required to be given within 10 days after receipt of section 8 notice. In this dichotomy, however by looking at the existence of dispute between them far before issue of section 8 notice, we rejected section 9 petition by holding that pre-existing dispute was present. When appeal was filed over it before the National Company Law Appellate Tribunal (NCLAT), NCLT order was reversed, but the CD, to bring it to its logical end, took it to Supreme Court. The Supreme Court set aside the appellate order and upheld the order of NCLT by holding that the word 'and' in section 8 (2) (a) and definition of dispute under section 5 (6) shall be read as 'or' enabling the Tribunal to construe that dispute is in existence even without pendency of either suit or arbitration proceeding if dispute is preexisting and the same is communicated to the OC. This Judgement passed by Hon'ble Supreme Court led to replacing 'and' with 'or' through an amendment on June 6, 2018.⁵ This judgement passed by the Honorable Supreme Court has indeed brought the law close to reality and made a mandate to take the preexisting dispute into cognisance even without pendency of suit or arbitration proceeding. Apart from this, another essentiality to be noted is the petition need not be admitted solely on the ground that reply to section 8 Notice is not given within 10 days of receipt of section 8 notice, in the instant case, notice was not given within 10 days as stipulated under section 8, but there was evidence disclosing dispute is found existing from 2015 itself, therefore this glitch has been set right by employing 'or' in the place of 'and'. This judgement passed by Hon'ble Supreme Court in *Mobilox Innovations Private Limited v. Kirusa*

*Software Private Limited*⁶, has brought paradigm shift in dealing with section 9 cases for admission. Of course, now these points may not be of great importance because this point has been followed by all ever since this judgement has come out. If we see the time taken to pass these two orders, one in section 7 case, and another in section 9 case, NCLT was able to pass admission orders within one month. Therefore, if workload of each bench is reduced by starting more benches, it is feasible to admit petitions within 14 days.

Another great experience at Mumbai was, while sitting with another Technical Member Mr. Doraisamy, Liquidator to Precision Fasteners Limited (corporate debtor) filed an application against Provident Fund Organisation to release the assets of the CD attached by the Provident Fund Organisation on the ground that once CIRP or liquidation is initiated, all assets of the CD shall be made part of liquidation estate in view of the overriding effect of IBC envisaged under section 238 of the Code.⁷ Over which Provident Fund (PF) authorities said that the dues payable to the PF Authority should not be treated as operational debt, whereas the Liquidator's counsel argued that the claim of the PF Authorities shall be treated as operational debt. To decide this point, we got a clue from section 36(4) of IBC, that all sums due to any workman, or employee from the PF, the pension fund and gratuity fund shall not be included in the liquidation estate. By reading this provision, we understand that the legislature has made it clear that the dues payable to PF and gratuity fund, even if left in the possession of the CD, shall indeed to be treated as an asset of the PF authority lying in the possession of the CD. Further, creditor-debtor relation cannot be attributed to the relation between PF authority and the CD and the dues payable by the CD cannot be treated as claim against the CD. They shall be treated as an asset of the PF authority lying in the possession of the CD. At the time of summation of the assets of the CD as liquidation estate, the dues towards PF shall be first cleared and remaining asset to be construed as liquidation estate as stated in section 36 (4) of the Code. By saying this, it has been directed that CD shall pay the dues falling under PF dues before either passing resolution or distribution of assets under section 53 of IBC. Though I decided many cases under IBC, no other case has given as much satisfaction as this case has given. I shall again put it that this order is also first of its kind and ever since, this order has been followed by NCLT as well as NCLAT.

While dealing with the issue whether the Limitation Act, 1963 (the Act) is applicable to IBC or not, every time the issue came for determination, without a blink, we have all through firmly held that the Act is applicable to IBC. Though it was initially not explicitly envisaged in the IBC, Mumbai Bench has strongly canvassed that the Act is applicable to IBC, the reasons are, right of claim is a property right, and though applicability of the Act is not explicitly included in the Companies Act, 1956, High Courts while dealing with winding up cases, definitively held that the Act is applicable to the Companies Act, 1956. IBC is nothing but other face of winding up, when the Act without explicit provision is applied to winding up regime under the Companies Act, 1956, the same principle is equally applicable to IBC. Of course, ultimately Supreme Court held that the Act is applicable to IBC. In between, to avoid ambiguity, IBC was amended by inserting section 238A envisaging that the Act is applicable to IBC.⁸

In September 2018, as I was transferred from Mumbai to Chennai NCLT, I worked with Mr. S. Vijayaraghavan, Technical Member, there also many cases were decided dealing with limitation point, in one of those cases admitted by our bench, a case filed by Stressed Assets Stabilization Fund (SASF) against M/s Uthara Fashion Knitwear Limited was admitted (order was written by my colleague Member Mr Vijayaraghavan) holding that the claim is not barred by limitation.⁹ On the appeal filed by the promoter V. Padmakumar against the said order before NCLAT, NCLT order was reversed holding that section 18 of the Act is not applicable on the ground routine entries of liabilities reflected in the balance sheet of the debtor company out of compulsion under the Companies Act, 2013, will not become acknowledgement under section 18 of the Act.¹⁰ When Second Appeal was filed against the order of NCLAT, full bench of the Supreme Court in *Asset Reconstruction Company (India) Limited v. Bishal Jaiswal and Another*¹¹ (dated April 15, 2021), set aside five judge bench order, passed by the NCLAT in *V. Padmakumar v. Stressed Assets Stabilization Fund (SASF)*, 2020, holding that entries in the balance sheet will amount to acknowledgement under section 18 of the Act.

While continuing as Member Judicial at NCLT, Chennai, a rare opportunity came to me to assume charge as Acting President of NCLT, since I have decided cases there, I must also share one two experiences, which I consider as dear to me.

During my tenure as Acting President, the principal bench comprising Ms. Sumita Purkayastha and me approved *Jaypee Infratech's* resolution plan¹², that order was directly taken up by the Supreme Court for the sake of expediting the disposal. There is an order I shall mention which I have decided while sitting along with Mr. Hemant Kumar Sarangi, that is *Net4 India* case¹³, wherein application under sections 43, 45, 49 and 66 was decided saying that the promoter directors indulged in divulging the funds and the business of the CD attracting the ingredients of sections 43, 45, 49 and 66 of IBC by holding that if the fact of transfer of business or asset or the claim is proved from the facts available, burden lies upon the respondents to prove that such transaction will not fall under the respective sections mentioned above.

Another noticeable order that was passed by the same bench is over a land leased out by the New Okhla Industrial Development Authority (NOIDA) to the CD namely M/s. Three C Projects Private Limited for development, in the said case, the point for consideration is whether the dues payable towards lease of the land will amount to financial debt or operational debt. It was held that the lease of the land for development will amount to finance lease as stated in accounting standards, therefore the debt payable by the CD to NOIDA was declared as financial debt.

Before concluding this article, I must say that I have come across perhaps thousands of applications under section 60 (5) of IBC. But out of those, two kinds of applications I personally feel are more important than many other issues we often come across. They are verification of claims and vulnerable transactions. As these two are concerned, skill sets of all the parties, Insolvency Professionals, Committee of Creditors and AA, who are involved in dealing with these matters, shall be improved. To understand them and to take swift and stern action, above three shall be

fully equipped with not only commercials and simpliciter legal provisions dealing with vulnerable transactions, but also other civil laws and especially judicial dispensation. Of course factual aspects and preliminary confirmation that certain transaction is a claim payable by the CD or that certain transaction is a vulnerable transaction avoidable under law have to come from Interim Resolution Professional (IRP) or Resolution Professional (RP), once it is complete, pendulum swings towards the AA to balance with his skills to determine whether the said claim is admissible or not and if it is a vulnerable transaction, whether it is vulnerable transaction or not. Here, AA has to carefully and timely decide those transactions, preferably before inviting Expression of Interest by the RP, so that clarity will come how much value lies in the assets of the CD. Not only that, it will become a checkmate upon the wrongdoers and they start believing that they cannot get away with past practices. Nowadays admission or rejection is not a big issue. It has become routine.

Here in the two aspects above mentioned, missing either factual aspect or legal aspect will mar the rights of the stakeholders or let the wrong doer escape from the clutches of law. To my little knowledge, existing law is more than sufficient to effectively deal with these two issues. The only aspect is RP shall know what information is required to present his case, the AA must know how to adjudicate the vulnerable transactions. If acumen comes over these two areas, IBC will attain 360 degrees accomplishment.

I tell you it is practicable provided these participants apply their skills and time to work on these areas, instead of simply sweeping them under the carpet. Last but not least, to clear this backlog, Government may have to take action on war footing by constituting Special Benches for a period of two years, then people will believe it is not to make slate clean, it is indeed to make the fraudsters clean from the system and to add value to the assets of the CD. Above all these, it will become a road path to timely disclosure and transparency in the system which ultimately makes the country good to ourselves and credit market will become more open in India.

My journey with IBC came to end on May 31, 2021, as I completed my tenure. Here I must convey my gratitude to the Government because this opportunity of working as Member and as Acting President in NCLT has given immense pleasure and a place in the society. My days in NCLT have passed in a split second, I could not even realise how fast my tenure has come to end.

Throughout my career, I adhered to implementation of the law given by the Parliament. I have never given a chance to allow my perceptions to prevail over the mandate of IBC. Whenever I felt the point for determination is complex, I searched for ways and means to bring the point within the ambit of the Code so as to do justice, but never held any point that goes beyond the mandate of IBC. Who am I to write so? I am an agent to render justice as indicated by the Code, as a judge in a Tribunal, I cannot regurgitate the concepts by travelling back to the purpose and object of the Code because Code is a complete Code in all respects. It has set out destiny, destination and road to reach the destination. I cannot take any short cut or long route to reach the destination and I cannot set out different roads to achieve the purpose and object. So long as Members of the Tribunal remain adherent to the provisions of the Code, one can maintain uniformity and predictability and one

would be in a position to avoid inconsistency. This continuity will avoid many problems. If really any infirmity is present in the Code, there are Constitutional courts to take care of it, Parliament is there to re-look if any provision is not working. Dispensation of justice is to the litigant public, not to the ‘Gallery’. All kinds of noises keep coming from the ‘Gallery’, that is not our concern. Our concern is facts proved before us and the law given by the statute.

NOTES

¹ *ICICI Bank Limited v. Innoventive Industries Limited*, Company Petition No. IBC 1/2016.

² *Innoventive Industries Limited v. ICICI Bank and Ors.* (2018), 1 SCC 407.

³ Section 9 of the Code refers to filing of the application for initiation of CIRP by the OC against the CD.

⁴ Section 8 (1) of the Code states that an OC may, on the occurrence of a default, deliver a demand notice of unpaid operational debt or copy of an invoice demanding payment of the amount involved in the default to the CD in such form and manner as may be prescribed.

⁵ The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018.

⁶ (2018) 1 SCC 353.

⁷ *Precision Fasteners Limited v. Employees’ Provident Fund Organisation*, Company Petition No. (IB)1339 (MB/2017).

⁸ Supra Note 5

⁹ *Stressed Asset Stabilization Fund v. Uthara Fashion Knitwear Limited*, IBA/895/2019.

¹⁰ *V. Padmakumar v. Stressed Asset Stabilization Fund (SASF) and Anr.*, Company Appeal (AT) (Insolvency) No. 57 of 2020.

¹¹ Civil Appeal No. 323 of 2021.

¹² *IDBI Bank v. Jaypee Infratech Limited* (2020), (IB)-77/ALD/2017.

¹³ *Edelweiss Asset Reconstruction Company Limited v. Net 4 India Limited* (2021), (IB)-409(PB)/2017.

6

JOURNEY OF THE IBC: PERSPECTIVES AND LESSONS

R. V. Verma

The spirit and aspiration of the Nation and the Government’s expectations from the new law, viz. the Insolvency and Bankruptcy Code, 2016 (Code/IBC), is captured by the following excerpt from the press release issued by the Ministry of Finance, Government of India on May 11, 2016 after passage of the IBC by the Rajya Sabha:

The objective of the new law is to promote entrepreneurship, availability of credit, and balance the interests of all stakeholders by consolidating and amending the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner and for maximization of value of assets of such persons and matters connected therewith or incidental thereto....

Five years down the road, the following excerpt from The Economic Times of June 7, 2021 captures in a nutshell, the tentative outcome of the new law and the expected achievements going forward.

Financial Creditors may realise ₹ 55,000-60,000 crores in fiscal 2021-22 through successful resolution plans under the Insolvency and Bankruptcy Code (IBC), according to credit rating agency ICRA.

Between the two dates, lot of distance has been covered as this early part of the journey of IBC, spanning five years, has been marked by important policy and institutional developments, including amendments to the Code, validation and learnings, achieving institutional milestones, awareness building and capacity building for all stakeholders, and above all, building of hope, optimism, confidence and sense of conviction.

While such news pertaining to recovery of bad debts is always welcome as it bodes well for the banks and the financial sector and the broader economy, we need to look at it in the larger perspective of

the promulgation of the IBC itself, the objective and purpose behind this initiative, and the journey so far and what it portends for the future.

NEED FOR THE CODE

To quote Michele Bachmann, an American Senator from the Republican party- '*A normal way that the American free market system has worked is that we have a process of unwinding. It's called bankruptcy. It doesn't mean necessarily, that the industry is eclipsed or that it's gone. Often times, the phoenix rises out of the ashes.*' This view could represent a view at the extreme end of the spectrum. The Indian context would suggest a more balanced interpretation. But the essence does not change. Bankruptcy does not mean all is lost but rather signifies a new beginning, a new hope for the business that did not do well. Bankruptcy is a channel of exit provided by the system for those entrepreneurs/promoters/management who, for some reason, are not able to sustain their business operations, preferring to give way to others possessing greater skills and better management bandwidth, with capital to invest. In other words, the provision of bankruptcy provides a measure of hope and confidence to the entrepreneurs and investors, existing and potential, that they will not be stuck with their investments, and will be able to exit from such predicaments, if such situation arises. This itself acts as a huge potential incentive for the entrepreneurs and investors to freely take up economic activities and contribute to the country's GDP and progress. After all, there is 'risk' associated with any enterprise or economic activity that can materialise anytime in the economic life of the project or the entity, in whatever form. All people are not alike nor do they possess identical skills. Some are better than others, are better skilled and better equipped to handle such risks or even bankruptcy conditions. They get an opportunity to takeover and continue the business after the exit of the earlier promoter and the earlier promoter gets an opportunity to exit and move on in life. A fair deal for all in the larger public interest and impacting the economy in a positive way

Rooted in the larger agenda of economic reforms, the IBC got the final parliamentary sanction in May, 2016 to become law of the land, an important milestone in the evolution of the economic reforms in the country. Drawing upon the best out of the multiple archaic insolvency laws prevalent in the country, historically and adapting it to the current context, the IBC has been acknowledged and hailed as one of the most significant economic reforms in recent times in India. During the five years of operation of the IBC, insolvency resolution in India has witnessed the development of a whole new ecosystem embedded in a sacrosanct piece of statute, reflecting the need of the liberalised economy in the new global regime, The new law has sought to address and reform the age-old laws and regulations regarding insolvency and bankruptcy. The legacy of insolvency had taken different forms and different institutional shapes - latest being the Board for Industrial and Financial Reconstruction (BIFR) under the Sick Industrial Companies Act, 1985 (SICA) - but none so comprehensive and complete as the IBC, scripted on the lines of reforms, aligned with the changing dynamics of the new international economic order. The objectives of the past initiatives and legislations were limited and confined to the recovery of bad debts, without much consideration for their restoration and rehabilitation, or aimed at minimising waste and preserving resources for

the economy, including scarce entrepreneurship. As a result, the macro economy and larger systemic and behavioral remedy were not reckoned as important long-term objectives, and emphasis was laid on short-term measures to effect recovery of debts from the companies.

Stance of the IBC

As the growing size of non-performing assets (NPAs) continued to drain the resources in the economy, delay in the instituting of IBC was proving to be inimical and costly to the banking sector and the larger economy. Prior to the Code, the recourse available to the bankers and lending institutions were cumbersome and rarely definitive, and the provisions and remedies lacking in long-term purpose and vision. As a result, at the systems level, the whole past regime of resolution remained unpredictable, uncertain and time consuming. This together with lack of efficient out-of-court settlement mechanisms, meant huge drain on resources, time and energy of the institutions, both debtors and the creditors community, all this accounting for big disincentive for the entrepreneurial class and investor community to take up or enhance economic activities. The prevalent climate neither inspired confidence among the creditors or debtors nor enthused them to deploy their resources in the form of capital/debts and entrepreneurship to the benefit of the economy. It dampened the spirit of the participants in the economy, affecting flow of funds into the economy, by way of equity and debts, and most importantly, lack of enterprise and motivation for entrepreneurs. Economic growth was an obvious casualty, as a result of the negative externalities.

Over the years, the growing scale of stressed assets standing at a staggering ₹ 12 lakh crores (₹ 12 trillion) and counting, has proved to be a huge burden on the economy. Though the central bank has been intervening through various directions and guidelines for banks on a piecemeal basis, they have not resulted in the best expected outcomes, in terms of impact on the magnitude of the problem. The malaise runs deep and nothing short of systemic intervention would work. A structural reform and a paradigm shift through new legislation, as an important reform agenda, was considered to be a move in the right direction and perhaps long overdue. Global examples had demonstrated that reform in this area could play a major role in strengthening a country's economic and financial system. IBC was conceived in this background to provide for an effective and efficient insolvency regime as a measure of support for the domestic banking and the financial system. The core provisions of the IBC are aimed at enabling banks to curtail the deterioration in the quality of their assets and claims, including claims on the corporate sector, whether through a court-approved restructuring/resolution or through an efficient liquidation mechanism. Insolvency reforms are particularly relevant for economies in transition, where it can play a critical role in addressing the problems of insolvent enterprises, which may continue to waste scarce resources in a developing economy. The reforms under the insolvency laws apply to all such entities irrespective of the reasons for their delinquency or insolvency, including even weak performance. The underlying rationale being that the resources such as capital, physical assets and human resources etc. could be better managed in the larger interest of the economy under different management. However, the switch over to a new management has to

be a seamless and smooth transition supported by law and due processes, involving all stakeholders. The IBC provisions are tailored to meet the requirement of the economy and the whole ecosystem comprising all stakeholders, while balancing their divergent and conflicting interests.

Confidence building

The Code has recognised the need for all round confidence building to optimise the gains to the economy. Transparency and credibility are the two pillars of the Code that act as critical elements in promoting and ensuring confidence among all the stakeholders, in the best interest of the economy. Building confidence among the creditors and the new management through a transparent and efficient bidding process is the mainstay of the Code. In the context of financial crises, an orderly and effective insolvency system can provide an important means of ensuring adequate incentives for all stakeholders for their cooperation and contribution towards the resolution of such crises. That's what an ideal ecosystem should look like! Although insolvency procedures are implemented through the courts, the principles and the processes involve negotiations between debtors and their creditors, which may lead to out-of-court agreements being reached within the broad framework of law. Predictability and certainty in the interpretation of laws and regulations always play an important role in drawing all the parties to the table in the right spirit of mutual trust and confidence, and hence agreement.

The IBC is witnessing changing debtor-creditor dynamics in as much as it allows for a more positive contribution for both in their respective roles. There have been rising instances of debtors settling debts on their own, even before the admission of cases in the National Company Law Tribunal (NCLT), or immediately on filing of such applications. There is growing realisation among debtors that as a result of resolution, they may lose control and management of the firm permanently. The resolution provision under the Code thus acts as a major deterrent for the debtors and existing promoters of the firm from operating at low efficiency levels, draining the resources of the enterprise, under-utilising and mis-utilising them.

Broader objectives of the Code: Preserving value with ease of doing business

One of the central objectives of the Code is to ensure swift redeployment of resources trapped in sick companies by putting them under better management, which would be efficient, more responsive and more responsible. Whatever the reasons of sickness or distress, the sooner it is detected and resources redeployed, better will be the chances of turnaround, revival, and revitalisation through protecting and enhancing the value of the assets and the enterprise. Thus, early identification of such cases is key to successful resolution and revival of the company as a 'going concern'. At the macro-economic level, it attracts both enterprise and capital available in the country for re-channelising as investments in distressed assets and companies with the aim to turn them around into viable, vibrant and a performing entity. The process encourages and facilitates freedom of exit and entry of capital and enterprise into the market, thereby improving the efficiency in deployment of resources, better price discoveries through transparent valuations and better economic outcomes, through competitive

biddings. The Code provides easy exit and access route to various economic entities or factors of production, thereby providing a whole new ecosystem with 'ease of doing business'.

Economic activities at the enterprise level are aided by banks and financial institutions (FIs) through their credit extension function, their primary role being to provide credit and liquidity to the economy for supporting higher level of economic activities through the enterprise of people and business entities. Over the years, with deepening and widening of the financial system and the economy, the role of banks in economic development of the nation has increased manifold impacting the growth and economic transformation, serving the credit needs of various sectors, different segments of the people across widely dispersed geographies, enterprises and business entities. It is therefore critical that the health of the banking institutions is sustained, strengthened and reinforced through good and bad times. In this context, the role of IBC in protecting and fostering the health and vitality of the banking institutions as creditors are key and absolutely central.

As a general principle, the IBC protects the interest of creditors in as much as it strikes a healthy balance between the two sides of creditors' roles viz. on the one hand, preventing secured creditors from undermining the objective of maximising the value of the assets of the estate (by securing their own interest only at the cost of others) and, on the other hand, protecting the interests of such creditors so that the value of their security and, as a consequence, the availability of credit, is not undermined and eroded. This is a delicate balance involving mutually conflicting interests.

The overall economic objective of rehabilitation mechanism is to enable a financially distressed enterprise to become a competitive and productive participant in the economy, thereby benefiting not only the stakeholders of the enterprise (owners, creditors, and employees) but also the larger economy on the whole. For a rehabilitation process to achieve this objective, it must create incentives for all stakeholders to participate in the proceedings, or when necessary, prevent some stakeholders from undermining it. Again, it requires the Code to provide for a healthy balance between the two sets of activities. This may differ from case to case, but the Code and its ecosystem has strived to work consistently in accordance with this objective.

JOURNEY OF THE IBC

While the IBC is still evolving and being tested and revalidated practically on a case-to-case basis, the COVID-19 pandemic has thrown a major spanner in its otherwise smooth, at times bumpy, but eventful journey. Early part of the journey of the IBC could not be without challenges, as the Code is dealing with a complex subject, complex set of issues involving diverse institutions in the financial, capital market, legal and economic jurisdictions, including the courts of law and various regulators. The Insolvency and Bankruptcy Board of India (IBBI/Board), the regulatory body to implement the Code and its various provisions, will be completing five years of its existence in October, 2021. There is certainly much to celebrate but also a lot more to cover and longer distances to travel, as the Code extends its jurisdiction to cover Financial Service Providers (FiSPs) with all its cumbersome, complex and complicated contours. Besides these challenges, dealing with the

creditors' claims amid deteriorating conditions of assets with the debtors not cooperating, have posed problems that need to be resolved at the systemic level. Delays in identification of the assets under resolution and the actual resolution has impacted the outcome and the quality of the solution. However, it has been encouraging to note that the Code has gone through various tests of legalities, constitutionality and the challenges of building the right institutions, across the entire ecosystem associated with the Code and the processes defined thereunder. This has only brought maturity to the Code while strengthening the IBBI as the regulator. There have been commentaries and counter-commentaries which have only strengthened the Code and its implementation. The commentaries and analyses proved to be an essential part of the Code's evolution, meaningfully sensitising all stakeholders, including the judicial/legislative communities and the courts. The Economic Survey of the Government of India for the year 2021-22 has also commented on the implementation of the Code's provisions, emphasising that '*the time taken to complete a resolution has to be sped up.*' '*The 308 cases, which yielded resolution by the end of December 2020, took an average of 441 days for conclusion, more than 100 days from the 330 days outer limit specified by the Code.*' Hopefully, with more experience and greater maturity of the entire ecosystem, the timelines will get better.

Making for an efficient resolution mechanism

That being said, the experience so far suggests that the success of the Code stands on certain basic premises, viz. early detection of corporate stress; timely action and resolution; value maximisation of the assets, security and the entity. Thus, in the larger context, the performance of bigger companies, involving debts from banks and FIs and the impact of the Code on the FIs will be critical considerations in decisioning and resolving the distress scenario, including the haircuts that may have to be taken by the lenders. This will invariably necessitate an efficient resolution mechanism that would seek to satisfy all parties to the deal, thereby ensuring a good balance of interest of all stakeholders. It will therefore be in the best interest of all if the stress in the business entity is detected early, which will pave the way for the best resolution formula involving minimum sacrifice for all. Fire can spread fast and devastate vast areas, unless detected, brought under control and dowsed early. Similarly, incipient sickness unless treated early, can become chronic ailment resulting in bigger damage, bigger costs and eventually greater sacrifice (by all resolution partners). Hence, the need for early stress detection and speedy resolution as prerequisites for a successful insolvency resolution, cannot be overemphasized enough. These abiding *mantras* are universally accepted by all stakeholders and policy makers. The IBC provides for timelines within which the resolution has to be arrived at. Resolution through IBC is considered to be most efficient. In case resolution fails, the journey from resolution to liquidation can be quite painful and arduous, calling for greater time, attention, resources and decisioning with due diligence on the part of all stakeholders, for a near finality in terms of the entity value running into dead loss. The liquidation regime as provided under the IBC or outside it, comes into play, once resolution has failed.

The procedure for liquidating assets should be timely and efficient and should provide for a sale that maximises the value of the assets being liquidated.

Implementational infrastructure

The Preamble of the Code recognises the need for reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner as one of the primary objectives of the Code. Considering that the big institutional FCs are governed by the regulations and directives of the Reserve Bank of India (RBI), there is need for smooth and seamless integration of the two regimes, viz. the RBI's directions for banks/FIs and the provisions under the Code, the underlying theme being 'early detection' as pre-requisite for timely resolution.

One of the primary reasons of implementing the Code was to resolve the increasing NPA crisis in India through an efficient system of reallocation of economic and financial resources through transparent, efficient and well-defined processes in the best collective interest of all stakeholders, and more importantly the larger economy. It is expected that the Code, besides addressing the financials of the banks and FIs, would also act as a catalyst for building a positive and conducive investment climate in the country for investments by domestic as well as global investors.

The purpose and object of IBC is early and efficient resolution of the corporate debtor (CD) by maximising the value that can be received by the creditors and stakeholders from the assets and the enterprise. Having identified the case early, its equally important to conduct the resolution swiftly through the well-defined process and mechanism under the Code with due regard to the prescribed time lines for each stage with overall effort on minimising the time. However, this is also a function of a number of other factors, viz. the number of courts and judges, their training and capacity to handle and adjudicate efficiently, and cooperation of all other stakeholders. However, what is always at stake is the value and quality of the asset which, with the passage of time, keeps deteriorating, eventually leading to substantial erosion of enterprise value. Early resolution essentially depends on early filing by the lenders, and sufficient cooperation between the lenders and the borrower to reach the end of the tunnel. Given that the success of the Code majorly depends on the incentives that drive the lenders to initiate quick action, the best incentives are in the form of early recovery, leading to value-maximisation and value-unlocking with best re-distributional outcome. The creditors have to be kept motivated for their quick front-end decision making role in insolvency resolution process and monitoring of activities while the CD continues to operate as a going-concern. These are indeed challenging aspects that will need to be smoothened out. The jury is still out on this.

On the other hand, possible disincentives could be- (a) collective process versus individual recovery - this would be subject to the relative exposure taken by the lenders and the value of security; (b) rigours of the Code - actions of the lenders are subject to decision/approval of the Adjudicating Authority; (c) administrative or investigative action in future against the creditor's decisions.

Timeliness of resolution will depend a great deal on the actual time taken after filing of application. Quarterly reports issued by the IBBI indicates a substantial time lag between filing of application and its admission, and finally resolution. The time lag between filing and admission could be due to the overburdened tribunals- another reason emphasising the need for a robust informal mechanism.

However, the bigger problem lies in the subsequent delay witnessed in reaching a resolution plan. As against the stipulated timeline of 180, 270 and ultimate 330 days, the average time taken to resolve insolvency has been 433 days. Creditor inaction or procrastination has been a major contributor to such delay. Given the significant haircuts for the creditors as a result of approval of resolution plans, it is often seen that committee of creditors (CoCs) have remained unresponsive/indecisive on these issues or alternatively seeking lower haircuts which may not be realistic given the value of the assets and the enterprise. All this is resulting in excessive delay in resolution, in turn leading to further deterioration in value of the asset and the enterprise, and eventually liquidation. The time-bound process prescribed under Code, coupled with the competitive acquisition process forms the basis for value maximisation through competitiveness and optimum price discovery.

Role of creditors

Given that creditors are key beneficiaries of the insolvency process, the Code provides for an active role of creditors across the entire design and process of implementation. They are key decision-makers in a number of important areas, which have a bearing on the value and net worth of the entity. Giving creditors an active role in the process is particularly important when the institutional framework is relatively underdeveloped. Creditors as well as the potential investors will lose confidence in the process if all of the key decisions are made without due regard to their interest and involvement. Moreover, the development of institutional infrastructure, will be critical for inspiring confidence among creditors/investors and other stakeholders. Though it still remains work-in-progress, there has been significant improvement in the appointments of courts and judges/members. To quote some numbers, 15 benches of NCLT covering 36 jurisdictions have been instituted, 3504 Insolvency Professionals (IPs), 3 insolvency professional agencies (IPAs), 83 insolvency professional entities (IPEs), one information utility (IU), 3967 Registered Valuers, 35 registered value entities and 16 registered valuer organisations are already in place and functioning.

The Code recognises the important role of the creditors both in pre-insolvency regime as well as post insolvency. Accordingly, regulations provide for complete transparency in conduct of insolvency proceedings, including adequate notice of meetings and decisions, participation, and sufficient information to enable them to make fully informed decisions.

Behavioral aspects of the economic agents

The Code has been widely acknowledged as having brought about a significant behavioral change amongst the creditors and debtors. The inevitable consequence of a resolution process is that the control and management of the firm moves away from existing promoters and managers, most likely, forever. This in turn, encourages the debtors to settle default expeditiously with the creditor at the earliest, even outside the Code.

The Code provides for easy entry and exit of capital owners and entrepreneurs, bringing huge positive externalities to the economy. The fact that the owners and promoters of business, can be

replaced by more serious and more competent entrepreneurs, acts as a huge incentive for the existing owners to perform to the optimum. In turn, this also emanates from a sense of realisation that the enterprise or the business/economic entity is a national resource which can go into others' hands if not managed well. This fear of being replaced with a negative tag is already seeing significant behavioral changes in the debtor community in our country. This development has also brought a new sense of awakening with widely growing interest among potential new management and new promoters to take over and run the entity as going concern by infusing more investments. They are looking at this as an opportunity as the baton in the relay race gets transferred to the next runner. In the larger context, this saves capital and other resources, and keeps up the employment and production in the economy. Besides, potential acquisition by new players and new managements through the resolution plans is already being seen as an opportunity for inorganic growth by the promoters and investors in other companies, and thus provides huge potential to infuse and channelise investments in the economy through this route by attracting capital from the domestic as well as international markets. Sanctity of the Code and binding nature of resolution plans brings about certainty and confidence around the transaction promoting competitiveness and need for fair valuation.

The investment opportunity in the enterprises under insolvency is further backed by section 29A of the Code, which ensures a change of guard, making it compulsory for the CD to move into new hands. Barring the original promoters from buying back their companies at liquidation values and ablation from past offences, civil as well as criminal, has lent credibility to the Code's provisions, enhanced confidence among the new promoters, making it a lucrative investment opportunity. The whole insolvency ecosystem under the Code works to the advantage of the businesses and the economy. This also significantly impacts the behavior of the promoters/CDs driving them to run their businesses efficiently with diligence and commitment, preserving and enhancing the value and net worth of their business entity.

The number and incidence of cases being withdrawn upon filing of application, on grounds of settlement between the creditor and debtor, signifies such behavioral change. Transparency in the resolution process, symmetric and adequate information flow for all stakeholders, genuine price/value discovery and timeliness in execution will be the *sine qua non* of an efficient resolution mechanism.

On the flip side, as we recount the negative impact on the behaviour of debtors and creditors, recent experience has revealed that in the absence of orderly and effective insolvency procedures, the economic and financial woes of the corporates can get exacerbated, adding to the financial and economic downturn. In the absence of predictable and definitive procedures under the insolvency regime, both creditors and the debtor community may not be performing to their optimum levels. Creditors may feel shortchanged when unable to collect on their claims, which will adversely affect the future availability of loans and 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 may also assist in the prevention and resolution of financial difficulties at the firm level and economic crisis or downturn at the macro level. Certainty and predictability of procedures induce greater caution in undertaking liabilities by debtors and greater confidence in creditors when extending credit or rescheduling their claims. These are important early learnings from the Code's implementation, a journey still under way.

Up the learning curve: Balancing debtor-creditor interests

It may be useful to dwell here on the issue or desirability of a pro-debtor insolvency regime, which could be in some sense a taboo in the Indian context. A debtor gone insolvent or bankrupt is always looked at with circumspection or suspicion of foul play or misdeeds bordering on criminality. No one can be blamed as many of such cases (for instance the legacy dirty dozen cases transferred to IBC from BIFR regime) have turned out to be such. More recently, the first FiSP case of Dewan Housing Finance Corporation Ltd. (DHFL) will not draw sympathy or advocacy from any quarter for a pro-debtor regime. However, notwithstanding this, a pro-debtor regime has a deeper significance in terms of incentive to the entrepreneurs to undertake debt/liabilities to promote economic activities of their business. Hypothetically, there could be a number of reasons, valid and legitimate, for failure of a business or a corporate entity. In fact, this should be the more natural assumption, unless otherwise proved. There are a number of laws to address criminality, while there is only one law to address insolvency and bankruptcy. As it is, in some countries a pro-debtor insolvency law exists that favors the management of the debtor company, thereby allowing it to retain control of the company or to negotiate from a position of strength with its creditors. In other countries, insolvency law will be characterised as being pro-debtor primarily because it allows the enterprise to survive and the employees to keep their jobs, while the managers are replaced by an Administrator and, eventually, a new owner of the enterprise. Similarly, pro-creditor laws may differ regarding the way they address the respective rights of secured and unsecured creditors. While secured creditors are often the main beneficiaries of outright liquidation proceedings in which the realisation of their collateral will ensure the full and prompt payment of their claims, unsecured creditors may benefit from a rehabilitation procedure that will maximise the value of the debtor's assets and, therefore, the value of the unsecured creditors' claims.

In any event, experience shows that the degree to which an insolvency law is perceived as pro-creditor or pro-debtor is, in the final analysis, less important than the extent to which these rules are effectively implemented by a strong institutional infrastructure. In particular, given the complex and urgent nature of insolvency proceedings, effective implementation requires an effective and efficient institutional infrastructure for the entire insolvency and bankruptcy ecosystem. Nothing would be more important features of such regime than 'certainty and predictability' of the laws and the procedures that would influence the behavior and decisions of the creditors and debtors. There have been rich learnings in this field across the stakeholders, ranging from policy makers, regulators, tribunals, debtors, creditors etc. A somewhat counter intuitive argument has been that a pro-debtor law that is applied effectively and consistently will generate greater confidence in

financial markets than an unpredictable and inefficient pro-creditor law.

Allocation of risk among participants

The inter-relationship between the IBC provisions and allocation of risk among different players plays an important role in instilling confidence in the stakeholders and enhancing their role and contribution to the credit system in fostering economic growth. An important consideration that will have a bearing on the behaviour and motivation of the different participants is how predictable, equitable and transparent is the risk allocation in the market place across all participants. In terms of the creditor-debtor relationship, the ability of a creditor to commence insolvency proceedings against a debtor as a means of enforcing its claim reduces the risk of lending and, thereby, increases the availability of credit and flow of investments. It also adds to the confidence of the existing and potential investors and creditors at the sectoral level.

Predictability: a hallmark of an efficient and effective insolvency regime: Market participants are often able to take measures (including through price adjustment) to help manage the risk, if the application of these rules is relatively predictable. In contrast, when the rules or their application are uncertain, such uncertainty erodes the confidence of all participants and undermines their willingness to make credit and other investment decisions. In turn it also enhances the cost of credit, while restricting its supply. Either situation is not in the interest of economic activities or eventually the ultimate consumers of products and services. The Code has gone past these tests and challenges and has successfully laid down a regime of insolvency resolution through a set of well-defined and transparent processes, even though they had to be legally and constitutionally validated/modified.

Equitable treatment: The collective nature of the IBC proceedings does provide assurance to creditors that problems will be resolved in an orderly and equitable manner, which can calm markets effectively.

Transparency: Transparency is an important feature of insolvency proceedings. It is also closely related to the objectives of predictability and equity. During insolvency proceedings, interested participants must be given sufficient information for them to take informed decisions and also exercise their rights under the law. For instance, creditors must receive adequate notice of meetings where creditor decisions are to be taken and must receive sufficient information from the debtor to ensure that their decisions are based on adequate and complete information, made available to them as much as to anybody else involved with the proceedings. Asymmetry in information must be avoided.

The most important objective of an insolvency law is to protect and maximise the value for the benefit of all interested parties and the economy in general. This objective is most obviously pursued during rehabilitation, where value is maximised by continuing a viable enterprise. On the other hand, value is also maximised (or losses minimised) to the economy by liquidating unviable enterprises that cannot be rehabilitated.

Some key considerations in the implementation of the law and the proceedings will hinge on how well the above objectives are consistent and balanced against each other. These choices become important in determining who the beneficiaries of value maximisation are going to be, the debtors (management/employees/shareholders/promoters) or the creditors or both or the broader economy in terms of enterprise value, employment, continuation of sensitive and important industry, serving the interest of larger public policy objectives.

When determining how to strike a healthy balance between the various objectives it is necessary to avoid casual or easy simplistic approach towards debtors as well as creditor community. Debtors are not always fraudulent or incompetent, and creditors are not always demanding and excessive. As borne out over the years in different country contexts, although companies may fail because of incompetence, they may also fail because of economic difficulties beyond their control.

Viewed from the perspective of the economic policymaker, and in light of the above objectives, an effective insolvency law can clearly play a critical role in a number of areas. Generally, the discipline it imposes on a debtor increases the competitiveness of the enterprise as well as the sector and facilitates the provision of credit.

With respect to the financial sector, an effective insolvency law enables FIs to curtail the deterioration of the value of their assets by providing them with a means of enforcing their claims. In that context, it can also facilitate the development of capital markets. If an insolvency law is applied with sufficient predictability, a secondary market in debt instruments can develop. That will enable FIs to transfer their loans to other entities that specialise in the workout process.

Not only does such a mechanism reduce the public cost of the crisis and relieve external financing needs, it also strengthens the stability of the financial system by forcing creditors to bear the costs of the risks they incur.

Institutional framework

IBC being of recent origin, the institutional infrastructure is still evolving. The designated courts have appointed qualified professionals (Liquidators and Administrators) who are designated to handle key administrative matters (recording, collection and evaluation of the assets and liabilities, management of the enterprise, etc.). The IBBI has been actively building up the capacity of the professional cadre and developing their skills and orientation to successfully implement the provisions of the Code. The Board has been proactively ensuring the availability of an experienced cadre of such professionals with adequate commercial expertise to handle such cases. The Board's regulatory and supervisory oversight also ensures that there is no conflict of interest between the designated professional and others having an interest in the proceedings.

Viewed from a broader perspective, both insolvency and liquidation procedures constitute an important orderly and predictable mechanism under which the rights of creditors can be enforced,

which in turn acts as an important source of comfort to the creditors when they make their lending decisions. Thus, the provisions of insolvency and liquidation promote the interests of all participants in the economy, as much as they facilitate the provision and flow of credit and the development of financial markets.

Rehabilitation features

In contrast to liquidation procedures, rehabilitation procedures are designed to give an enterprise some scope and possibility to recover from its temporary liquidity difficulties or more permanent over-indebtedness and, where necessary, provide it with an opportunity to restructure its operations and its relations with creditors. The Code and the procedures do favor rehabilitation over liquidation, wherever possible. Such an approach is also obviously preferred by creditors if the value derived from the continued operation of the enterprise will enhance the value of their claims.

Before IBC came into existence, the recovery rate of debt was around 26% and the time taken for closure of cases was over four years. With the introduction of IBC, the average recovery rate is 43% in case of FCs and 49% in case of operational creditors.

CONCLUSION

In 2016, India ranked 136 out of 189 countries in the 'resolving insolvency' indicator of World Bank's Doing Business Report and by 2019, India's ranking in the same jumped to the 52nd rank.

Freedom to exit from the business is the ultimate economic freedom for an individual, firm or a corporate. It is a powerful facet of IBC that promotes 'ease of doing business', with the freedom to enter or exit as an economic entity. To quote the Chairperson of IBBI, Dr. M. S. Sahoo:

...allowing 'creative destruction' in an otherwise dynamic economy. It has been a paradox that an economy which allowed free entry and free competition did not permit free exit and, in the process, suffered the inefficiencies of several zombie entities in the system for so long. The third pillar has now been erected in the form of the Insolvency and Bankruptcy Code, 2016. This Code offers a market directed, time bound mechanism for resolution of insolvency, wherever possible, or exit, wherever required, and thereby ensures freedom to exit.

EVOLUTION OF IBC : A PRECURSOR FOR 'ACHHE DIN'

Ashishkumar Chauhan

Efficient distribution of resources requires strong insolvency laws that allow failing businesses to close efficiently and encourage new ventures. Business failures in a market-driven economic system cannot be avoided. However, they need to be handled in a way that causes the least disruption to the affected stakeholders and the economy. Strong insolvency laws are also important for ensuring the availability of credit for households and businesses. Despite being an essential requirement for a well-functioning economy, India lacked a robust insolvency regime until 2016. This led to several inadequacies and contributed to the deterioration of the 'non-performing loans crisis' or the 'non-performing assets (NPA) crisis' in the Indian banking sector. The NPA crisis exerted significant pressure on bank lending, increased the cost of capital and made it considerably difficult for small businesses and individuals to obtain loans. Given this gap, the need to reform the insolvency regime arose and the Indian government enacted the Insolvency and Bankruptcy Code, 2016 (Code/IBC) by streamlining and consolidating all the laws/legislations regulating insolvency to make the process simpler.

The results of the last five years have shown that the IBC provides an easy exit option for insolvent and sick firms. It has also enabled quick and prompt action to be taken in the early stages of debt default by a firm, maximising the recovery amount and extending to individuals, companies, limited liability partnerships and partnership firms in a time-bound manner. In addition to promoting the availability of credit and promoting entrepreneurship, the IBC has helped in the preservation of millions of jobs by facilitating the rescue of several viable businesses. It has also helped in creation of new jobs through the development of an entirely new ecosystem of insolvency professionals, turn-around experts, accountants, lawyers, and investment professionals who support the IBC processes.

BEFORE THE IBC

In British India, the Presidency Towns Insolvency Act, 1909 covered the insolvency of individuals, partnership firms and association of individuals in three erstwhile presidency towns of Chennai, Kolkata and Mumbai and the Provincial Insolvency Act, 1920 covered areas other than the aforesaid Presidency Towns. The laws covering corporate insolvency were the Companies Act, 1956 for winding-up and strike-off of companies; Sick Industrial Companies Act, 1985 (SICA) that focused solely on restructuring of sick industrial companies; Recovery of Debts and Bankruptcy Act, 1993; and Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). To add to the above list, applications were filed to the Board for Industrial and Financial Restructuring (BIFR) and a simultaneously application was filed by a creditor under SARFAESI Act.

These laws did not yield the desired results due to inefficient enforcement and court delays and turned out to be completely ineffective. The functioning of these legislations was unsatisfactory as many issues were identified during its implementation. A key problem of the present environment is the presence of multiple frameworks such as Debt Recovery Tribunal (DRT), Corporate Debt Restructuring, etc. The bankruptcy process became drawn out and involved battling through many steps, creating moral issues in industrial, banking and political areas which necessitated the new legal framework in the form of the IBC.

In the pre-IBC days, the process of winding up sick enterprises was not only time-consuming and value-destructive, but there were inherent deficiencies in legal provisions that were exploited by promoters for delaying recoveries and indulging in asset stripping before resolution. The Goswami Committee (1993), constituted to recommend reforms to overcome the challenge of industrial sickness in India, in its report remarked '*There are sick companies, sick banks, ailing financial institutions and unpaid workers. But there are hardly any sick promoters. There lies the heart of the matter.*' The legal and regulatory framework for insolvency and bankruptcy was grossly inadequate for creditors, especially those other than banks and financial institutions. Uncertainty about timely resolution and recovery hindered the growth of corporate debt market. As a result, the Indian financial system remained predominantly bank oriented.

IBC: IMPACT ON THE GROUND

The creation of the IBC as a single unified legislature to resolve insolvency of companies, limited liability partnerships, partnership firms and individuals and thereby balancing the competing interest of debtors, secured creditors and other stakeholders was a game changer.

The introduction of the IBC has reduced the time taken for resolution of companies in India from over four years to an average of about 1.6 years as noted by the World Bank in its Doing Business Report (DBR) of 2020. Through faster resolution, the Code had one major objective – to address the issue of around ₹ 10 trillion of NPAs in India's banking system. As the asset quality of banks gets better, it will promote new investments and consequent economic growth.

It is heartening to note that debtors and creditors alike are utilising the provisions of the Code. Till March 2021, a total of 4376 cases were admitted, out of which 2653 cases have been closed. Out of the closed cases, 617 have been closed on appeal or review or settled, 411 have been withdrawn, 348 ended with resolution plans and 1277 companies proceeded for liquidation. Rich jurisprudence has developed. The government has been proactively addressing the issues that come up in the implementation of the reform.

The DBR, which ranks economies on the basis of the business friendliness of their legal systems, ranked India's insolvency system at the 52nd position (out of 190 countries) in its 2020 Report, a jump in rankings by 56 places. In addition to the strength of the legal framework, the report also measures outcomes, recovery rates and cost of proceedings for the purpose of assigning the rankings. The recovery rate reported in the survey (about 71 cents on the dollar) is better than the average recoveries in the OECD high-income countries. In 2017 Report, India was at the 137th position and the reported recovery rate was around 26 cents on the dollar. This transformative reform has brought about several structural changes to the economy which are likely to have a far-reaching impact on India's growth and development going forward.

For market watchers, one of the most positive impacts of the IBC is the growth of the domestic corporate bond market and the behavioural changes among corporate debtors (CDs). The fact that IBC gives higher priority to both unsecured and secured debt over the government taxes in the waterfall mechanism lends comfort and interest to the bondholders. For instance, in the last financial year 2020-21, while the global economy faced adversities due to the COVID-19 pandemic, Indian investors showed faith in investing funds in Indian corporate sector primarily via the BSE bond platforms. ₹ 18.56 lakh crores (USD 252.95 bn) worth of funds was mobilised through listing of equity, bonds, REITs, InvITs and commercial papers, a growth of 53%. The BSE bond platform continues to be the preferred choice by Indian corporates to raise debt capital through private placements, structured instruments, public issues, etc. and also by municipal corporations for raising municipal bonds. A sharp increase has been observed in the debt platforms which is ₹ 5.55 lakh crore of bonds, and ₹ 10.52 lakh crore of commercial papers.

(Amount in ₹ crore)

Fundraising on BSE				
Type	FY18	FY19	FY20	FY21
Commercial Paper	-	-	433730	1052952
Debt	433226	487981	484147	555533
Equity (FPO, Rights, QIP etc)	107240	202144	273787	189770
Equity - IPO	77792	20833	21002	28651
InvITs	4543	4097	-	25215
REITs	-	-	2014	4245
Total	622801	715055	1214680	1856366

While there is a positive correlation between recovery rate, recovery timeline and corporate bonds/GDP ratio, experience also shows that there is a time lag between the implementation of bankruptcy laws and effect on bond market to the extent of 5-10 years. It is predicted that in the next 5 years issuance of ₹ 100 lakh crore in the domestic corporate bond market may happen on account of IBC implementation only in the BSE.

One of the most remarkable achievements of the Code has been the significant behavioural changes that it has effectuated or 'nudged' among the debtors and creditors alike. This behavioural shift has resulted in substantial recoveries for creditors outside the Code and improved the performance of firms. It is further motivating them to make the best efforts to avoid default. It encourages the debtor to settle default with the creditor(s) at the earliest, preferably outside the Code. With the Code in place, non-repayment of loan is no more an option and ownership of the firm is no more a divine right and equity is no more the only route to own a firm. It is also been seen that promoters of companies in default have started seeking an audience with bankers to pay up since the IBC came into effect.¹

Based on the information with the BSE, we believe that there is palpable fear among erring promoters for charges that may be initiated under the IBC and the banking system just cannot be taken for granted, and any delay in repayment could mean promoters losing business. Promoters are now eager to do a one-time settlement of their accounts, and square off their dues.

On the banking side, bankruptcy reforms appear to have already started bearing fruits. After having peaked to around 11.6% in March, 2018 due to the increased pace at which NPAs were recognised, the Gross Non-Performing Asset (GNPA) ratio across all Scheduled Commercial Banks (SCBs) has come down to 7.5% in September, 2020. NPAs recovered by SCBs through the IBC channel increased to about 61% of the total amount recovered through various channels in 2019-20 against 56% in 2018-19. IBC, under which recovery is incidental to rescue of companies, remained the dominant mode of recovery, according to RBI's Report on Trend and Progress of Banking in India 2019-20. In absolute terms, of the total amount of ₹ 1.72 lakh crore recovered through various channels in 2019-20, IBC route accounted for ₹ 1.05 lakh crore.

The IBC is also one of the major drivers in spurt of mergers and acquisitions (M&A) deals in India, as bidders are eagerly looking to acquire stressed assets that are now available at lucrative prices and several such entities are close to conclusion of their resolution processes. Despite multiple concerns including the COVID-19 pandemic, macroeconomic outlook and geopolitical tensions, deal values in 2020 nearly retained momentum with the previous year, recording 1268 transactions worth US \$80 billion, up 7% from 2019.² M&A accounted for over 50% of the total deal value this year, while private equity activity kept pace with last year, recording investments worth US \$38.2 billion. M&A accounted for over 50% of the total deal value this year, while PE activity kept pace with last year, recording investments worth US \$38.2 billion.

RESPONSE TO COVID-19

On March 11, 2020, the World Health Organization declared novel coronavirus (COVID-19) a pandemic. Countries globally have amended their insolvency laws to ease the burden of stressed companies. Governments across the world were aware of the fact that disruption caused in demand and supply chain, due to lockdowns or slowdowns, will have severe effects, including insolvency and it will continue to affect the financial capabilities of the companies for some time unless some relief is given.

Due to the economic upheaval on account of the COVID-19 pandemic and the resultant restrictions on economic activity, the Indian Government announced the possibility of suspension of the right to initiate insolvency resolution proceedings against CDs under the IBC on March 24, 2020, and May 17, 2020. While this measure was finally implemented on June 5, 2020³, the Government introduced several other measures relating to the IBC in the interim.

To mitigate the impact of the economic disruption caused by COVID-19, the Government took a series of steps to help struggling businesses stay afloat last year. One was to prevent the initiation of the corporate insolvency resolution process (CIRP) against any CD for a default committed between March 25, 2020 and March 25, 2021 (period of suspension). Coupled with restricted functioning of the National Company Law Tribunal (NCLT), activity under the IBC slowed significantly. For instance, only 161 new CIRPs were initiated between March and September, 2020, in contrast to 889 CIRPs being initiated between March and September, 2019 [as per data reported by the Insolvency and Bankruptcy Board of India (IBBI)].

With the lifting of the suspension on filing of fresh IBC cases, a question worth examining is whether it will result in a surge of fresh cases, and importantly, how India handles it. In the past, most crises have been followed by surges in restructuring and bankruptcy filings. For instance, in the aftermath of the 2001 Argentine crisis, there were 243 bankruptcy and creditor contests. Debts declared by companies and individuals in the bankruptcy proceedings reached \$183.58 million. The Netherlands experienced a 50% increase in the number of enterprise filings in 2009 during the global financial crisis.

In these circumstances, a greater focus is required on enhancing the efficacy of existing out-of-court and in-court restructuring mechanisms and introducing new mechanisms to preserve value, such as the pre-packaged insolvency resolution process (PPIRP), which would provide statutory approval to a mutually agreed resolution plan in a cost-effective manner. It is indeed encouraging that the Government and regulators were prepared and following significant deliberations by the Insolvency Law Sub-Committee, the Government of India, notified the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 on April 4, 2021 to introduce a framework for PPIRP for corporate micro, small and medium enterprises (MSMEs).

The COVID-19 pandemic resulted in significant distress to Indian businesses and particularly to MSMEs. It became imperative to introduce an attractive framework for resolution of stressed

companies – particularly MSMEs, in which the promoters would willingly adopt it due to features such as the promoter in control, quick process, promoter participation, statutory process, wide creditor participation, independently run process and court approval to minimise risk of future objections. The pre-pack process, which has now become a law, will hopefully allow creditors and MSME companies / promoters to resolve stress at the earliest with speed, efficiency and efficacy of process, certainty in outcome and a chance to improve value for all stakeholders.⁴

PPIRP is currently available to MSME companies but is intended to be extended to all other companies in time. When that happens, PPIRP may be just the restructuring solution needed for a company in the early stages of distress (and in this case, with the promoter incentivised to action the restructuring). From the date of default, a promoter will have 15 months before he is likely to be disqualified from bidding for his own company if it were admitted under IBC proceedings. It is in this 15-month window that promoters, otherwise eligible, will hopefully initiate a PPIRP.

INTO THE FUTURE

Individual bankruptcy

IBC provisions have only been operationalised for individuals who have given guarantees for loans taken by corporations, and not for other individuals and business (operating as sole proprietorships or partnership firms). This leaves out a large population of debtors who could benefit from the IBC provisions at this time. As a logical step forward, the Government should look to make rapid strides towards introducing a comprehensive 'individual insolvency' regime, now that it has achieved several milestones in corporate insolvency. As and when it is implemented, it will complete the bankruptcy side of the process.

Insolvency of Financial Institutions

The IBC deals with the insolvency and resolution of corporate entities, other than those providing financial services. But financial institutions have a connected and integral part to play in the maintenance of financial stability of the economy, the protection of the rights of their deposit holders, and the protection of the linked economy that they service. This was seen when the liquidity crunch in India's NBFC sector slowly started to affect other sectors as well. The defaults pertaining to IL&FS and the crisis faced by Punjab and Maharashtra Cooperative Banks suggest the need for a more comprehensive resolution mechanism for financial institutions.

The Financial Resolution and Deposit Insurance Bill, which aimed to establish a resolution regime for banks, insurance companies and other financial institutions, was withdrawn within a year due to public outcry regarding a proposed bail-in clause, as a result of which there is a regulatory void in this regard. The regulation and protection afforded by a resolution legislation like the IBC is essential to tackle the current financial slowdown that has impaired the Indian economy. Similar framework for resolution of financial institutions needs to be created for lending and borrowing

financial institutions to give end-to-end predictable and considered resolution framework to all. In case required, resolution process for financial institutions could also have credit enhancement and protection for smaller investors.

XBRL Reporting can enable faster resolution

The Supreme Court⁵ has held that entries in balance sheets can amount to acknowledgement of debt for the purpose of extending limitation under section 18 of the Limitation Act, 1963. The periodic and annual reporting made to Ministry of Corporate Affairs (MCA) including balance sheet and profit and loss statements has been made easy with compulsory XBRL formats. This can easily allow all company financial data including debt numbers to be converted in a database with minor changes in the MCA reports as well as balance sheet reporting of debt. This will help identify the outstanding debt of a company easily which can enable faster resolution.

Advent and Usage of Artificial Intelligence

In today's world, there is an inexorable integration of technology in our lives which could enhance some of quintessential human capacities. We stand on the threshold of a technological revolution that will fundamentally alter the way we live, work, and relate to one another. In its scale, scope, and complexity, the transformation will be unlike anything humankind has experienced before. In recent times, Artificial Intelligence (AI) has become the talk of the hour. There is a need to better understand AI's integration and impact at work in order to accelerate innovation and scale its benefits, especially in the context of emerging economies such as India.

In FY 2018, BSE introduced a data analytics-based solution that relies on AI to track news related to listed companies on digital media using social media. The primary objective of the tool is to detect and mitigate potential risks of market manipulation and rumours, and to reduce information asymmetry arising from it on digital media platforms, including social media. BSE was an early mover to understand the importance of data and analytics and invested substantially to leverage the benefits of big data implementation. BSE has also implemented machine learning and language parsing for rumour verification and implemented open-source natural language processing framework for voice to text conversion.

With the potential benefits and capabilities of AI, law firms and regulators can adopt AI systems to automate tasks like data entry, data management and repetitive time-consuming tasks. AI systems combined with machine learning ability could analyse thousands of pages of complex legal documentation and find relevant documents once it is shown a sample relevant document like a judicial precedent. These systems would be highly effective in conducting due diligence, reviewing contracts and risk assessment. There are four major significant roles, that AI can perform:

- *Document discovery and research* - production of several documents, and accurate and authentic data that are relevant to the research through the database, thereby reducing work hours.

- *Due diligence* - ability to verify background information, contracts, and electronic discoveries.
- *Contract automation* - submitting the required documents to be incorporated in a legal document to get a legal contract ready within minutes with the correct legal clauses.

A Deloitte Insight report predicts 'radical changes' and 'profound reforms' in legal sector due to AI systems, that would automate around one lakh tasks performed in legal sector by 2036. While some are concerned about threat to their jobs, some expect that if used correctly, AI systems could help legal firms to have small, specialised workforce review what the AI tools have provided and then can focus more on better advisory work for clients. Another legal service provider called 'Legalist Inc.' using proprietary algorithms estimates the likelihood of success of a case, the likely duration of disposal of the case, the likely expected return on success, and suggests whether to settle or move forward with the litigation.

Due to advent of big data, Insolvency Professionals could also have access to more data than ever before, which would allow the advisor to identify strategies, factors, and issues that will impact business performance. More digitised data can assist the Resolution Professional trace the relevant documents faster and more efficiently. Using data analytics AI systems can analyse big chunks of data to enable the professional to reach quicker conclusions confidently about what are the drivers of performance in a specific business and what needs to be changed in the business. AI programs can also be employed to analyse data which has been reported in XBRL format to check on companies going to bankruptcy and flagging them before they become bankrupt. It will also allow all creditors to check the legal status of their lending against each company in real-time, giving complete transparency and comfort to the lenders increasing trust.

AI algorithms can sure help the insolvency practitioners to discover compliances and non-compliances easily. Appointing human arbitrator along with an AI-enabled system can help in reaching to a conclusion much faster by analysing documents before the award is passed and answer the queries asked by the arbitrator while passing the final award.

The adoption of AI people could come up with their own problem-solving strategies, as do researchers.⁶ If professionals become either highly specialised or collaborate with AI service providers, a large amount of work could be automated. Researchers predict that such advent of technology may have two-fold impact on the legal profession. The first is that by replacing traditional technologies and tools, the work efficiency of professionals would increase while costs would decrease. There could be emergence of 'para-professionals' i.e., those who are equipped with such technology would be able to perform tasks that previously required expert professionals, that too at much lower cost. As the technology evolves, AI can be used for advanced prediction of bankruptcy to resolution and monitoring of resolution.

CONCLUSION

The IBC is a landmark reform among various 'Ease of Doing Business' initiatives undertaken by the Government of India, mainly because it consolidated all past provisions to institutionalise a common legislation for insolvency resolution and reorganisation of corporate entities, partnership firms and individuals in a time bound manner. Its results have proved that it was rightly hailed as a progressive and dynamic economic legislation. It is the true embodiment of time bound justice-oriented reforms, providing the much needed 'freedom to exit' to failing businesses. It is a paradigm shift from the erstwhile insolvency regime in terms of its design and architecture, professionalisation of insolvency services and delicately balancing the interest of all stakeholders.

Like everything else, this reform, too, should keep evolving. That means only one thing, that is, embracing the future. Despite the threat, the key thing to remember is that embracing future technologies is not an option but necessity, both for the sake of legal professionals and clients. This is the only way for India and the IBC. The IBC has, till now, evolved and attuned to every emerging market requirement. It will continue to do so and remain pertinent for all times to come.

NOTES

¹ Dhinjal S. S. (2020), "India records \$80 billion of M &A and private equity deals in 2020: A report", *Mint*, 23 December.

² *Ibid.*

³ The Insolvency and Bankruptcy Code (Amendment) Ordinance, April 04, 2021.

⁴ AZB & Partners (2021), "The Jigsaw's Missing Piece? Government Notifies Ordinance for Pre-Packaged Insolvency Resolution", *Lexology*, 16 April.

⁵ Live Law Network (2021), "Balance Sheets Entries Can Amount To Acknowledgement Of Debt U/s 18 Limitation Act: Supreme Court Sets Aside NCLAT Full Bench Ruling", *Live Law*, 15 April.

⁶ Briscoe F. and Gardner H. (2017), Richard Susskind and Daniel Susskind: *The Future of the Professions: How Technology Will Transform the Work of Human Experts*, Sage Publications, pp. 42-44.

EXPERIENCING THE CODE

Koushik Chatterjee, Pratosh Gupta and Raghav Sud

Three years ago, Tata Steel acquired Bhushan Steel Limited (BSL), the first large company to be successfully dealt with, under the new Insolvency and Bankruptcy Code, 2016 (Code/ IBC). Subsequently, we have also participated in the resolution processes for other companies under the IBC. This has given us an opportunity to review the bankruptcy resolution process especially in the context of the significant improvements to the Code since its inception. This article is an attempt to share the learnings from Tata Steel's experience. Towards the end of the article, we also look at the potential for further improvements to the resolution process.

CONTEXT SETTING- ESSENTIALITY OF IBC

In most mature economies, an effective bankruptcy or insolvency code has been instrumental in ensuring that lenders and providers of debt capital are able to exercise their rights and protections, resolve potential deadlocks and maintain the overall quality of credit. In India, the IBC came into effect in 2016 and it went into implementation with speed given the context of the financial stress in the banking sector.

The Preamble of the Code states that,

IBC, 2016 is a Code to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues.....

The Code therefore offers a process for resolution of a stressed asset in a transparent manner with price discovery linked to market forces while balancing the justified claims of multiple stakeholders.

If the corporate insolvency resolution process (CIRP) fails, the consequences are clear- the asset goes into liquidation.

What this has done is break the ‘too big to fail’ myth and given lenders greater flexibility in negotiating with promoters when businesses are faced with financial difficulties. Prior to the IBC, the mechanisms available to lenders were based on a variety of legislation with overlapping areas. The processes involved were complex and time consuming, and during that time the control of the stressed asset remained with the existing promoters. Banks had insufficient access to the assets and were rarely able to enforce security or dispose-off such assets. In many cases, there was lengthy litigation without clear judgements. The only practical and relatively quick solution was to restructure existing indebtedness. But, this did not allow external value discovery. In the absence of such a restructuring, the lack of funds meant that the asset would keep deteriorating in value, hurting the interest of all the stakeholders including banks.

The ‘threat’ of bankruptcy in the context of IBC gives the banks greater bargaining power in recovering their dues from corporate debtors (CDs), who wish to avoid default. Banks are in a position to trigger IBC and move the management control of the debtor company into the hands of a Resolution Professional (RP). In this regard, the introduction of section 29A has made the IBC more effective. The Code, in its original form had allowed for existing promoters to bid for the stressed asset under the resolution process at a significant discount to existing liability levels. This created an imbalance between their position and other financial creditors (FCs) who were faced with sizeable haircuts. Introduction of section 29A with four separate layers of ineligibility for connected persons and related parties has addressed this and is a welcome innovation in the Indian context.

Another issue which historically delayed the resolution of stressed assets was the mismatch between the carrying value of liabilities/assets in the books of the borrowers and the underlying value of the assets and the banks’ natural reluctance to accept large write-downs in the absence of irrefutable evidence of value. The IBC has provided the required market price discovery process, which gives greater confidence to the lenders. In its first few years, banks had to record very significant provisioning against their assets given large accumulated debts in the borrower’s balance sheets. However, we have seen a real shift in lender and borrower attitudes where they are looking for a resolution together, and this bodes well for asset quality in bank balance sheets moving forward.

The IBC has ensured that entities which are in financial difficulty, but are otherwise good businesses requiring restructuring, can escape liquidation. This is important for the suppliers, customers and the entire value chain of such businesses. It also helps preserve employment and avoid needless closures. Several resolved businesses which were large in scale but over-leveraged, have found new capital and emerged stronger. The overall sectors have also benefited from consolidation. The steel sector represented USD 24 billion of debt claims and despite multiple resolution processes being run simultaneously, all the assets witnessed good interest and true value discovery.

The IBC has also, of course, created a new financial services vertical, with opportunities for Insolvency Professionals (IPs), Liquidators, technical experts, and restructuring advisors.

It is worth noting that the Insolvency and Bankruptcy Board of India (IBBI) itself has played a very important role in making the IBC more effective and bringing about greater clarity in the resolution process. The IBBI’s regulation making process has been commendably robust since it is based on public consultation, economic analysis of the regulations’ impact and subjecting them to periodic reviews. The IBBI has also played an important role in developing and regulating valuation professionals and IPs. As a regulator the IBBI has been focused not only on implementing the letter of the law, but also ensuring that it delivers the intended critical reform to the banking and financial landscape in India, through thought leadership and democratic policy making.

TATA STEEL’S ACQUISITION OF BHUSHAN STEEL

The State Bank of India as the lead bank of the consortium of lenders had filed an application for the initiation of the insolvency process in relation to BSL. After issuance of notices and filing of the reply, BSL was admitted to CIRP on July 26, 2017. The RP published an advertisement on October 7, 2017, inviting prospective applicants. The due diligence and site visit phase continued up to November, 2017, subsequent to which resolution plans were prepared and submitted in February, 2018. The discussions with lenders, the RP and their counsel continued through February and March, 2018. H1 selection and acceptance of the letter of intent was completed on March 23, 2018. After approval of the Competition Commission of India and finalisation of definitive documents, the National Company Law Tribunal (NCLT) approved the resolution plan on May 15, 2018. Tata Steel expeditiously implemented the plan, paying the FCs their dues of ₹ 35,200 crore within three days of the date of order. The acquisition was completed on May 18, 2018; the first of India’s twelve largest NPA accounts to be resolved. Post-acquisition, the board of directors of BSL was re-constituted and a new management was put in place. The name of the company was changed from Bhushan Steel Limited to Tata Steel BSL Ltd. (TSBSL).

As BSL was a listed company at the time of its acquisition, and the June 2018 amendments¹ to the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009 (Delisting Regulations) (discussed below) were carried out subsequent to this acquisition, Tata Steel was not in a position to seek specific dispensations in this regard as part of the resolution plan. This meant that in compliance with the listing obligations, Tata Steel’s equity stake had to remain under 75% to maintain the minimum public shareholding and the vast majority of the funding from Tata Steel of ~ ₹ 20,000 crore was injected as preference shares, with the residual amount borrowed in BSL itself.

At the time of its acquisition, BSL was a distressed asset with large financial liabilities and an inability to finance its working capital requirements. Its operating processes and enterprise resource planning systems were inadequate. Due to the inconsistent supply of quality raw materials and fluctuating operating parameters, most of its facilities were operating below rated capacities. Post-acquisition, Tata Steel’s primary focus was to ramp up crude steel production to BSL’s rated capacity. Tata Steel has a long history of implementing successful continuous performance improvement programs with defined targets and timelines.

Within 45 days of the acquisition, TSBSL launched an accelerated improvement program ‘Be1: *Alag Pachan, Uchi Udaan*’ (Be1 program) which is a single platform to achieve benchmark levels in operational excellence, customer centricity and financial performance. The program had clearly defined objectives of maximising throughput, optimising resource consumption, minimising waste, reducing cost & working capital and driving energy efficiency. It drove change bottom-up, by collective problem solving through data analytics. Site visits to Tata Steel’s other plants were facilitated while Tata Steel’s own subject matter experts were deployed in TSBSL. To build momentum, capability building sessions focused on technical and managerial skill-sets were conducted across the workforce. A daily ‘Dispatcher’ was instituted where 70+ senior leaders across the value chain met to review operational matters and solve problems collaboratively and quickly. Operational and commercial roles were delineated with clear accountability. In order to align the organisation with Tata Steel, it was important to embed the ‘Tata Values’, foster a long-term planning mind set and encourage data and risk-based decision making.

Emphasis was placed on de-bottlenecking operations and reducing input material cost to make the CONARC furnaces viable. One of the key levers that contributed to increase in blast furnace productivity was the greater use of PCI coal, which also reduced fuel cost. This was possible because of cross-functional learning with the Jamshedpur and Kalinganagar works of Tata Steel. The production of crude steel increased from 3.65 million tonnes in FY2018 to 4.46 million tonnes in FY2020. The blast furnace capacity utilisation increased from 83.7% to 93.6%. Several projects were undertaken to improve the capability and productivity of downstream mills. Customer service practices were adopted from Tata Steel and products were migrated to common brands. In addition to the Tata Steel brands- ‘Shaktee’, ‘KOSH’, ‘Steelium’ and ‘Astrum’, TSBSL launched three new coated brands of its own ‘GalvaRoS’, ‘Colornova’ and ‘Galvanova’. Tata Steel’s distribution channels were leveraged and old BSL distributors were on-boarded onto the Tata Steel system where appropriate. Original equipment manufacturer sales were significantly ramped up in automotive and other value-added products. A number of initiatives were taken to reduce power cost by ~25%-increasing internal generation, and major overhaul of boilers and generators. Over ₹ 4,000 crore of improvement savings were realised under the Be1 program from FY 2019 to FY 2021. The cash conversion cycle came down to eight days in FY 2021 from 106 days in FY 2018, as working capital management was strengthened. Since its acquisition, TSBSL has released ₹ 4,700 crore of working capital through inventory, debtors and creditors management. EBITDA per tonne of crude steel increased from ₹ 5793/t in FY 2018 to ₹ 12,637/t in FY 2021, while free cashflow from operations increased from ₹ 678 crore to ₹ 8,219 crore. The proof of the turnaround is in the contrasting performance *vis-à-vis* lenders: since its acquisition by Tata Steel, TSBSL has been able repay external debt worth ₹ 9,500 crore within a span of three years.

PERSPECTIVES ON THE RESOLUTION PROCESS

Tata Steel’s experience through the acquisition process for BSL was a constructive and positive one where the Tata Steel leadership team worked seamlessly with the lenders and the RP to facilitate

a quick and timely closure. In fact, our experience in all IBC processes has been consistent. The RPs have been competent, have organised detailed site-visits, provided historical information and facilitated a good understanding of the asset. The fact that the assets are in control of the RP has also given us some comfort in terms of limited value deterioration during the process.

At the time of the acquisition of BSL, the legal landscape with regard to IBC process was still evolving. A clean break and cleansing of legacy liabilities through the resolution process is essential for a successful outcome. In the months following the BSL acquisition, there was considerable uncertainty over historical statutory and tax claims as well as cases involving investigations in relation to the actions of the erstwhile promoters/ management. Subsequently, however, there have been several judgements over last couple of years which have reinforced the clean balance sheet concept. In the judgement by the Hon’ble Supreme Court (SC) in case of *Ghanshyam Mishra v. EARC*², it was held that, ‘*The legislative intent of making the resolution plan binding on all the stakeholders...that after the approval of the resolution plan, no surprise claims should be flung on the successful resolution applicant.....*’.

It was also held that

once a resolution plan is duly approved.... the claims as provided... shall stand frozen and will be binding on the Corporate Debtor and its employees, members, creditors, including the Central Government, any State Government or any local authority, guarantors and other stakeholders... and all such claims, which are not a part of resolution plan, shall stand extinguished....

The SC also held in the case of *Pr. Commissioner of Income Tax v. Monnet Ispat and Energy Ltd.*³ that ‘*the provisions thereof (of the IBC Code) will have an overriding effect, if there is any inconsistency with any of the provisions of the law for the time being in force or any instrument having effect by virtue of any such law*’. These judgements have addressed several concerns that participants in the process have had when valuing assets and helped engender confidence.

In June 2018, the Securities and Exchange Board of India (SEBI) amended the Delisting Regulations such that they will no longer apply to any delisting of equity shares pursuant to an IBC resolution plan, if the latter sets out a specific delisting procedure; or provides an exit option to existing public shareholders at a price not less than the liquidation value; and if the exit price for public shareholders is not less than any exit price given to promoters. Regulation 3 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, which restricted an acquirer from acquiring more than the maximum non-public shareholding of 75%, has also been amended. This has been a very welcome policy reform to ensure the resolution process is more efficient.

These amendments were necessary to facilitate the timely resolution of financially stressed listed companies. As we all know, once a company has reached a stage where it can no longer pay off its debts or carry on its operations, the capital of the company has eroded with the shares of the company having lost their value. In such a situation, it is unlikely that a resolution applicant (RA) would pay any money to acquire the public shareholding. However, even after these regulatory

changes, the shares of a company continue to be traded even after its admission to a CIRP (it is only once the value of shares is established to the liquidation value (i.e. nil), that the trading of shares is halted). This practice risks creating a speculative price environment for the stock in the interim period. The regulators need to consider suspending trading of shares immediately for any listed companies which are admitted into a resolution process under the IBC.

Certain critical uncertainties on the income tax front have also been addressed. Until three years ago, the continuity of carry forward and set-off of losses in a closely held company was allowed only if there was also continuity in the beneficial owner of the shares owning not less than 51% of the voting power of the company. This has been amended to make an exception for change in voting power or shareholding pursuant to a resolution plan approved by the NCLT. Furthermore, an amendment through the Finance Act, 2018 clarified that the aggregate amount of unabsorbed depreciation and loss brought forward (excluding unabsorbed depreciation) shall be allowed to be reduced from the book profit, once a company's application for CIRP has been admitted (as opposed to the minimum of the two, specified earlier). These amendments on the tax front have been extremely helpful in creating greater interest in the resolution process for stressed assets, and facilitating higher realisations for banks and creditors.

FURTHER IMPROVEMENTS AND RECOMMENDATIONS

Quite early on, it became clear that simply adopting bankruptcy laws from mature markets is insufficient to deal with the specific challenges we have with stressed asset resolution in India. A robust legal framework to deal with insolvency in India, must take into account local conditions including the fact that majority lending is still done by public sector banks. It is natural therefore to expect that a law like the IBC would not be a static one-shot implementation, but something that would evolve over a few years of experience. Given this context, it is creditable that in its relatively short lifetime, the IBC has been strengthened by complementary changes in other laws and important judgements which have provided a comprehensive framework within which an applicant can make an informed choice when placing a bid for stressed assets.

Having said that, the authors would like to record a few areas where continuing work and thinking is required to make our insolvency related processes more efficient and robust. One area where Tata Steel's experience suggests more work is required, is in nailing down a firm price discovery process, from which there should be minimal deviations, if at all. Having seen multiple resolution processes play out, there is a need for creditors to abide by the initially outlined process even given their focus on value maximisation. An uncertain approach is vulnerable to gaming and the best outcome may not be achieved, while also causing delays. Currently, the price discovery process has become a continuous auction whereby lenders are allowing bidders to improve their offers and even accepting new bidders in the process. The RAs participate in a process with the knowledge that there would be multiple rounds of negotiations. The applicants are therefore unlikely to submit their best price initially and will try and match or marginally improve their offer over the other bidders. The final

price for the assets under this mechanism, therefore, becomes the price quoted by next best bidder (H2 price) plus a margin. The banks may never be able to discover the highest price (H1). This is also because while the process is ideally meant to be fully confidential, as a practical matter information on bids does become available publicly given the large number of stakeholders involved who have to be kept informed. The committee of creditors (CoC) continues to negotiate with the bidders until they feel options are exhausted. This causes significant time delays and in situation where the asset is in a vulnerable business position, this can be counterproductive in terms of final value realisation.

We would suggest that the process being followed by the Department of Investment and Public Asset Management for auction of assets under disinvestment constitutes a better methodology for price discovery. If this process of single round bidding would be followed, the RA would be required to submit their best offer, knowing there would be no further scope for negotiation, and the same would be the final. This will also help in meeting the target timelines of the resolution process. This is particularly effective for assets where there is significant interest with multiple competing bidders.

We have now seen multiple instances where the resolution process has become mired in protracted litigation at multiple levels of the judiciary. As the IBC and associated regulation matures in India, one measure of its increasing effectiveness and success must be in terms of whether it can achieve or even better the original contemplated completion timelines of 180 days. This may require us to look at alternatives or possible redesign. For example, all stressed asset situations do not require a formal resolution process, with transfer of control to RPs and periods of diligence, auction and negotiation run by the CoC. The need for quicker resolutions was especially borne out last year when certain provisions of the IBC were suspended given the pandemic related disruptions. The IBBI has studied and made recommendations on adopting a version of the pre-packaged insolvency resolution process (PPIRP/pre-pack) to the Indian context, and quite speedily an Ordinance based on the same has even been adopted for micro small and medium enterprises. It has been highlighted that pre-packs are significantly less time consuming and expensive. They also offer a viable alternative where the relationships between the existing promoters/ management and lenders have not completely broken down and a restructuring is possible with concerted effort and dialogue on both sides. We believe this creditor in control/ debtor in possession model can also work well in case of large stressed assets with the right safeguards. In their detailed study and paper, the IBBI has rightly identified the key issues in ensuring that the commercially correct outcome for the Indian context is reached- both in terms of retaining the ineligibility criteria from section 29A and having a Swiss Auction process for value maximisation.

In the case of businesses of a certain scale and complexity, it is also important to consider what skills and competencies are required to run them during the CIRP, especially one which gets extended. In order to preserve value in the business so that the optimal outcome can be achieved for all stakeholders, we need to ensure that it is operated by seasoned professionals with an understanding of the business and who are mindful of the health and stability of assets and installations. From a skill development and resource building point of view therefore, we need to think beyond finance,

legal and accountancy professionals.

Another aspect to highlight is the need to bring about transparency and simplification in corporate structures. One key aspect is the inherited investments in subsidiaries and joint ventures/ associates along with the acquired stressed asset entity, including overseas holdings. The current IBC framework does not capture these within the resolution process. While it is clear that there are legal challenges and the subsidiary companies cannot be deemed to be insolvent along with the parent, we need to explore options to create more visibility on the full structure and asset/ liability position within that for the RAs. It is possible that the applicant ends up acquiring companies which may have significant liabilities or where there are structural difficulties to operate in the future. It is also possible for the CoC to work along with the RP, the Reserve Bank of India and relevant authorities to try and establish management control early in these inherited investments, especially where the stressed entity has a controlling stake.

CONCLUSION

The IBC has indeed been an important step and integral to the required economic reforms in India. It may not have been a seamless implementation from inception and has required multiple amendments, changes in other laws and clarificatory judgements, but that is to be expected given the complexity of the Indian business and legal landscape. On the other hand, it has significantly empowered lenders and created a level playing field for banks in situations where borrowers are in financial difficulty. It has created the right incentives to try and resolve default situations by restructuring early, rather than push them out through sub-optimal compromises. The changes which have been made subsequently in capital market and tax regulations have shown that the Government regards the IBC as critical and wishes for it to succeed. These reforms will strengthen industry in India, while bringing in long-term capital into the country.

NOTES

¹ Securities and Exchange Board of India (Delisting of Equity Shares) (Amendment) Regulations, 2018.

² *Ghanshyam Mishra and Sons Private Limited v. Edelweiss Asset Reconstruction Company Limited* (2021), C.A. No. 8129 of 2019.

³ C.A. No. 6483 of 2018.

9

IBC : HISTORY, IMPACT AND LOOKING AHEAD

Rashesh Shah

There are some moments which have defined India's economic history since independence. The Industrial Policy Resolution of 1948 and subsequently of 1956; creation of the Planning Commission in 1950 and introduction of the first five-year plan in 1951; the push for Green and White Revolution in the 60s and 70s; the ending of the license raj and the 1991 budget; the disinvestment and privatisation plan of 1999; the creation of National Institution for Transforming India (NITI) Aayog; the introduction of one nation and one market in the form of Goods and Services Tax (GST) are some of these seminal moments and phases. The introduction of the Insolvency and Bankruptcy Code, 2016 (Code/IBC) falls in the same category. Since its introduction, the Code has undergone multiple changes, but the core remains the same – to ensure an equitable solution for all stakeholders in the case of a company's bankruptcy. The Code has achieved success but also faced its own set of challenges. However, the ability to be able to provide a solution to large-sized insolvencies has accorded a lot of hope around what has been a transformative change for the nation.

HISTORICAL CONTEXT

The Indian ecosystem has seen multiple laws that deal with insolvency and bankruptcy for different entities under different situations. Due to the complexity of multiple laws, the resolution process historically has been fragmented, expensive and time-consuming with very limited recoveries to show. India's journey in bankruptcy laws began with setting up of the Board for Industrial and Financial Reconstruction (BIFR) under the Sick Industrial Companies Act, 1985 to check industrial sickness. However, BIFR failed to address the issue due to inherent weaknesses in the system which were used by defaulters to escape recovery action by banks. Subsequent steps including the setting up of specialised courts (Debt Recovery Tribunals (DRT) in 1993) followed-up by another significant

legislation in the form of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (SARFAESI Act), were a few of the improvements made but, also met with limited success due to some shortfalls. At the same time, the provisions of the Companies Act, 1956 (Companies Act) dealing with compromise and arrangements or winding up proceedings were also not very effective.

Most of the above-mentioned approaches failed to yield desired results for various reasons. One primary reason was that most of these mechanisms were more favorable to specific stakeholders and not necessarily all-encompassing in coverage. All in all, there was hardly any legal route available which could have provided a reasonable exit to the potential investors in a holistic manner. As a result, interest of the investors largely remained muted in the distressed assets market of India.

IBC – AN INTRODUCTION

The Code was brought into force based on the report submitted by the Bankruptcy Law Reforms Committee headed by Dr. T. K. Viswanathan. The Code was conceptualised and framed upon the principles and learnings of the then existing mechanism under the Companies Act, BIFR, Corporate Debt Restructuring and various Reserve Bank of India (RBI) schemes besides the practices followed in other jurisdictions such as the UK and the USA and United Nations Commission on International Trade Law (UNCITRAL) Guide on Insolvency Law. As such, the Code provided in-built checks to plug-in the loopholes experienced under the previous regime.

In essence, IBC was the first comprehensive resolution forum addressing needs of resolution/revival as well as liquidation in case of failure of resolution efforts. It was under this forum that the interest of all the stakeholders of a corporate debtor (CD) was addressed while also protecting the value of the assets of the CD, besides saving precious employment in the company.

IMPACT OF IBC

IBC has had a multi-faceted impact on the country, even in the short period it has been in existence. This has spanned not just an economic and legal impact, which in itself, has been significant *vis-à-vis* other historical bankruptcy regimes. It has also created a marked societal impact, especially around saving livelihoods as well as driving behavioural changes.

Economic Impact

Enhanced efficiencies in process and improved recoveries: We have witnessed sizable enhancement in the recovery made by the financial creditors (FCs) as compared to previous legal mechanisms available with the creditors. A realisation of ~40% in value for the resolution cases under IBC is a significant improvement over the ~20% realisation achieved in the erstwhile bankruptcy mechanisms. It is also important to note that this 40% realisation is nearly double the liquidation value of these assets (which is typically what most historical bankruptcy regimes would achieve in terms of realisation).

Equally importantly, out of the nearly 28,000 applications filed under IBC, more than 50% (~15,000) were withdrawn before admission. This has been enabled by the very real possibility of promoters losing their companies once under IBC as has been seen in many cases. As a result, indirectly, IBC has also become a tangible early-resolution mechanism and a strong tool in the kit of creditors.

However, to take a balanced view, one also has to take cognisance of the fact that a sizable chunk of these recoveries has come from a few large cases like *Essar Steel*, *Binani Cement* and *Bhushan Energy*. Excluding these three assets, the realisation versus claim comes to around 27%. However, this is still more than 1.5 times the liquidation value of these assets.

All in all, IBC has managed a total realisation of more than ₹ 2 trillion in its short journey since inception. This is a sizable achievement, though with its set of challenges, and one which will only improve in terms of economic value generated as the Code is sharpened with each subsequent improvement.

Improving timelines: While the IBC took birth amid highly promising and probably over-optimistic timelines of 180 days with a maximum extension of 90 further days, the ground reality has not exactly been the same. The very fact that the average resolution time period in previous insolvency regimes was almost four and a half years made these kinds of target timelines seem unrealistic.

However, to its credit, the average resolution time-period in IBC has been in the range of ~400 days. While not the same as the intended timelines, it is still much better than other insolvency mechanisms. For a new law which is still finding its feet and still undergoing significant changes in construct as new gaps being identified are plugged, this is still a very credible achievement. As we move forward, it is expected that these timelines will get further compressed and some other long-stuck cases will see quicker resolution. However, it is clear that there is still some distance to be travelled in terms of resolution timelines to make this a truly efficient insolvency process.

Improving Ease of Doing Business: Implementation of IBC, in conjunction with other significant initiatives like GST, have led to an improvement in India's ranking in the World Bank's Ease of Doing Business report which has improved from ~140 to ~60 in five years. Insolvency resolution forms a key parameter in the evaluation of ease of doing business and this significant improvement in rankings is in no small part to the strength of IBC. IBC has therefore helped drive a holistic improvement in the attractiveness of India as an investment destination, a long-term change whose impact will continue to be seen in the years to come.

Other economic benefits: Apart from the measurable gains in economic parameters, the Code has also resulted in various other long-term gains, *viz.* enhanced availability of credit, heightened levels of entrepreneurship, driving competition and innovation, improvement in corporate governance, resource allocation and resultant greater economic growth. Availability of interim finance for distressed assets market was a tedious task earlier which has now been institutionalised under the Code leading to some very good results in turning around several CDs. Another significant improvement seen was the impact on the overall cost of capital which came down substantially since

the recoveries by creditors are being ploughed back into the credit cycle.

Finally, all these positive impacts have also led to enhanced capacity utilisation and resource allocation, thereby leading to higher economic growth.

Social Impact

While the social impact of IBC has been across multiple avenues, it can be broadly classified into two big buckets:

Behavioral Changes: The single most important achievement of IBC, apart from recovery facilitated, is the fact that the Code has brought about significant and much needed behavioral changes among the creditors and debtors, thereby redefining debtor-creditor relationship. Threat of losing control of the enterprise has led to a perceptible change in the manner the ecosystem looks at default. In the absence of a potent legal regime, defaulting to banks was not perceived as a threat by promoters as litigations before the DRT or otherwise, action under the SARFAESI Act seldom posed threat of losing control of the enterprise. However, the Code delinked 'default' with lenders and thus paved way for initiation of a corporate insolvency resolution process (CIRP) even when the company is not in default to that lender. Threat of action under the Code has forced debtors to address and settle default expeditiously with the creditor, preferably outside the Code. It is very much visible from the fact that since the enactment of the Code in 2016, till March 2021, about 17,000 applications for initiation of CIRPs having underlying default of close to ₹ 5 lakh crore were resolved before their admission. Only a few companies, who fail to address the distress in earlier stages, pass through the entire resolution process. These figures indicate that almost 83% of the cases are getting resolved on the way, before the official commencement of CIRP under the Code on account of behavioral change among the defaulting debtors.

Saving and creating jobs: As per rough estimates, IBC has saved more than four lakh jobs in the country. For a nation where gainful work for the masses is still a challenge and where every enterprise is a source of both direct and indirect job creation, these lost jobs without IBC would have added to the country's unemployment challenge. In parallel, it has also created new jobs in itself as we see thousands of insolvency professionals (IPs) amongst others specialising in the IBC process as the law gains traction. In due course, the IBC economy will create even more jobs, bring unproductive assets back into the productive fold and generate lakhs of more direct and indirect jobs in the future.

IBC – A JOURNEY OF CHANGE AND IMPROVEMENT

The Code has seen an incredible roller coaster ride since its early stages through interplay of various forces including legislation and regulatory initiatives and has been complemented by timely and proactive judicial interventions at every critical stage of the journey.

Some of these changes had a substantial impact on the implementation of the Code. Section 29A

which lead to exclusion of promoters and their related parties came into play in the *Essar* case. Section 12A enabling withdrawal of application paved the way for settlement between parties at any stage before approval of resolution plan. This has helped establish IBC as a viable part of the creditors' toolkit, leading to a substantial behavioral shift amongst borrowers.

Section 14 was amended to clarify the position that the moratorium under the section will not include action against guarantors, thereby clearing the deck for action against guarantors even while borrower is undergoing CIRP. It strengthened the position of the lenders. It also reduced the voting requirement for approval of resolution plan from original percentage of 75% to 66%.

Amendments last year introduced a critical and much-needed provision in the form of a new section 32A in the Code, which facilitated a 'clean slate transfer' of 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. This has significantly helped enhance corporate interest in assets under IBC.

The above legislative initiatives were very well supplemented by proactive regulatory interventions by RBI and others. The issuance of the June 7, 2019 circular by RBI, which is now in force for the purpose of recasting of distressed loans outside courts / National Company Law Tribunals (NCLTs), was an important initiative. RBI also issued directions regarding first/second set of 12 / 28 large cases identified by the RBI for resolution under IBC, involving debt of ₹ 4 lakh crore, one-year window for regulatory approvals upon approval of resolution plan etc.

The contribution from the judiciary was equally important, especially in some large-ticket cases. Jurisprudence evolution in form of judgements and orders was significant since various contentious issues which could not have been addressed by the legislative changes were captured by various judicial pronouncements. The major issues addressed include constitutional validity of the Code, the primacy of commercial wisdom of the committee of creditors (CoC), protection of *inter-se* priorities of secured creditors, effect of moratorium on the guarantors, treatment of the homebuyers in CIRP, applicability of the Limitation Act, 1963 to NCLT proceedings under IBC, amongst others.

Despite the comparatively more successful journey of IBC, there remain kinks in the armour which need to be addressed if IBC is to become a truly all-encompassing insolvency solution.

WHAT NEXT?

There are some areas where we have seen some activity in terms of defining the next frontiers of IBC. These include cross-border insolvency, pre-packaged insolvency resolution process (PPIRP/ pre-packs), personal insolvency and resolution of financial service providers, group insolvency, amongst others.

Cross-border insolvency

This has been a buzzword in the insolvency and bankruptcy sphere in India since the Government released a draft chapter on cross-border insolvency, which was to be included in the IBC. This chapter essentially provided for the adoption of the UNCITRAL Model Law on Cross-Border Insolvency (UNCITRAL model) by India, with certain modifications. The model is widely considered to form international best practice in insolvency law, with 44 countries across the globe having adopted it. The Insolvency Law Committee (ILC) too recommended the adoption of this UNCITRAL model. The emerging focus on cross-border insolvency is a welcome move. This is because, several Indian companies now have a global presence, and cross-border insolvency regulation is essential to ensure that first, assets of CDs located in foreign jurisdictions can be brought within the fold of the CIRP and second, that the claims of foreign creditors are also adequately met.

Pre-packaged insolvency resolution plans

The Government has introduced the pre-packs within the IBC, not as an alternative to the existing framework, but as a complementary solution within it. However, there are some fundamental issues with pre-packs that have emerged in jurisdictions such as the UK and USA which may have to be addressed in its Indian variant too.

First, given that speed and secrecy are two important components of a pre-pack scheme, often the interests of the management and the secured creditors are favored over that of the unsecured creditors, with unsecured creditors often remaining in the dark about a large part of the process. Second, there exist concerns that this process does not allow for the best realisation of the value of the business on account of the fact that there is no 'open marketing'. The CIRP process under the IBC allows for bidding, which is largely considered to be the best strategy to maximise asset value of an insolvent company. Third, and possibly most importantly in the Indian context, pre-packs allow for the earlier management (and promoters) to continue to have control over the enterprise. Given that the last few years have shown a determined focus of the Government and the NCLT to restrain the rights and powers of promoters (as seen through the introduction of section 29A), allowing the promoters and existing management to control the insolvency plan appears contrary to the established goals of the current insolvency framework. There has been a lot of emphasis on keeping the promoters of a sick entity out of the insolvency process to the largest extent possible due to the understanding that the promoters themselves (in their self-interest) may have had a hand to play in the bankruptcy of the company. Thus, pre-pack schemes, while may help greatly in cutting costs and delays come with several other concerns which the Government should note and seek to adequately address.

Personal Insolvency

The Central Government has, from December, 2019, brought into effect Part III of the Code dealing with the insolvency and bankruptcy of individuals and partnership firms. The Government has also

enacted various rules and regulations around the same. However, no visible progress was seen on this area mainly since the validity of the provisions were challenged before the Supreme Court (SC). The SC has since finally decided the issue and it is hoped that some progress would be made in coming years.

Resolution of Financial Services Providers

Dewan Housing Finance Limited (DHFL), one of the biggest mortgage lenders in the country, was the first financial services provider (FSP) to be notified for insolvency resolution by RBI. NCLT has recently approved Piramal Group's ₹ 37,250-crore resolution plan for DHFL subject to certain conditions.

While this development is significant considering that this was first of its kind experiment towards resolution of an FSP, it needs mention that impact of resolution of this magnitude would have a far-reaching impact touching the economic, social as well as the legal fabric of the country, more so since resolution of a major FSP invariably goes beyond few specified stakeholders and covers all segments of the society and the ecosystem including small investors. This is a welcome development for IBC but one which needs careful evaluation of the subsequent impact it will have on the entire ecosystem.

Group Insolvency

The Code has seen little progress in consolidation of insolvency proceedings at the group level for multiple entities. This has mainly come through judicial interventions in select cases. Legislative means in group insolvency are an important requirement, without which the full share of dividends of the progress made may not be achieved. In the recent past, quite a few successful resolution applicants have faced serious bottlenecks on account of absence of a detailed group insolvency regime. Getting control of critical operations of subsidiaries, not party to CIRP has been one such instance.

Apart from the structural changes in the construct of IBC which need to be worked on, there are some other smaller legal and operational challenges as well, which need attention of the Government and regulators. These will ensure smooth functioning and help drive efficiency in the resolution process.

- (a) Training of IPs/ Liquidators by mandatory on-the-job training with existing Resolution Professionals (RPs)/ Liquidators for a particular period before being appointed as RPs/ Liquidators.
- (b) Improving infrastructural capacity of NCLT/ National Company Law Appellate Tribunal (NCLAT).
- (c) Criminal action against promoters of CDs under section 19 of IBC for not complying with NCLT's orders.

- (d) Simultaneous arbitration proceedings should be allowed to address complex commercial points of disputes by experts to be merged later with IBC proceedings. This will fast track the CIRP process, especially in large and complex cases.
- (e) Exclusive Tribunals under IBC must be set up to deal with applications regarding preferential, extortionate, and fraudulent transactions.
- (f) While we have set timelines for a CIRP, no such limitations are specified for the appeals which renders the entire scheme of definitive periods infructuous. This needs to be corrected.
- (g) Though any substantive modification of a given approved plan may not be permissible under the Code, yet certain instances of tweaks and fine tuning of the ongoing plan during the implementation stage cannot be ruled out especially if the overall objective of the Code to maximise stakeholder claims is kept in consideration. Such instances can be in the form of repayment structure or management / monitoring formulas of operations etc.

Despite being a relatively new legislation, IBC has undergone several amendments within a short span of time in a bid to eradicate any loopholes and/or ambiguities that may hamper the smooth and efficient functioning of the Code. In this journey of IBC, the relevant authorities, legislative think tanks and the judiciary have played a crucial role by manifesting new dimensions of law within the strict timelines which further clarified the derivatives of such critical amendments.

All the stakeholders played an important role and the approach adopted by them so far has made it a success as measured by the impact made by the Code in the social, economic and legal landscape of the Indian ecosystem. While extended timelines have raised concerns on efficacy of the law, it should not be forgotten that any new law takes four to five years to settle. Even in the US, it took nearly a decade for bankruptcy law to take shape before it became a speedy and efficient mechanism to resolve financial trouble. In India, the learning curve has been remarkably shorter by all standards.

As IBC evolves further, it could become the most potent instrument in driving good credit behavior and ethical business practices among borrowers, and proactive, responsible behavior among lenders, proving to be a boon for the economy and the nation.

10

ECONOMIC AND FINANCIAL IMPACT OF IBC

Soumya Kanti Ghosh and Saket Hishikar

The Insolvency and Bankruptcy Code, 2016 (Code/IBC) is a landmark legislation in the post-reform history of India. The legislation came at a time when banking system was reeling under the pressure of mounting non-performing assets (NPAs), most of which were concentrated in the large corporate segment of the banking book. The legislation is a turning point in many ways. This is because for large part of the post-independence period there was no major effort to create a legal framework for resolution of capital locked in failed business. Till the year 1985, the legal framework for dealing with corporate insolvency and bankruptcy in India consisted of only one law - The Companies Act, 1956 (Companies Act). Personal Bankruptcy was adjudicated by two archaic laws – The Presidency Towns Insolvency Act, 1909 and The Provisional Insolvency Act, 1920. The former relates to individuals residing in the erstwhile Presidency towns of Calcutta, Bombay and Madras. The latter covers all individuals residing in other places. Section 425 of the Companies Act provided a base framework for involuntary dissolution as well as voluntary dissolution. Various other sections including sections 433, 443, 444, 455, 463, 466, 481 and 488 contained detailed procedures for the resolution process. Despite several sections addressing the resolution process, the Companies Act was incapable of dealing with corporate insolvencies. The absence of legal framework for resolution of bad debt was soon felt in 1980 as industrial sickness was reaching alarming proportions in many parts of India, accompanied by massive downsizing. Government's effort towards the interim management of sick industrial units and nationalising sick industries proved futile. Workmen's dues were mounting, loan recovery was anemic, and unemployment was going up. In this context the Sick Industrial Companies Act, 1985 (SICA) came into being. The SICA had several shortcomings, and abuse of section 22 of SICA is often highlighted as an example of the inherent deficiency in its provisions. Section 22 allowed companies to seek a bar on proceedings for execution, arbitration, recovery suits, enforcement of security interest etc. and was often misused by

unscrupulous promoters. Eradi Committee findings¹ clearly highlighted the lack of success of SICA. The success rate of companies referred to the Board for Industrial and Financial Reconstruction, as per Eradi Committee, was only 19%. The inability of the system to recycle locked capital affected the capital efficiency of the economy resulting in a very mediocre growth rate of 3%. As the balance of payment crisis struck in 1990s, for the first time some attention was paid for an urgent resolution of bad debt in the banking system. Subsequently, with the advent of first-generation reforms, the legal framework related to insolvency and bankruptcy was initiated with the introduction of the Recovery of Debts and Bankruptcy Act, 1993 (RDB Act), through which Debt Recovery Tribunals (DRTs) were formed. Initially the system functioned well. But as time progressed the RDB Act failed to make any improvements in the muddled insolvency landscape, primarily since SICA had precedence over RDB Act. Soon DRTs were found to be overburdened with many pending cases. The annual average recovery percentage of cases adjudicated by DRT between period FY13 to FY20 was an abysmal 7.95%.² Within a decade, the Government introduced a new legislation called the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). Around the same time when SARFAESI Act was introduced, Reserve Bank of India (RBI) introduced a Corporate Debt Restructuring Scheme that provided broad guidelines for debt restructuring by banks. The recovery percentage of insolvency cases administered through SARFAESI Act was marginally better at 22.35% between FY13 to FY20.³

It was clear by the year 2010 that a single, comprehensive framework was required to effectively tackle delay in insolvency and bankruptcy proceedings. In 2014, the Ministry of Finance instituted the Bankruptcy Legislative Reforms Committee, led by Dr. T. K. Viswanathan which culminated into the IBC. The objective of the IBC is 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 priority of payment of government dues. The Code separates commercial aspects of insolvency and bankruptcy proceedings from judicial aspects.

LAW AND SOCIETY

How has IBC impacted the economy and financial system of India? The question can be posed in more generic terms – how legislation interacts with society at large and what are interrelationships with agents over time. From a pure legal perspective, law must have three attributes - law has its sovereign authority, law is accompanied by sanctions and the command of law should compel a course of conduct. IBC satisfies all the three. From a pure game theoretic framework, purpose of any legal framework is to set the rules of the game. The idea is that different parties involved in the game reach a Nash equilibrium so that there is no incentive for anyone to unilaterally deviate from the equilibrium. Bankruptcy resolution involves many parties besides borrower and creditors. The claim of operational creditors, bond holders, pension/mutual funds and Government all need be accounted for in the resolution. Since, not all will be fully satisfied; any bankruptcy resolution will have distributional consequences. Further how will a new legislation harmonise with other

legislations also determines the outcome. Thus, it is imperative that quality of law and its associated rule are clearly articulated and enforced so that result is as close to theoretical construct of Nash equilibrium. Equipped with these thoughts, we now investigate the impact of IBC on economy and financial markets, notably banks, corporate bond markets and asset reconstruction companies (ARCs).

IMPACT OF IBC

Impact on banks

To start with, let us see how IBC has impacted the debtor-creditor relationship within the banking system. There has been a concern in the RBI that debt contract embedded in bank loans needs to be improved, especially where the borrowing is large. Thus, there is a need to change this and restore the sanctity of the debt contract, lest bank debt becomes subordinate even to equity.⁴ Up till recently the borrowers were enjoying the arbitrage by raising funds through borrowing from banks *vis-à-vis* raising funds from the capital markets. In fact, if a borrower delays coupon/principal payment on a corporate bond even for one day, the market would penalise the borrower heavily – the rating would be downgraded, the yields on the bonds would shoot up, cost of further financing would increase, and suits would be filed by investors. So far, defaults in bank borrowings have not attracted similar reactions. Only when the overdue stretches beyond 90 days, the loans would be classified as NPAs; hence, efforts by lenders and borrowers have been to avoid the account having to be *de jure* classified as NPA. The RBI revised NPA framework of February, 2018 (later revised after Supreme Court judgment) tries to address this concern. How have NPAs fared after IBC came into force in May, 2016. Table 1 shows the position of sector wise NPA levels as on March, 2016 and their corresponding levels on March, 2021. Clearly in many of the sectors NPAs have come down. If we compare sectoral distribution of corporate insolvency resolution process (CIRPs) as on March 2021 in Table 2, the sectors with large share of CIRPs are also the sectors that witnessed drop in NPA. Thus, there is correlation which is also supported by the fact that resolution of a few large accounts through the IBC occurred during this period and in general 45% of recoveries of the Scheduled Commercial Banks (SCBs) happened through the IBC route.

Table 1: Gross NPA Ratios of major Sub- Sectors

Sector within Industry	Mar-16		Mar-21	
	Share In portfolio (%)	NPA (per cent of advances of their respective sector)	Share In Portfolio (%)	NPA (per cent of advances of their respective sector)
Mining & Quarrying	1.3	16.3	14	16.1
Food processing	5.0	17.7	6.1	13.5
Textile	6.9	21.3	6.6	12.3
Paper & their products	1.2	16.0	1.2	10.3

Chemicals	5.3	11.8	6.5	5.6
Rubber, plastics & their products	1.2	10.8	18	9.8
Cement & their products	1.7	19.0	1.6	8.2
Basic metals & their products	13.6	34.0	9.9	10.9
Engineering	5.3	16.5	5.0	18.0
Vehicles, parts & transport equipment	2.4	13.8	3.1	7.0
Gems & jewellery	2.5	13.2	2.5	24.0
Construction	2.9	27.1	3.7	23.5
Infrastructure	32.8	16.7	32.7	10.5

Source: RBI FSR

Table 2: Sectoral Distribution of CIRPs as on March 31, 2021

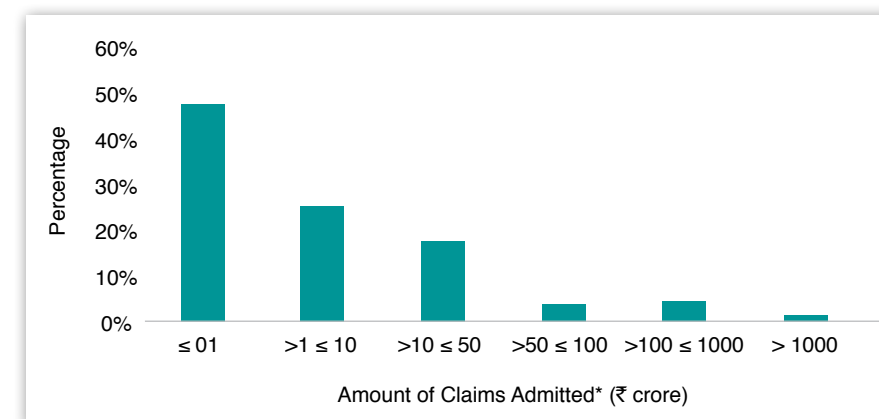
Sector	No. of CIRPs						Ongoing
	Admitted	Closed				Total	
		Appeal/Review/Settled	Withdrawal under Section 12 A	Approval of Resolution Plan	Commencement of Liquidation		
Manufacturing	1784	214	166	178	566	1124	660
Food, Beverages, Tobacco Products	228	22	22	24	70	138	90
Chemicals and Chemical Products	175	21	23	23	52	119	56
Electrical Machinery and Apparatus	136	16	4	6	56	82	54
Fabricated Metal Products	97	12	13	6	34	65	32
Machinery & Equipment	198	33	25	15	54	127	71
Textiles, Leather and Apparel Products	304	36	26	21	119	202	102
Wood, Rubber, Plastic & Paper Products	214	24	23	26	55	128	86
Basic Metals	308	35	16	41	93	185	123
Others	124	15	14	16	33	78	46
Real Estate, Renting Business Activities	862	159	100	46	214	519	343

Real Estate Activities	205	46	18	8	23	95	110
Computer and Related Activities	127	19	16	2	40	77	50
Research and Development	5	1	1	1	0	3	2
Other Business Activities	525	93	65	35	151	344	181
Construction	458	90	46	32	94	262	196
Wholesale & Retail Trade	442	56	35	20	156	267	175
Hotel and Restaurants	99	17	12	12	24	65	34
Electricity and Others	134	15	4	13	32	64	70
Transport, Storage and Communications	132	17	9	9	48	83	49
Others	465	49	39	38	143	269	196
Total	4376	617	411	348	1277	2653	1723

Source: IBBI Quarterly Newsletter, January -March 2021.

But can we say that IBC has achieved a behavior change as any law is expected to do so. On this, evidence is mixed. The distribution of CIRPs (Figure 1) withdrawn up to March, 2021 shows that highest withdrawals happened in less than ₹ 10 crore brackets. Thus, IBC has brought in a change of behaviour for small ticket loans.

Figure 1: Distribution of CIRPs withdrawn



Source: IBBI Quarterly Newsletter, January-March, 2021.

Impact on bond markets

The IBC cannot be the sole vector of change in behaviour. Looking at IBC in conjunction with RBI Framework for Enhancing Credit Supply for Large Borrowers through Market Mechanism, one is compelled to surmise that issuances in the corporate bond market will increase. But the question is issuances in what form?

A peculiar feature of our corporate bond market is that private placements are the norm. Private placements which were ₹ 2.18 lakh crores in FY 2011, touched ₹ 4.5 lakh crores in FY2016, according to data from SEBI. These increased sharply in FY 2021 crossing ₹ 7.7 lakh crores. More than 95% of total issues in the corporate bonds are privately placed. It is interesting to note that secured lending accounted for close to half of the total amount raised even in the private placement market of corporate debt. The private placement market for corporate debt is dominated by private financial companies which account for 47% of the total amount raised during the period FY16 to FY18. It is possible that IBC may further strengthen private placements. After all, financial transactions are substantially relational and IBC reduces the cost of borrowing further.

Table 3: Trends in Indian Corporate Bonds Market

Year	Private Placement Data of Corporate Bonds		Trading in Corporate Bonds	
	Issues	Amount (₹ Crore)	Trades	Amount (₹ Crore)
2016-17	3377	6,40,715.5	88495	14,70,662.5
2017-18	2706	5,99,147.1	91404	17,98,098.4
2018-19	2358	6,10,317.6	105150	18,35,941.5
2019-20	1787	67,47,029	127957	20,64,806.8
2020-21	1783	67,75,110	138754	18,72,718.0

Source: SEBI

How has the private placement feature of the corporate bond markets moved since the IBC? Table 3 shows that while number of issuances have increased, number of issues have fallen. Thus, borrowing is concentrated only in a small pool of borrowers. Accounting for confounding effects due to COVID-19 and non-banking financial companies (NBFCs) crisis, IBC may have benefited few who have a track record of raising funds in corporate bond markets. This conclusion is partially consistent with the recent empirical work⁵ on links between corporate bond markets and bankruptcy system predicting that safe firms will issue bonds (to avoid paying high interest rates required by banks), but higher risk firms, for which insolvency is more likely, will issue bonds if bankruptcy processes are efficient.

The second characteristic of the corporate bond markets in India is thin secondary market. Only 45% of the outstanding stock is available as free float indicating predominance of passive investors

in Indian bond markets. Thus, will IBC impact secondary trading? Will new investors who are absent in primary market, notably the retail investors, enter this market given the comfort offered by IBC? How will pension funds react to the fact that unsecured borrowings in corporate bonds have been placed quite low in waterfall mechanism under the IBC? Table 3 shows that there is no significant change in volume of trading despite rise in number of issuances.

Lastly, India's corporate debt market is dominated by financial institutions. Bulk of the issuance is in the so-called BFSI sector (Banking, Financial Services and Insurance). Banking and financial services account for 74% of all primary issues in FY 2015. Non-financial corporates account only for 19% of all outstanding issuance. Here the issue is more complicated. IBC alone is not the deciding factor. Financial Resolution and Deposit Insurance (FRDI) Bill pending in the Parliament will decide how well the issuance by BFSI sector will be received in capital markets. Government of India, vide its notification dated November 15, 2019, has expanded the applicability of IBC to cover systemically important Financial Service Providers (FiSPs) other than banks. The bail-in clause in FRDI changes the risk profile of debt issuances by banks. Those debts which are eligible for bail-in will carry a higher spread over debt even when the overall insolvency risk of the bank is reduced. Thus, in a nutshell, IBC may have increased the issuances in debt capital markets. The new issuance may come from non-financial corporates. It remains to be seen how IBC enhances the participation of retail investors, increases the volumes in secondary market and dissuades passive investors from investing in corporate bonds at a later stage.

Impact on ARCs

In respect of ARCs, the interaction of IBC with SARFAESI Act needs much clarity. This became evident when recently the bid submitted by an ARC for a distressed telecom player under IBC was rejected.

The issues in respect of IBC and ARC in India are quite complex. The recent report of RBI⁶ has noted that, the growth of the ARC industry has not been consistent over time and not always been synchronous with the trends in NPAs of banks and NBFCs. The rise in the number of ARCs, the growth in their assets under management (AUM) has been largely trendless except for a major spurt in FY14. During FY20, asset sales by banks to ARCs declined, which could probably be due to banks opting for other resolution channels such as IBC and SARFAESI Act. The acquisition cost of ARCs as a proportion to the book value of assets declined, suggesting lower realisable value of the assets.⁷

Accordingly, a committee has been constituted to review existing legal and regulatory framework applicable to ARCs and recommend measures to improve efficacy of ARCs. It will also review the role of ARCs in stressed asset resolution under the IBC.

The development of ARCs in India is at odds with what is seen in the US. The distressed asset funds or ARCs evolved in 1980s and 1990s on the back of opportunity made possible by reforms to the US Bankruptcy Code and the increased use of Chapter 11 of the Bankruptcy Reform Act of 1978

in the US. This resulted in out-of-court settlements post 1990 declining in favour of bankruptcies being resolved through a more formal Chapter 11 court process. Distressed investment firms were involved in some of the largest bankruptcies of the junk bond crisis and created legal and transaction precedents through introducing new financing and investment techniques.

When SARFAESI Act allowed ARCs to be introduced in India, ARCs were originally conceptualised as a parking lot for stressed assets, where the focus was on recovery. The role of an ARC has significantly evolved with the changing business environment.

Since its inception, a host of relaxations have been granted to ARCs. For instance, ARCs did not originally enjoy a right to convert the outstanding debt, which was introduced in 2013, upon the recommendations of a Key Advisory Group set up by the Government. However, the equity shareholding of an ARC in the borrower company post-conversion of debt was restricted to 26%. In order to equip ARCs with greater control and flexibility in turning around sick units, this 26% limit was relaxed in 2017 subject to certain conditions. RBI also relaxed the norms allowing non-institutional investors to invest in security receipts issued by ARCs and allowing ARCs to raise capital from foreign investors. In June 2019, RBI permitted ARCs to acquire financial assets from other ARCs, which was so far allowed for limited purposes.

Hence, the current issue of harmonising IBC and SARFAESI Act is a legacy issue and that needs to be addressed under changed circumstances allowing full potential of IBC to be realised in future.

CONCLUSION AND WAY FORWARD

Given the short history of just five years, of which for one year the IBC was under suspension due to COVID-19 outbreak, there is a clear evidence that IBC has had a positive impact on the recoveries of bad loans in the banking system. The IBC has overall recovery rate of 42% which is almost double the best option before IBC. At the same time, the time to recovery has averaged at 328 days indicating that the time cost of CIRP has not been contained and speedy resolution is the need going forward. IBC has resulted in change of behaviour of borrowers. Some form of settlement is a preferred mode once CIRP has been initiated. However, this is confined to low ticket borrowers. The impact of IBC on corporate bond markets is mixed. While there is no impact on secondary trading, primary issuances have seen higher volumes on narrow issuer base. The ARC's which deal directly with stressed assets have somehow been insulated from the positive current that IBC has generated. This study identifies legacy issues and overlaps in laws governing ARCs and IBC. Treating ARCs as integral part of the IBC ecosystem can bring in the necessary capital for stressed asset resolution in future. ARC recourse to increase their realisable value is one option that needs to be explored.

Going forward, in the backdrop of COVID-19, IBC is now evolving to incorporate pre-packaged insolvency resolution wherein an entity is restructured as a going concern. This will have a beneficial impact on the economy as job losses can be contained. The use of technology in reducing time cost for CIRP must be explored as Adjudicating Authority cannot be assumed to be closed perpetually.

The issue of whether the IBC has resulted in change in behaviour of large borrowers needs more study. The counter petitions have delayed the resolution, leading to sharp decline in liquidation value which increased the deadweight loss and cost of bankruptcy for the system. In this context, we must appreciate that in countries like China and Japan where insolvency law has been largely successful, culture has played a crucial role. As an example, Japan makes bankruptcy a personal, not a business failure. This characterisation of bankruptcy in Japan often leads to tragedy for the individual, be it isolation from family or otherwise. Culture also plays a substantial role in Chinese laws. In Chinese society, the notion of bankruptcy has long been condemned as 'bad luck'. If a father owes a debt, his sons or grandsons would be responsible for it; bankruptcy implies living with a burden for generations to come. Is Indian culture any different? Interestingly, in India, ordinary households take it upon themselves to repay their debt. Thus, culture is indeed important. But in the larger context, we must learn from outcomes and strengthen the Code so that the law is robust over time (in US, the bankruptcy law was first passed on April 4, 1800), which is currently being done. The ultimate test for culture is when promoters themselves approach the IBC for resolution for the benefit of all stakeholders.

NOTES

¹ Report of the High-Level Committee on Law relating to Insolvency and Winding up of Companies, 2000, Ministry of Corporate Affairs, Government of India.

² RBI, Report on Trends and Progress in Banking, various Issues.

³ Supra Note 2

⁴ N. S. Vishwanathan (2018), "It is not Business as Usual for Lenders and Borrowers", Speech by Deputy Governor, RBI at NIBM, Pune on 18 April.

⁵ Becker B. and Josephson J. (2016), "Insolvency Resolution and the Missing High-Yield Bond Markets", *The Review of Financial Studies*, Vol. 29, Issue 10, pp. 2814–2849.

⁶ RBI (2021), "ARCs in India: A Study of their Business Operations and Role in NPA Resolution", *RBI Monthly Bulletin*, 26 April.

⁷ Supra Note 2, December Issue, 2020, p. 64.

PART II
QUINTESSENCE

IBC: LIBERALISING EXIT

Bibek Debroy and Aditya Sinha

Ease of Business is not only about liberalising the entry of firms but also about liberalising exit. For efficient capital markets, it is imperative to have a mechanism to ensure the efficient exit of capital. Insolvency and bankruptcy laws primarily liberalise the exit of capital. The Bankruptcy regime should aim to encourage reorganisation. It should also *'balance several objectives, including protecting the rights of creditors (which is essential to the functioning of capital markets and the mobilisation of capital for investment) on the one hand, and obviating the premature liquidation of viable enterprises on the other hand'*.¹ The enactment of the Insolvency and Bankruptcy Code, 2016 (Code/IBC) has been a critical reform that has precisely helped achieve these objectives.

IBC has created a mechanism that ensures the firm's survival or exit while safeguarding the interest of all types of creditors. In several instances, it has been instrumental in resolving non-performing assets. It has also acted as a deterrence, as creditors have used IBC proceedings as a tool to nudge debtors to restructure and fulfil their obligations to the creditors. The enactment of IBC has also been instrumental in India's improved Ease of Doing Business Rankings of the World Bank. In resolving the insolvency parameter, India's ranking jumped 56 places to reach 52 in 2019 from 108 in 2018.

Nevertheless, some reports have highlighted that often there is a delay in the process of resolution.^{2&3} The case of corporate insolvency resolution process (CIRP) of Era Infra Engineering Ltd. highlights some of these issues. Referred by the Reserve Bank of India for insolvency proceedings in 2017 and admitted in 2018, the closure of this case is still pending.

Procedural delays and delays at the end of the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) to deal with IBC related matters in a time-bound manner have been impeding the success of this critical reform. The Supreme Court (SC) has also flagged this issue and, in one instance, transferred all cases related to a builder from NCLAT to

cut down on delays.⁴

Further, to provide relief to the pandemic affected firms, the government had suspended insolvency proceedings against the fresh defaulters for a year. This has proved to be a relief for cash-starved firms. At the same time, it would have potentially hit financial creditors (FCs) and operational creditors (OCs) hard. It would have temporarily deprived the OCs of a credible mode of bad debt resolution.⁵ Nonetheless, as the moratorium is now over, there will be an uptick in default filings, which will, in turn, further burden the caseload of the tribunals.

Some had anticipated that IBC suspension would ease the NCLT backlog.⁶ However, an analysis shows that up till June 30, 2020, NCLT did not revert to even 20% of its output in the pre-lockdown period.⁷ There was a 95% drop in the number of cases heard by NCLT. This can be attributed to the pandemic induced lockdown. Further, from April to December, 2020 merely 45 CIRPs were reviewed, settled, or appealed.

Even before the pandemic, creditors had started favouring opting for one-time settlement rather than approaching NCLT.⁸ The banks and creditors are sceptical about approaching tribunals, given the existing backlog of cases. To ensure that there is an effective mechanism for quick resolution of IBC matters, it is imperative to address some of the issues faced by the stakeholders at the earliest.

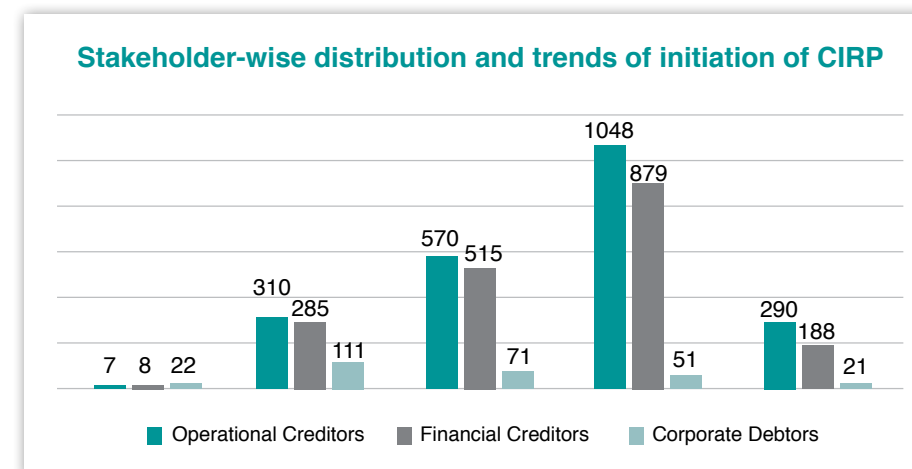
Against this backdrop, this paper briefly discusses the benefits of IBC. In the second part, the authors flag the issue of resolution delays and the reasons for such delays. Further, to provide an alternative mechanism to deal with bankruptcy in distressed micro small and medium enterprises (MSMEs), the Government of India promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 on April 4, 2021 to allow pre-packaged insolvency resolution process (pre-pack) for MSMEs. There are several benefits of pre-packs, and the third part of this paper discusses some of those benefits. Most importantly, it will significantly ease the burden of NCLT. This will be a pre-IBC window for the resolution of toxic assets. The fourth part outlines some of the suggestions which could be undertaken to achieve the intended benefits of this legislation.

INSOLVENCY AND BANKRUPTCY CODE: A GAME CHANGER

In a very short span of time, the IBC has ushered in a new era of corporate insolvency resolution in the country. Up until March, 2021, a total of 4,376 CIRPs were admitted before various benches of NCLTs. Out of this, 617 CIRPs were appealed/reviewed/settled, 411 were withdrawn under section 12A, resolution plans for 348 were approved and 1,277 CIRPs resulted in commencement of liquidation. While 74.37% of total CIRPs resulted in liquidation, a lot of these entities were already 'defunct, and the corporate value of corporate debtors was already eroded'.⁹

The stakeholder-wise analysis of stakeholders who initiated CIRPs, as of end of March, 2021 suggests that the majority of CIRPs are initiated by OCs, followed by FCs and corporate debtors (CDs).

Figure 1: Stakeholder-wise CIRP Initiation



Source: IBBI

The efficacy of IBC is often judged on the basis of number of IBC cases that have undergone the entire process, resulting in a resolution plan or liquidation. However, rarely do we mention how IBC has helped the stakeholders who did not go through the entire process. Since the enactment of the Code, out of the 28,441 cases filed under the IBC till September, 2020, 14,884 cases were withdrawn before admission viz. almost 83% of the cases, with a realisation value of ₹ 5,15,170 crores, were resolved before going through the entire process.¹⁰ There is a need to disseminate the important fact that a large proportion of IBC cases are getting resolved on the way.

Table 1:

Particulars	No. of Corporates	Amount (₹ Crore)	
Cases Filed	28,441	NA	
Cases Pending for Consideration	9549	NA	
Status of Applications		Liquidation Value	Realisation value
Applications withdrew before admission*	14,884*	NA	5,15,170*
Process commenced	4376	NA	NA
Process closed mid-way	1028	NA	NA
Process closed by a resolution plan	348	1,12,644	2,02,618
Process Closed by liquidation	1277	~46,000	NA
Ongoing Process	1723	NA	NA

Source: IBBI, Ministry of Corporate Affairs (MCA)

Note: *Data on applications withdrawn before admission is maintained by MCA. This data is as of September, 2020.

However, up until March, 2021, around 1,723 CIRPs are yet to be resolved. Then there are CIRPs that are yet to be admitted. It is expected that in the first quarter of 2021-22, the number of applications for CIRPs may increase due to the end of the COVID-19 induced moratorium on initiation of insolvency proceedings. The following section discusses some of the issues with overburdened tribunals.

OVERBURDENED TRIBUNALS

Delay in the admission of insolvency application by creditors

Sections 7, 9 and 10 of the IBC provide 14 days for the NCLT to admit or reject any application for initiating insolvency proceedings. However, due to excessive caseload with NCLT, the tribunals are unable to admit or reject cases in the stipulated time frame. As of January 31, 2021, a total of 21,128 cases were pending with NCLT benches, including 13,425 under the IBC.¹¹

In *Techno Electric & Engineering Co. Ltd. v. McLeod Russel India Ltd*¹², the FC, i.e., the Techno Electric & Engineering Co. Ltd., had initiated a CIRP against McLeod Russel India Ltd. on July 8, 2019 before Kolkata Bench of NCLT. However, the application for admission was left unattended by the bench for more than seven months. This led Techno Electric & Engineering Co. Ltd. to file an appeal before NCLAT. After that, NCLAT disposed of the appeal by an order on March 3, 2020, with a direction to the NCLT to accord priority and made all endeavour to pass the order within 15 days.

The NCLAT noted,

...though the statutorily prescribed period of 14 days for passing of an order by Adjudicating Authority with regard to admission or otherwise of an application under Section 7 of the Code has not been held to be “mandatory” but having regard to the timelines prescribed by I&B Code, there can be no dispute with the proposition that such order is required to be passed with utmost expedition.

As evident from the order itself, the 14 days’ time limit for admitting an application is not mandatory. Previously, in *JK Jute Mills Company Limited v. Surendra Trading Company*¹³, NCLAT had analysed various timelines under the Code. NCLAT noted that timelines mentioned under the Code are ‘procedural in nature, a tool of aid in the expeditious dispensation of justice and is directory’. It also noted that the timeline of 14 days is difficult to achieve and cannot be mandatory. Thus, NCLAT held a 14-days’ timeline as directory rather than mandatory, and that the NCLT has inherent powers to extend the 14 days on a case-to-case basis in the interest of fairness and justice.

NCLAT also clarified that the date of receipt of application as provided under provisions of section 7 (4) and section 9 (5) cannot be held as the date of filing of the application but shall be the date on which the application is listed for hearing (as the registry has to carry out checks for the omissions).

The ruling has, however, set a precedent wherein parties are allowed to use the arguments of procedural fairness as a tactic to delay insolvency proceedings under IBC. The ruling has essentially

resulted in the stretching of the timelines in the insolvency resolution process, particularly during the stage of admission.

Seeking Adjournments

Unfortunately, many lawyers are known for seeking adjournments on small and technical matters. Promoters of CDs, disgruntled OCs or FCs hold up resolution under one pretext or the other with the help of ‘adjournment experts’, which effectively defeats the purpose of the IBC.

Limited benches and shortage of members at the bench

The caseload for NCLT has increased over the years. At the same time, there is also a huge pendency of the cases. A lot of cases are not admitted in the stipulated time frame. Similarly, a lot of cases do not get resolved in the specified time frame post-admission of the cases. Under IBC, initially, proceedings had to finish within 270 days to resolve insolvency and bankruptcy cases, after which liquidation shall be invoked. In September 2019, the deadline was extended to 330 days as most cases had breached the 270 days deadline. The status on timelines in ongoing CIRPs under the Code as of end of March, 2021 is as follows:

Table 2:

Particulars	No. of Corporate Insolvency Resolution Processes
Total ongoing processes	1723
>330 days	130158
>270 days ≤ 330 days	57325
>180 days ≤ 270 days	67349
>90 days ≤ 180 days	8874
≤ 90 days	21077

Source: IBBI

Out of the total ongoing cases, 12% of cases are underway for 90 days or less and 3% of cases are underway for 270 or more than 270 days. At the same time, 76% of cases have breached the 330 days’ time frame. Apart from IBC cases, NCLT also deals with the Companies Act and the Competition Act cases. In comparison, NCLAT deals with IBC, Companies Act, Competition Act, Compensation Cases under Competition Act, MRTP Act.

Many have argued that there is an immediate need to increase the NCLT and NCLAT benches in order to reduce the delays. This is a very genuine demand. Also, the vacancies within the existing benches need to be filled. There are several vacancies in NCLT as of April 23, 2020. Further, the position of Chairperson is also lying vacant at NCLAT.

ADVERSARIAL LENS IN A RESOLUTION PROCEEDING

The SC in *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors.*¹⁴ has observed that the insolvency proceedings by nature are not adversarial to the CD. Insolvency proceedings are not recovery proceedings. As the resolution is the main objective of the CIRP, they should not be seen as adversarial proceedings.

The intent of the IBC is to resolve and revive a CD in stress. However, in some cases, the adversarial lens by tribunals seriously hampers in achieving this objective. It also delays the process of resolution.

Commercial Wisdom of CoC is often questioned

SC in *K. Sashidhar v. Indian Overseas Bank*¹⁵ held that decision of the Committee of Creditors (CoC) on the resolution plan of a CD was paramount. As within IBC, ‘the legislature has consciously not provided any ground to challenge the commercial wisdom of individual financial creditors or their collective decision before the NCLT, and therefore, the courts should not interfere with the same’.

Media reports suggest that despite such a clear ruling by the SC (about commercial wisdom of the CoCs being sacrosanct), many resolution plans get stuck due to litigation.¹⁶ There have been instances in which NCLT itself has questioned the commercial wisdom of the majority of the CoC. Occasionally, the Adjudicating Authority has arbitrarily ventured into the merits of resolution plans even after the majority of the CoC has approved the plan. One such instance happened in Jaypee Infratech (JIL). The NCLT in March, 2020 had approved a resolution plan for JIL by a majority of 97.36% vote by the CoC. Despite this, while approving the resolution plan, ‘unilateral’ and ‘arbitrary modifications’ were made by the court-by allowing objections of dissenting creditors; ICICI Bank and Yamuna Expressway Industrial Development Authority. Taking cognisance of this matter, the SC transferred all issues related to JIL from NCLT and NCLAT to cut delays.

Such arbitrary actions delay the resolution proceedings and create an environment of uncertainty. This defeats the whole purpose of introducing such a progressive reform.

INTRODUCTION OF PRE-PACKS

As evident, there is a long pendency of cases at NCLT. Even getting a bankruptcy application admitted is very difficult. This defeats the purpose of having a good insolvency and bankruptcy resolution process. Currently, the bid-like process is mandatory to get a resolution plan approved under the IBC. The CIRP requires that the creditors of the distressed company allow for an open auction for qualified investors to bid for the distressed company. This resolution process takes a lot of time. Pre-packs, which have proven to be quite useful in other jurisdictions like UK, USA and now in India can cut down on time taken in the current CIRP framework.

Pre-pack allows a distressed company to negotiate a plan with its creditors and a purchaser before

entering formal insolvency proceedings. Today, the CIRP takes at least 180 days. Everything starts after admission. However, pre-packs give an opportunity to have an informal understanding between debtor and creditor in the pre-admission stage. Once the creditors and the debtor are ready, they can approach NCLT. However, this informal understanding can also be reached in the present circumstances. Unfortunately, this did not happen so frequently in India previously due to the absence of a pre-pack insolvency framework. Now scepticism of market participants will be reduced with the promulgation of the recent Ordinance. Some of the other benefits of the pre-packs are:

- a) A pre-packaged insolvency resolution plan will help expedite the resolution process for stressed assets, and the process will be completed within 90 days.
- b) Drastically reduce the timeline for completion of insolvency resolution process which in turn will help in saving time, money and resources.
- c) The pre-pack process will cut short the time spent at the NCLT. NCLT will have to approve just the informal understanding reached between the debtor and creditor.
- d) Reduce the number of insolvency-related cases before the NCLT.
- e) If a pre-pack is appropriately implemented and court intervention is reduced, it is likely to bring efficiency in the resolution process. It will also have a positive effect on the value maximisation for creditors.
- f) As pre-packs act as an alternative resolution mechanism, the incumbent management retains control of the organisation. Unlike CIRP, where the creditor is in possession, in the case of pre-packs, it is the debtors who are in possession of the organisation. This ensures that there is no disruption in the business.
- g) Furthermore, loss of high-quality human resources and asset value are common once CIRP mandated transfer of control occurs from incumbent management to the insolvency professional. Pre-packaged insolvency resolution also helps in minimising this loss.

However, pre-packs may not be successful when the financial situation of the company is not good.¹⁷ The capital lender will be sceptical in lending to a stressed company as there is risk involved in the recovery of the money. Hence, if the company doesn’t have enough cushion to go on for weeks/months while the scheme is put in place, the idea may fail altogether.¹⁸

Pre-packs have other drawbacks too. It is often biased towards secured creditors. Often, OCs and statutory due holders are left out of the process. Also, there are apprehensions that if the process is not transparent enough, the existing management (being in charge) might not do justice to the rights of unsecured creditors. The management may end up alienating all the assets to keep the company afloat. This, in turn, may lead to unsecured credits approaching NCLT against the CD, thus again delaying the resolution process.

Regardless, pre-pack insolvency will help in reducing the shortcomings of the present system, which is also very time-consuming.

CONCLUSION

The IBC has liberalised the exit of capital. The Government has been receptive to the suggestions of all the stakeholders and regularly amended the Code to make it more effective. There recent Ordinance on pre-packs is one such example.

There is a need to reduce the burden of NCLT and NCLAT benches further. This can be done by increasing the number of benches, increasing the number of members on existing benches, and reducing the time taken to fill up the vacancies. Single-member benches should also be allowed to pass orders. Currently, the law requires the bench to consist of two members, with both judicial and technical competence, to hear cases related to the IBC. Why can't only one member hear and pass the orders?

NCLT was primarily designed for dealing with matters related to the Companies Act, 2013. Thus, it required both judicial and technical members to be part of a bench. Cases pertaining to IBC should be dealt with differently. Single-member benches would ensure that there are extra human resources to deal with IBC related cases.

The Tribunals should also expedite the adoption of technology. This will help in cutting down on human intervention. This was also proposed by the Bankruptcy Law Reforms Committee.¹⁹ While the Ministry of Corporate Affairs has given its approval for implementing e-courts and e-governance solutions for NCLT and NCLAT, its implementation needs to be expedited.

Cross border insolvency has been an unregulated sphere in India.²⁰ Recently in the Jet Airways²¹ case, the Mumbai Bench of NCLT noted that although insolvency proceedings against the CD have already been initiated before the NOORD –Holland District Court,

...there is no provision and mechanism in the I&B Code, at this moment, to recognise the judgment of an insolvency court of any Foreign Nation. Thus, even if the judgment of Foreign Court is verified and found to be true, still, sans the relevant provision in the I&B Code, we cannot take this order on record.

There is an urgent need for introducing cross border insolvency in India. The K. P. Krishnan Committee had already recommended rules and regulatory framework for the smooth implementation of cross-border insolvency in May 2020. This framework has not been adopted yet. India should also consider adopting UNCITRAL Model Law on Cross Border Insolvency. This will also help in improving Ease of Doing Business Rankings.

(The views expressed are personal)

NOTES

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ENTREPRENEURSHIP AND INSOLVENCY: WHY RULES OF EXIT MATTER

M. P. Ram Mohan and Vishakha Raj

Policymakers in India recognise the value of enterprise creation, and this is embodied in the Startup India Initiative of 2015.¹ The objective of the initiative is to promote innovation and sustainable growth in India.² The Startup India Scheme (Scheme) operationalises this vision of the Startup India Initiative. During its initial stages, administrative hurdles prevented a large number of start-ups from actually reaping the benefits of the initiative; the Scheme thus continues to be a work in progress.³ Though the Scheme is only available to enterprises that are engaging in a business that is novel and innovative, literature suggests that new enterprises, irrespective of how innovative they are make positive contributions to society.⁴ This article will thus focus on the relationship between insolvency law and entrepreneurship in general while also examining how insolvency law affects innovation. Solely focusing on start-ups recognised by the Department for Promotion of Industry and Internal Trade (DPIIT) under the Scheme may also prove to be restrictive as the definition of what comprises a start-up under the Scheme is narrow. An enterprise needs to be less than 10 years old and have a turnover of less than ₹ 100 crores for all financial years since its incorporation in order to be classified as a start-up.⁵ Thus, in addition to examining the scope of the Scheme's special interaction with insolvency law, a broader scrutiny of the interaction between insolvency law and entrepreneurship is also warranted.

Several regulatory initiatives contribute to building a business environment that is conducive to entrepreneurship. The Scheme, for instance, attempts to create this environment by offering tax exemptions for three consecutive years, easier access to public procurement contracts, fast track patent examination, access to funding, and self-certification under environmental and labour regulations.⁶ Though sparsely studied⁷, the features of insolvency law also have a significant effect on the entrepreneurial ecosystem and affect how prospective entrepreneurs perceive downside risk

(the risks associated with their business failing).⁸ An entrepreneur-friendly insolvency regime is one that is able to minimise this downside risk for entrepreneurs and encourage more people to engage in the activity.⁹ The Scheme recognises this and has included expedited winding up under the Insolvency and Bankruptcy Code, 2016¹⁰ (Code/IBC) as one of its regulatory features. This article provides a conceptual overview of how insolvency law interacts with entrepreneurship. In doing so, it identifies the characteristics of insolvency regimes that are best suited for promoting innovation and enterprise creation. The following section offers brief coverage of the regulatory background in which these discussions will take place.

POLICIES SPECIFIC TO STARTUPS UNDER THE IBC

The IBC contains a fast-track insolvency resolution process which requires insolvency resolution proceedings to be completed within 90 days of their initiation.¹¹ Other provisions of the corporate insolvency resolution process (CIRP), however, continue to apply equally to start-ups, including conditions regarding who is eligible to be a resolution applicant (RA). After a corporate debtor (CD) enters the insolvency resolution process, its creditors vote on insolvency resolution plans submitted by RAs. On the specific question of who can be an RA and propose a resolution plan, section 29A of the IBC describes a set of ineligibilities. Persons who cannot submit a resolution plan include those who are undischarged insolvents, prohibited from trading in the securities market, convicted of offenses punishable with imprisonment etc. One of the ineligibilities under section 29A is the possession of or control over an account that has been declared a non-performing asset (NPA) for over a year.¹² Creditors are expected to give adequate time so that ineligible applicants may repay their dues and become eligible under section 29A.¹³ However, this allowance operates as a truism for many promoters whose corporations have entered the insolvency resolution process because of their inability to pay debts. The ineligibilities under section 29A, coupled with the creditor-in-possession model of the IBC thus signal a clear scepticism towards the incumbent management and promoters of a distressed company.

In addition to recognised start-ups, the IBC has special provisions for micro, small, and medium enterprises (MSMEs). MSMEs are classified as micro, small or medium based on their investment and turnover. For micro enterprises, the investment and turnover limits should not exceed ₹ 1 crore and ₹ 5 crores respectively. For small enterprises, the investment and turnover limits should not exceed ₹ 10 crores and ₹ 50 crores respectively. For medium enterprises, the investment and turnover limits should not exceed ₹ 50 crores and ₹ 250 crores, respectively. MSMEs benefit from the relaxed application of section 29A of the IBC,¹⁴ the section 29A ineligibility relating to having control over a NPA account does not apply to MSMEs.¹⁵ Since the annual turnover limit for being recognised as a start-up is ₹ 100 crores, start-ups are essentially medium enterprises. Consequently, start-ups can also be exempt from the section 29A prohibition which prevents NPA account holders from submitting resolution plans.

There is no doubt that MSMEs play a vital role in driving India's economy and warrant being

exempted from portions of section 29A. However, the importance of MSMEs should not be a reason to detract from the interaction between insolvency law and enterprises that have outgrown their MSME status. Other regulators, such as the Securities and Exchange Board of India (SEBI) seem to recognise this. SEBI has amended its listing regulations to make it easier for start-ups to raise capital.¹⁶ The SEBI Board Memorandum discussing these amendments refers to start-ups¹⁷, but this term is not restricted to the meaning given to it by the Scheme. The amended SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018¹⁸ does not prescribe any maximum turnover or paid-up share capital for companies to be able to issue shares under less strict norms. There are relatively young businesses in India such as Swiggy and Flipkart, which are often referred to as start-ups but are by no means MSMEs.¹⁹ In order to play a role in encouraging entrepreneurship, the IBC also needs to consider such businesses and ensure that their promoters are not at a disadvantage during the CIRP.

Instead of identifying classifications of companies that can be exempt from some of the IBC's rigours, it might benefit policymakers to look at the relationship between insolvency law and entrepreneurship more broadly. Enterprises may grow at an exponential rate, or they may find it efficient to operate at the scale of an MSME. If one can agree that both these types of enterprises are of value, then there is no reason that the insolvency law they operate under should affect them differently. This is not to say that smaller companies should not have special provisions that either expedite insolvency proceedings or make it easier for them to file for insolvency. However, features such as the ability of promoters or the incumbent management to bid for their company (subject to creditor approval) are not solely procedural and play a role in shaping perceptions about risk-taking and business failure.

INSOLVENCY LAW AND ENTREPRENEURSHIP

The sphere of influence attributed to insolvency law is constantly expanding and this is a testament to how the discipline has gone beyond simply facilitating the orderly collection and distribution of a debtor's assets.²⁰ This area of law plays an active role in moulding the business ethos of a society and projecting its priorities and perceptions of the risks that businesses may legitimately take.²¹ Seen in this light, corporate insolvency law has the ability to influence corporate culture. Though insolvency law primarily devises paths of exit for distressed corporations, the provisions of this law also indicate the downside risks of starting a business to entrepreneurs.²² The manner in which entrepreneurial risk is distributed, thus, determines the willingness of persons to start enterprises.²³ Recognising this, one of the objectives of the IBC, as contained in its Preamble, is the promotion of entrepreneurship.

The stage at which insolvency law is most relevant for an entrepreneur is not when their corporation is fledgling. Usually, insolvency becomes a real risk once irreversible investments are made at later stages of a company's growth.²⁴ This suggests that the role of insolvency law after several years of a company's inception is just as important as the role it will play during the company's initial stages.

Low-cost insolvency proceedings also incentivise inefficient firms to file for insolvency more quickly, thus allowing for their liquidation in case reorganisation is not feasible and pushing them out of the market.²⁵ Ease of entry and an even playing field in the market thus need to be coupled with feasible exit and reorganisation strategies in order to foster entrepreneurship and innovation.²⁶ Accordingly, ease of insolvency proceedings can be crucial in determining the success of government policies geared towards promoting innovation, competitiveness, and entrepreneurship.

The effects of an insolvency regime on enterprise creation are two-fold. The first can be seen as the implications of insolvency law in signalling a jurisdiction's business culture, specifically, its attitude towards risk taking and entrepreneurial failure. The second set of effects refers to more direct considerations of entrepreneurs that arise from the characteristics of exit and rescue options offered in case their business goes into distress. These characteristics include the possibility of reorganisation in insolvency, the ability to have a fresh start after liquidation, the availability of a stay on assets after bankruptcy commences, the speed of the insolvency process, and the management's ability to stay on once proceedings commence.²⁷

The IBC possesses most of the characteristics mentioned above. India's insolvency law limits the time within which insolvency proceedings must come to an end²⁸, and the amount of time a CD spends in the formal insolvency resolution process is likely to reduce further once the pre-packaged insolvency resolution process (PPIRP) is fully rolled out.²⁹ The IBC also provides for a moratorium to prevent any detraction from collective decision making by creditors and the provisions on individual bankruptcy provide for discharge.³⁰ These features of the IBC are shared by insolvency regimes in other jurisdictions such as the United States (US) and the United Kingdom (UK).

CORPORATE CONTROL DURING INSOLVENCY AND PERCEPTIONS OF RISK

Despite the differences in their economies, the insolvency and bankruptcy laws of the UK, the US, and India have several features in common, making comparisons between them useful. All three insolvency laws require creditor approval for an insolvency resolution plan (or an Administrator's proposals in the UK).³¹ This, however, does not include PPIRP which can be carried out without majority creditor approval in the UK and the US. The US and India require court approval for regular insolvency resolution plans whereas the UK allows for out of court administrations as well.³² All three regimes also stay individual creditor action against a debtor's assets and provide for orderly liquidation in case reorganisation fails. There are of course several differences between these regimes. One, in particular, makes India a unique case amongst the three- section 29A. Though neither the US nor the UK prevent the incumbent management from purchasing the assets of a corporation as a result of insolvency proceedings; a comparison of the experiences of these two jurisdictions will be instructive for understanding the type of signalling that arises from section 29A.

The UK has a creditor-in-possession model like the IBC which is a contrast to the US' debtor-in-

possession model for bankruptcy.³³ The two contrasting models of the UK and US for control over a company during insolvency offer an opportunity to examine the effect of each on perceptions about business failure. This comparison is particularly interesting as both jurisdictions provide for reorganisation and liquidation in their insolvency regimes, and both are committed to rescue culture.³⁴ The shareholding and credit ownership patterns of both jurisdictions are also similar in that shareholding and control over credit tends to be dispersed for most corporations.³⁵

Contrasting insolvency models in the UK and US

Scepticism about leaving the incumbent management in charge of corporations that have run into financial distress has guided the UK's approach to its insolvency regime.³⁶ It is not only the Insolvency Act, 1986³⁷ but also the attitude of the judiciary in the UK which is more sympathetic towards the interests of creditors during insolvency.³⁸ The Administrator in the UK, akin to the insolvency Resolution Professional in India, takes over the affairs of the distressed company until administration proceedings are completed.³⁹ The Administrator who takes charge of the company's affairs during administration performs their functions with the objective of 'rescuing the company as a going concern'.⁴⁰ If achieving this objective is not feasible, then the objective of the Administrator must be to achieve a better result for the creditors of the company than if the company were wound up.⁴¹ Finally, if none of the previously mentioned objectives can be practicably achieved, the Administrator will focus on realising the value of the company's property to make distributions to secured and preferential creditors.⁴² Creditors' interests are, thus, firmly placed within the purpose of the administration process. The completion of administration also requires creditor approval, for instance, proposals of the Administrator with regards to the distressed company need to be voted on by its creditors before they can take effect.

The UK, thus, has a management displacing, creditor-in-possession regime.⁴³ Experts within the UK have expressed concern over the stigma towards failed entrepreneurs that underpins its insolvency law.⁴⁴ These concerns relate to unnecessarily deterring entrepreneurs and not allowing for enough risk taking, especially after the insolvency resolution process is completed.⁴⁵ The stigma attached to corporate insolvency, which still exists in the UK to some degree, discourages entrepreneurs from starting another enterprise upon the failure of one.⁴⁶ The UK's insolvency regime is not alone in sharing this sentiment. Australia and Germany also have insolvency laws that reflect a similar scepticism of entrepreneurs that have had to use the insolvency resolution process.⁴⁷

In contrast to the creditor-in-possession regime, societies that have a debtor-in-possession regime are less likely to attribute business failure solely to those in charge of an enterprise.⁴⁸ Investors in the US actually prefer entrepreneurs that have had some experience in the past, even if this means having filed for bankruptcy.⁴⁹ Chapter 11 of the US Bankruptcy Code⁵⁰, which contains the reorganisation procedure for distressed companies, allows the management of the company to remain in charge of its affairs while bankruptcy proceedings are ongoing. The CD is also given the exclusive right to submit a reorganisation plan for a period of 120 days after Chapter 11 proceedings commence.⁵¹ This framework encourages the management to initiate Chapter 11 proceedings when financial

trouble begins rather than letting it fester.⁵² The assurance that the incumbent management will not be displaced and that the CD will be allowed an opportunity to propose a plan, go a long way in facilitating the timely use of Chapter 11 proceedings.⁵³ Despite accounts of the US being more encouraging of risk taking with its debtor-in-possession regime, some stigma linked to filing for bankruptcy still exists in the US.⁵⁴ However, a counternarrative exists by way of Chapter 11⁵⁵, and businesses have started to look at bankruptcy as a tool of reorganisation rather than simply a means to exit the market.⁵⁶ Within this debtor-in-possession reorganisation framework, the US Bankruptcy Code has largely retained creditors' rights by requiring their approval for a plan to take effect.⁵⁷

The IBC: one step beyond creditor-in-possession?

When compared to the US and the UK, the IBC's treatment of failing entrepreneurs and businesses is quite strict. For a prospective entrepreneur, the IBC leaves little margin for error. If their corporation has grown out of its MSME status but has entered into financial distress subsequently, promoters are often barred from submitting a resolution plan due to section 29A. The NPA account related ineligibility in particular gives defaulting corporations little time to recover as a business cycle usually lasts for more than a year.⁵⁸ One may argue that the CD has the option of filing for insolvency before one-year elapses from the date an account under their control is declared as a NPA. While this is a possibility, it reduces the flexibility of the management's decision making. On the one hand, this ineligibility of section 29A encourages early filing (within one year of an account being declared an NPA), which could be premature. On the other hand, once the one-year threshold is passed, it may encourage the incumbent management and promoters to resist insolvency (even when they know their company is in distress) for it implies being unable to submit a resolution plan. The combined effect of having a creditor-in-possession regime along with the ineligibilities under section 29A may increase the costs associated with the CIRP. Promoters afraid of losing control of their corporation after the CIRP might pressure the incumbent management to postpone filing for insolvency.

In addition to affecting the propensity of entrepreneurship generally, insolvency laws have also been shown to have a bearing on the extent of innovation in a market. This should be of interest in the Indian context as the Scheme of the DPIIT emphasises the innovation and improvement of existing products or processes. It may be recalled that a business needs to be engaged in an innovative activity in order to be considered a start-up and benefit from tax exemptions, fast-track patent applications etc. under the Scheme. Securities regulations have also evolved to promote innovation by easing listing regulations for SEBI's Innovators Growth Platform.⁵⁹ Prior to a recent amendment, only issuers who had certified investors holding a minimum of 25% of the company's pre-issue capital for a period of two years could list on the Innovators Growth Platform.⁶⁰ The amendment has brought this time period down to one year.⁶¹ These new listing regulations apply to companies that intensively use intellectual property, nano-technology, bio-technology etc.⁶² The next section explains how insolvency laws influence the amount of debt innovative firms are willing to take on and their incentive to invest in newer technologies.

INNOVATION AND INSOLVENCY LAW

Though many factors go into determining whether an insolvency law is more accommodating of debtors' or creditors' interests, increased involvement of a company's management after insolvency proceedings begin contributes to a more debtor-friendly regime.⁶³ In the Indian context, section 29A can be seen as moving further away from the debtor-friendliness of the IBC. In a debtor-friendly insolvency regime, the management may choose to postpone insolvency proceedings for fear of liquidation.⁶⁴ On the flip side, in a creditor-friendly insolvency regime, the creditors may be quick to liquidate rather than seriously pursuing reorganisation through insolvency.⁶⁵ Notwithstanding whether the insolvency law is more conducive to the interests of creditors or debtors, incentives for each of these stakeholders to act according to their interests will continue to exist. Despite this equivalence, there are some distinct effects on innovation that arise from the level of flexibility given to a CD by an insolvency law.

A study has shown that debtor friendly regimes are less likely to discourage *ex ante* risk taking and innovation.⁶⁶ Acharya and Subramanian, in their empirical study, used information such as patent filings after the promulgation of the US Bankruptcy Code in 1978 to show that a more debtor friendly regime increases innovation.⁶⁷ One of the factors used to assess whether an insolvency framework was debtor friendly was the role of management after insolvency proceedings commence. Their study found that in countries that experienced an increase in creditor rights in the context of insolvency, the innovativeness of industries reduced.⁶⁸ Conversely, in jurisdictions where creditor rights were curtailed, innovativeness increased.⁶⁹ The study also uses data from G-7 countries to find that innovative companies are less likely to take on debt when compared to more conservative industries. This is a company's way to offset the effects of a creditor-friendly regime. The findings of this study are quite significant when one looks at insolvency law as a means of reallocating credit to more efficient uses in the market. The study of Acharya and Subramanian suggests that as creditor protections increase in insolvency regulation, the firms using this credit are less likely to be ones engaging in innovation that involves risk taking.⁷⁰

The takeaway from the above discussion should not be that creditors' rights need to be set aside in order to have an innovator-friendly insolvency regime. Rather, it shows that there are costs to ratcheting up creditor protections and curtailing the flexibility of the reorganisational property of insolvency law. Though the UK uses a creditor-in-possession regime and the US, a debtor-in-possession one, both satisfy the requirement of promoting collective decision making by creditors and encouraging rescue as the desired outcome of insolvency proceedings. This suggests that there may be less intrusive means available for creditor protection under the IBC than side-lining a company's promoters.

The creditor-in-possession regime of the IBC was envisioned to avoid some of the problems caused by the debtor-in-possession rescue framework that preceded it. Prior to the IBC, the reorganisation of distressed corporations under the Sick Industrial Companies (Special Provisions) Act, 1985⁷¹ was plagued with delays and its pro-rehabilitation bias resulted in inefficient companies being able to

remain in the market.⁷² Given India's history with a debtor-in-possession regime, its scepticism is understandable. However, caution must be exercised so as to not engage in overcorrection. Even when compared to another creditor-in-possession regime (the UK), the IBC imposes additional conditions that prevent promoters and the incumbent management from regaining control of their corporation through the insolvency resolution process.

As a result of business ingenuity, insolvency law has gone beyond operating at the stage of a company's exit from the market. Insolvency and bankruptcy laws across the world have been strategically used by corporations to get an edge over their competitors or even have better bargaining power against labour.⁷³ In situations where there are fears of the IBC being abused, the best recourse may lie in allowing stakeholders to more effectively exercise their existing rights rather than pushing the resolution process towards what may appear to be the optimal outcome. For instance, if the problem is with respect to some promoters taking advantage of the insolvency resolution process, mandating increased or better marketing, disclosure of the promoters' antecedents to creditors etc. can reduce the information asymmetry that facilitates such abuse. Should these measures fail, then stronger forms of intervention may be considered. Strong intervention often warrants equally strong justification and rhetoric. In the context of section 29A, the language that accompanied the amendment referred to 'unscrupulous promoters' whose 'misconduct' had led to the CD's distress.⁷⁴ This language has found its way into literature and judgements that justify section 29A.⁷⁵ While there is no explicit generalisation, this rhetoric has probably strengthened the stigma and scepticism associated with entrepreneurs who have undergone the insolvency resolution process. Irrespective of its intention, the scope of the ineligibilities under section 29A has left little room for a narrative in which there are promoters that deserve a second chance.

CONCLUSION

The IBC, over the past five years, has shown that it is capable of evolving based on the needs and characteristics of the market. This has allowed for experimentation and the testing of different regulatory policies. For instance, the debtor-in-possession model that was replaced by the IBC is once again being considered in the context of PPIRP. This article suggests that there exists a link between entrepreneurship, innovation, and insolvency regulation. This relationship is, thus, worth examining in the Indian context when evaluating how the IBC has progressed towards the objectives it had set out to achieve five years ago.

NOTES

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⁶⁵ *Ibid.*

⁶⁶ *Ibid.*

⁶⁷ *Ibid.*, p. 4952, 4955.

⁶⁸ *Ibid.*, p. 4952.

⁶⁹ *Ibid.*

⁷⁰ *Ibid.*, p. 4950, 4955.

⁷¹ Sick Industrial Companies (Special Provisions) Act, No. 1, Acts of Parliament, 1986.

⁷² Mukherjee D. (2016), “Decoding the bankruptcy code”, *India Business Law Journal*, Vol. 9, p. 24.

⁷³ Spizman L. and Kane J. (1990), “Chapter 11 Bankruptcy and the Termination of Collective Bargaining Contracts”, *Employee Responsibilities and Rights Journal*, Vol. 3, pp. 277-278.

⁷⁴ The Insolvency and Bankruptcy Code (Amendment) Bill, 2017, point 5.

⁷⁵ *Chitra Sharma v. Union of India*, 2018 18 SCC 575. *Arun Kumar Jagatramka v. Jindal Power & Steel Ltd.*, 2020 SCC OnLine 220. Chakravarty M. (2017), “IBC ordinance a blow against the Promoter Raj”, *Live Mint*, 28 November. Correspondence (2021), “Supreme Court does well to shut out unscrupulous promoters”, *The Financial Express*, 19 March.

13

LIQUIDATION : THE LAST RESORT

Pavan Kumar Vijay

Prior to the enactment of the Insolvency and Bankruptcy Code, 2016 (Code/ IBC), insolvency resolution in India took 4.3 years on an average, according to World Bank’s Ease of Doing Business Report. The said time period was much longer than the time taken to resolve insolvency in countries across the world which is approximately 11 months. IBC was made effective with an objective of proactive, incentive-compliant, market-led time bound resolution of the insolvency of the corporates and individuals to improve the market economy.

IBC: PROVIDING A FRESH START

The Code ensures that the business/firms which have failed, should get a fresh start to employ the available resources to a better use and to release the resources from inefficient uses in order to create benefits and returns from the available resources, while ensuring maximisation of the interests as a whole. It is well established that economic freedom is directly linked with the economic performance. Countries which have been able to provide a well-established exit mechanism and fresh start to the businesses thereafter have been able to grow their economies and directly contribute to economic growth.

Time bound insolvency resolution

The Code was enacted seeking timebound reorganisation and insolvency resolution of the firms and individuals keeping in mind the maximisation of the value of the assets available and to promote entrepreneurship, availability of credit and balancing of interests. The Code separates the interests of the promoters from an entity with the primary objective of the survival of the firm and its protection from the failed management by putting the creditors in control to decide the best interests of all the stakeholders and to avoid the death of the firm by liquidation. The Code provides for the procedure where a company once admitted by the Adjudicating Authority (AA) for resolution of its insolvency,

is managed by a Resolution Professional (RP) with the financial creditors (FCs) in control of the decision-making process related to the business and affairs of the firm. Such RP is vested with the duties and responsibilities which include the identification of interested persons to take over the firm and revive such firm from its current state. The Code ensures the discipline imbibed in the process for the promoters of the firm undergoing insolvency who would understand the consequences of default as well as for the creditors who enter into the business with the firm by advancing loans and / or supplying goods or services and the risk involved and therefore to guide for the future transactions to curb the chances for default and benefits from the revival of the firm.

Closure of firm has a wider impact

It is understood that when a firm is put to unnatural death, it is not only loss to the shareholders or the creditors of such firm but has a wider impact upon the economy at large. When a firm is closed, the employees of the company lose their jobs, the operational and other creditors associated with the business of the firm like suppliers, raw material producers, aggregators etc. also tend to lose business. The list does not end here. The loss of revenue to the State is also imminent as is the loss of value of intellectual property created by the business over the years and its contribution to Brand India Inc. Therefore, it is imperative, and in line with the object of the Code, that the resolution of insolvency, in case where it leads to the approval of resolution plan, creates multifarious benefits and achievements for the stakeholders at large.

RESOLUTION Vs. LIQUIDATION

Since the enactment of the Code, stakeholders have witnessed the creditors and the companies / corporate debtors (CDs) rushing to the AA for resolution of insolvency. As of March, 2021 as per the data published by the Insolvency and Bankruptcy Board of India (IBBI) in its quarterly newsletter of January - March, 2021, the number of companies referred into liquidation is much more than the cases where the debts were resolved by way of approval of resolution plan. In this regard, following data is worth noting:

Table 1: Corporate insolvency resolution process

Particulars	Number	Percentage
CIRPs commenced	4376	100
CIRPs closed	2653	60
CIRPs closed due to settlement or withdrawal or appeal or review etc.	1028	23.49
CIRPs where resolution plan was approved	348	7.9
CIRPs resulted to liquidation	1277	29

Source: IBBI Quarterly Newsletter, January-March, 2021.

The corporate insolvency resolution process (CIRP) closed as indicated above were either due to the settlements arrived at between the parties, withdrawals by the applicants or the appeals decided

against the admission of the admission order. The aforementioned figures would indicate that out of 1625 cases comprising of CIRPs which resulted into liquidation and CIRPs under which resolution plan was approved, only 21% approximately could achieve a resolution plan or in other words only 21% businesses could survive whereas almost 79% of the cases were sent for the liquidation. The aforementioned 348 companies (where a resolution plan could be achieved) include 8 companies from 'Big 12' list published by RBI¹ which collectively owed ₹ 3.45 lakh crore, out of which after resolution, ₹ 1.36 Lakh crore has been recovered as per information available in public domain. This may sound less when we compare the numbers, however, the amounts recovered are almost three-fourth of the liquidation value of these corporates.

Liquidation changes focus of creditors

Needless to say that liquidation defeats the very order of the objectives of the Code which is the survival of the business and use of liquidation as a last resort. The sequencing provided under the objective of the Code is sacrosanct. The first order objective is resolution. The second order objective is maximisation of value of assets of CD and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests. Once the company is ordered to be liquidated, the focus and the objective of the creditors shift towards recoveries to the maximum possible extent, including their personal specific secured interests as against the revival of the CD which otherwise would benefit the stakeholders at large rather than serving individual or specific interests.

Reasons for Liquidation

Table 2 provides the reasons for the referral of the CD for liquidation:

Table 2: Reasons for Liquidation

Reasons for Liquidation	Number	Percentage
CoC decided for liquidation	725	57
Resolution plan not received	501	39
Resolution plan rejected for non-compliance	46	0.04
CD contravenes provisions	5	0.0039
Total	1277	

Source: IBBI Quarterly Newsletter, January-March, 2021

Table 2 would reveal that maximum cases which are presently undergoing or have completed the liquidation process under the provisions of the Code are due to the decisions taken by the committee of creditors (CoC) for such companies. There could be many reasons for the CoC deciding to liquidate a company but certainly one such reason is the option for enforcement of security interest available with the secured creditor under section 52² of the Code which empowers the secured creditor to recover its claim from the secured asset as per the manner prescribed therein. In this manner such a creditor may address its individual interest but may harm the other creditors by segregating the

assets from the liquidation estate. Under section 52 of the Code, *inter alia*, the secured creditor is free to dispose of the asset to recover its dues in priority to the other stakeholders as provided under the Code taking such secured asset out of the liquidation estate. Such decisions may however also be motivated and self-centric and may cause loss to the other stakeholders of the CD and defeat the objective of the Code. Such an action by a secured creditor may also be detrimental to the chances of revival and could kill the opportunity for the business or the company to be sold as going concern, thereby causing harm to the other creditors / stakeholders.

Information asymmetry in public domain for larger participation

The companies where the resolution plan could not be received could be due to various reasons including the lack of information available in the public domain, especially in relation to the reasons for failure of business. Efforts for wider marketing of the stressed assets have been limited for several reasons including the lack of sector specific expertise, lack of enthusiasm by the CoC to expend funds and inappropriately timed efforts. Addressing these deficiencies in the present mechanism will help improve outcomes.

Liabilities

Potential investors do not have complete information on a company's liabilities including in particular the baggage, if any, carried on by the company, which may have been as a consequence of actions taken by the previous management. Availability of information on a company's valuation in public domain in a structured format can attract new investors and increase competition. Lack of information available in the public domain leads to lack of interest which leads to non-compliances or instances where the resolution applicant loses the incentive to acquire the company. Similarly, litigation by the erstwhile management also leads to disinterest by the potential investors.

Achieving resolution should be the prime objective

In line with the objective of the Code, it is imperative that the first endeavour is made for achieving resolution by way of a resolution plan. The Hon'ble Apex Court in the case of *Essar Steel*³ discussed the objective of the Code and observed the importance of continuation of business and its ultimate benefit to the economy at large. The Hon'ble Apex Court stated that:

The Code is first and foremost, a Code for reorganisation and insolvency resolution of corporate debtors. Unless such reorganisation is effected in a time-bound manner, the value of the assets of such persons will deplete. Therefore, maximisation of value of the assets of such persons so that they are efficiently run as going concerns is another very important objective of the Code. This, in turn, will promote entrepreneurship as the persons in management of the corporate debtor are removed and replaced by entrepreneurs. When, therefore, a resolution plan takes off and the corporate debtor is brought back into the economic mainstream, it is able to repay its debts, which, in turn, enhances the viability of credit in the hands of banks and financial institutions. Above all, ultimately, the interests of all stakeholders are looked after as the corporate debtor itself becomes a beneficiary of the

resolution scheme— workers are paid, the creditors in the long run will be repaid in full, and shareholders/investors are able to maximise their investment. Timely resolution of a corporate debtor who is in the red, by an effective legal framework, would go a long way to support the development of credit markets. Since more investment can be made with funds that have come back into the economy, business then eases up, which leads, overall, to higher economic growth and development of the Indian economy.

Issues surrounding liquidation

In order to discuss the viability of the liquidation process under the Code, one needs to segregate the issues surrounding the liquidation process as follows:

(a) *Time involved*: Whereas on one hand, the CIRP under the Code is provided as time bound, the liquidation process does not have any fixed timelines within which the entire process has to be completed. Law does provide that the liquidation process is to be completed within a time span of one year, but such time period may be extended, subject to the reasons to that effect, duly informed and thus extended by the AA. The delay in realisation in liquidation process defeats the objective of the Code.

(b) *No haircuts, no recoveries*: While on one hand, the resolution plan in the CIRP of the CD may involve certain haircuts *vis-à-vis* admitted debts of the creditors, as has been witnessed by the stakeholders in past, in the event of liquidation of the CD, the realisations have come out to be far less as compared to the realisations achieved by way of resolution plan.

(c) *Distribution amongst the creditors*: Section 53 of the Code provides for the distribution waterfall in the event of liquidation. The realisation made by the Liquidator are distributed in terms of section 53 of the Code which places the Government dues to be paid at last and just above the shareholders of such CD. It is generally seen that for the CD undergoing liquidation, the funds realised are not even sufficient to pay to the secured creditors and the remaining creditors are not paid even a single penny. However, in case of a resolution plan, the resolution applicant may provide some monies to all such stakeholders who in the event of liquidation would not get any value.

(d) *Motivation to the Liquidators*:

(i) *Absolute independence to deal with the company*: Liquidators of the CD may have different motivating factors in pursuing the liquidation especially due to the absolute control over the assets of the CD which under the liquidation process, is vested with the Liquidator as against the process under CIRP where the control is exercised by the CoC. John Acton said that '*Power tends to corrupt, and absolute power corrupts absolutely*'. Such absolute control may affect the decision making of the Liquidator for the disposal of such assets which are generally sold at throwaway prices during liquidation as compared to the value which could have been achieved by way of a resolution plan. Generally, the cause of such sale at throwaway prices is the lack of interest due to lack of information in the public domain and discounting at the rate of 30-40%, which is adopted as a matter of practice by the valuers. This practice is not opposed by the Liquidators who are in a rush to finish the process.

A clear example of this are errors and mistakes committed by the RPs / Liquidators which attract disciplinary actions from IBBI.

(ii) Unlimited extensions for completing the process as compared to CIRP: The timelines provided under the liquidation process are not stringent. Law provides that the liquidation is to be completed within one year from the liquidation commencement date which however may be extended after approval of AA by way of filing application stating the reasons for not completing the liquidation within the stipulated timeline. In practice it is seen that such extensions are generally provided. There are companies undergoing liquidation whose CIRP was admitted in early 2017 and completion of liquidation process has not been achieved till date.⁴

(iii) Pecuniary interest of the Liquidator: In case where the CoCs fails to decide the remuneration to be paid to the Liquidator for the liquidation process, the fee provided to the Liquidator in terms of the IBBI (Liquidation Process) Regulations, 2016 (Liquidation Regulations) is paid in percentage of realisation if such realisation is made within six months and ranges from 5% to 0.25% relatable to the amounts of the recoveries made.⁵

LIQUIDATION SHOULD BE THE LAST RESORT

Hon'ble Apex Court in the matter of *Essar Steel* observed that:

What is interesting to note is that the Preamble does not, in any manner, refer to liquidation, which is only availed of as a last resort if there is either no resolution plan or the resolution plans submitted are not up to the mark. Even in liquidation, the Liquidator can sell the business of the corporate debtor as a going concern.

Further, the provisions of the Code provide for strict timelines to complete the resolution process, however, there are relaxations, according to reasons that judicial authorities deem fit, for extension of timelines beyond the statutory timelines⁶ that could potentially lead to the revival of the CD. In one such recent case, Hon'ble Appellate Authority held that the CoC of a CD is empowered to even withdraw a plan which is approved by them and is yet to be approved by the AA.⁷ Such a scenario could be in a case where any better offer which maximises the returns for the stakeholders, is available with the CoC at a later stage. Such process may seek additional time for completion of the process and is also allowed (if viable) by the AA. Similar position also applies to cases where the CoC, has passed a motion for liquidation of a company and such application is yet to be approved by AA. If a person interested in submission of plan approaches the CoC before such application is allowed by AA, such a person may be given a chance to submit a plan. The sole objective behind the above stated approach is the growth which is likely to take place when a new investor will infuse funds in a company which will also generate employment, benefitting the economy at large.

The IBC has been a successful mechanism for the stakeholders in cases where resolution of the CD could be achieved in comparison to other previous enactments including the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI

Act). There are cases wherein the financial institutions have been able to recover most of the portion of their claims submitted during the process. Stakeholders have witnessed that once the butchering of the company starts, the value of the company and its assets diminishes to a considerable extent as discussed in this article. Even the valuers have followed a practice for companies in liquidation wherein the value determined as per applicable guidelines is seen to be discounted by a considerable percentage due to the tag of 'liquidation' upon the company. Liquidation not only diminishes the value of the CD but also impacts the economy at large by rendering the staff and workers of such company jobless. The stakeholders have now understood the importance of approval of the resolution plan or in the event of liquidation, sale of a company as a going concern and its benefits towards the maximisation, as against butchering a company where multiple jobs are lost, impacting the livelihood, tax revenue and economy. Hon'ble Apex Court has held that the liquidation of the CD should be a matter of last resort in the proceedings under the IBC.⁸ Stakeholders have witnessed from the inception of the Code that the companies which have gone into liquidation, have automatically deteriorated in value.

Liquidation diminishes value considerably

Table 3 demonstrates the reduction in the value in the event of liquidation:

Table 3: Value reduction in liquidation.

Valuation during CIRP and / or liquidation	Value
<i>Valuation of CD in CIRP</i> <ul style="list-style-type: none"> As a going concern 	<i>Fair Value</i> <ul style="list-style-type: none"> Fair value in terms of the market parameters is arrived at and is generally higher than the liquidation value.
<i>Valuation of CD in liquidation</i> <ul style="list-style-type: none"> Discounting due to the event of liquidation. Deterioration in value if the assets are lying idle. Mind-set of the valuer. 	<i>Realisable value</i> <ul style="list-style-type: none"> 30% - 40% of the gross value arrived at by the registered valuer. Sometimes valued at the rate of scrap. Some valuers still consider the event of liquidation as death of the CD as compared to the ability of the business being sold as a going concern.

Segregation of the interests of the company and its assets from that of the management of the company

The aforesaid would reveal that under liquidation, there are various factors which contribute to diminishing the value of the assets of the company. The basic reason is not only the accepted practice but also the mind-set of not being able to segregate the business from its owners. It is essential that some process is devised to manage the market sentiment to segregate the defaulting management from the defaulting company / business in which case the business would always be revivable. Like in the case of *Satyam*, the government had to interfere to save the value for the stakeholders and the company was finally taken over by Tech Mahindra thereby preserving the value available to the

stakeholders and economy.

Having said that, one may conclude that the liquidation for any company shall be a last resort and every possible effort should be made to revive the company, its business and value which will ultimately contribute to the employment, revenue, taxes and economic growth. We also believe that the need is for something that creates its own space, and the reach of such need is to the maximum extent possible. If the assets available under the regime of the Code are properly published, specifying the business details and related aspects, liquidation may not happen at all except in certain circumstances where the value of the business is completely lost.

If liquidation is inevitable, sale as a going concern will maximise value

Having dealt with aforementioned issues, it is imperative to discuss the sale of the assets during liquidation as a going concern which may seem a viable option for maximisation of value available to the creditors. Law provides that the Liquidator may sell the company as a going concern or the business of such company as a going concern.⁹ The idea is to capitalise the value available from viable resources against the unviable resources which consume the value created by the viable resources. If a part of the company or business or the units can possibly undergo segregation after ironing out the reasons for default by the company, there could be a scenario that some unit may be a viable opportunity when segregated from the company and achieve a better bid and option to keep running as a going concern, then such an option should be availed.

Revival of company under Scheme of Arrangement under the Companies Act, 2013

Law also provides for an opportunity to save the company from its death by entering into a scheme of arrangement as provided under sections 230-232 of the Companies Act, 2013 within 90 days from the liquidation commencement date. Where a CD fails to achieve or survive through the aforesaid mechanism, the other option to save the business, employment, revenue to the State and the brand could be achieved through sale of a company as a going concern. The data mentioned in this article would demonstrate that where the Liquidators have opted for the sale of the company as a going concern, the recoveries have been on a much higher side as compared to the liquidation process where the assets are sold in piece meal basis and thus could be a viable option for maximisation of value.

Liquidation as a going concern

In an endeavour to promote the objective of the Code and to ensure the survival of the CD undergoing insolvency, there have been amendments at the instance of IBBI which allow even the business of the CD to be sold as a going concern during liquidation. The law currently provides that in the event of liquidation, the appointed Liquidator may sell the assets of the CD on standalone basis, slump sale, collectively, in parcels, CD as a going concern or the business of the CD as going concern.¹⁰ It

is an important development and being adopted by the RPs and the Liquidators where they segregate the running and viable unit from the failed / unviable businesses and invite the plans / bids for the company as a whole as well as the segregated businesses which are capable of being sold off as such. As a matter of business, a company or a unit which is running is always worth more than a unit sitting idle or defunct. The Liquidators / stakeholders have realised the potential of an asset being sold as going concern and moved to availing the option for selling the company as a going concern as a first endeavour.

Till March 31, 2021, liquidation process in the matter of six companies namely, M/s. Emmanuel Engineering Private Limited, M/s. K.T.C. Foods Private Limited, M/s. Southern Online Bio Technologies, M/s. Smaat India Private Limited, M/s. Winwind Power Energy Private Limited and M/s. Topworth Pipes and Tubes Private Limited were closed by sale as a going concern. These six companies had claims amounting to ₹ 4325.16 crore, as against the liquidation value of ₹ 290.03 crore. The Liquidators in these cases realised ₹ 336.76 crore which is 16% more than the liquidation value of these companies. That the companies which were sold as going concern were not only rescued keeping the employment, brand, revenue intact but also were rescued from unnatural death. However, had it been that such companies were sold as per the other available options including piecemeal basis, the objective of the maximisation of returns could have been defeated. The liquidation process offers a mechanism for sale of assets where the sale is primarily proposed through auction where the minimum reserve price is the liquidation value arrived at by the registered valuers in terms of the Code. Same mechanism is also used when the company is being sold as going concern, however, the valuation for the assets or the company as a going concern is higher as compared to the valuation of a company which is not doing any business and sold under liquidation. The authorities are also focused on continuation of the company after such company is segregated from the defaulting / inefficient management. It has been observed time and again that even though liquidation is the last resort, however, in the event of liquidation, a company can be sold as a going concern.

Suggestions

Having discussed the data, numbers and benefits of resolution as compared to liquidation of a company under the provisions of the IBC, it can be safely concluded that the endeavour of the RP and CoC ought to be the resolution of insolvency by way of a resolution plan so that the company survives and generates multifarious benefits for its stakeholders at large. The Code provides for the segregation of the interest of the promoters from that of the firm and that if the firm is able to survive, all the efforts should be made to revive the business. There are various reasons out of which some have been identified in this article which led to the liquidation of the company, diminishing the value and thereby defeating the objective of the Code. However, following steps would not only help in achieving the best value available of the business / assets but would also motivate the investors and increase competition in the market to purchase the assets and revive the company:

(a) *Reporting by RP/Liquidator:* The RPs / Liquidators should be under duty to prepare an assessment

report for indicating the factors leading to the insolvency of the business of the company and share the same on the website of the company for access by new investors for identifying interests. Further, the report should also provide for the benefits which may arise to the stakeholders and the economy, should the business of the CD continue.

(b) *Wider reach of information:* The RPs / Liquidators should be obligated to make maximum publication and advertisements in the form of a deal teaser similar to that done by investment bankers to attract investors and enhance competition between the new or interested investors / acquirers.

(c) *Specific format for valuation reports:* The valuation of a company under liquidation should be made available in the public domain with prescribed and uniform format delving into the necessary details in order to attract investors.

(d) *Fair competition leads to better value:* Open bidding in the liquidation process should be made mandatory for enhancing competition and fetching better value.

(e) *No burden of previous default on new investor/management:* Steps should be taken to devise a mechanism where the authorities are involved in promoting the approval of the resolution plan and it should be ensured that no confusion is created by the authorities post the approval of resolution plan regarding the past defaults of the company. Segregation of the inefficient management from the viable business should be focused and encouraged.

(f) *Adding value by the creditors:* Mechanism should be made where the CoCs / creditors / banks / financing institutions should be allowed to add value if the revival of the company is possible and provide acquisition financing at leverage.

(g) *Continuous updating of process in public domain:* Event based information related to CIRP and liquidation process, including the developments related to appeals, applications filed during the process should be readily made available on a single portal.

The aforesaid suggestions are a few of many and would keep increasing/changing as the Code evolves and India Inc. takes up new challenges for maximisation of the interest of the stakeholders and linking such interests with the economy.

CONCLUSION

While the Code has evolved to a level where the stakeholders have gained confidence in the process, authorities may still need to give confidence to the new investors by relieving the baggage of past failures and defaults of the company. The Hon'ble Apex Court has already stated that the Code's primary purpose is resolution of insolvency which firstly should be achieved by way of approval of resolution plan. This has spiral effects and benefits not only to the stakeholders but also the economy. It is important to understand the benefit of segregating the interests of the defaulting management and the business of the firm. It can be safely concluded that the objective of the stakeholders involved in the process should be to save the viable business by resolving the segregated defaults and keep the business of the company running, which will in turn contribute positively to the economy.

NOTES

¹ Bhushan Steel Ltd., Bhushan Power & Steel Ltd., Electrosteel Steels Ltd., Jaypee Infratech Ltd., Era Infra Engineering Ltd., Amtek Auto Ltd., ABG Shipyard Ltd., Jyoti Structures Ltd., Monnet Ispat & Energy Ltd., Lanco Infratech Ltd., Alok Industries Ltd. and Essar Steel India Ltd. are the twelve large accounts also referred to as 'the dirty dozen'.

² Secured creditor in liquidation proceedings – deals with the enforcement of security interest by the secured creditor in the event of liquidation.

³ *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta*, 2019, Civil Appeal Nos. 8766-8767 of 2019.

⁴ Liquidation of Clutch Auto Limited, Shree Rajeshwar Weaving Mills Private Limited etc.

⁵ Regulation 4 of the IBBI (Liquidation Process) Regulations, 2016.

⁶ In the case of CIRP of Bhushan Steel Ltd., Jaypee Infratech Ltd., Essar Steel India Ltd., Jet Airways etc.

⁷ *Siva Rama Krishna Prasad v. S Rajendran, Official Liquidator of M/s. Krishna Industrial Corporation Ltd. and Ors.*, 2020, Company Appeal (AT) (Insolvency) No. 751 of 2020.

⁸ *Kridhan Infrastructure Pvt. Ltd. v. Venkatesan Sankaranarayanan and Ors.*, 2020, Company Appeal (AT) (Insolvency) No. 202 of 2020.

⁹ Regulation 32 of IBBI (Liquidation Process) Regulations, 2016.

¹⁰ *Ibid.*

ROLE OF INFORMATION UTILITY IN INSOLVENCY RESOLUTION

R. B. Barman

The Insolvency and Bankruptcy Code, 2016 (Code/IBC) aims to protect the interest of creditors, debtors and other stakeholders including government through a time bound resolution process either through (a) National Company Law Tribunal (NCLT) for companies and Limited Liability Partnership firms or (b) Debt Recovery Tribunal (DRT) for individuals and partnerships. The responsibility for overseeing the insolvency proceedings lies with the Insolvency and Bankruptcy Board of India (IBBI/Board). The main purpose is to balance interest of debtors and creditors to promote entrepreneurship and maximise value of assets at stake thereby providing a kind of predictability in such resolution.

INFORMATION UTILITY AS A SERVICE

As stipulated in the Code, the financial information on debts should be maintained by Information Utility (IU) to bring about a kind of non-refutability to expedite the process of resolution. Towards this end, every IU shall–

- (a) create and store financial information in a universally accessible format;
- (b) accept electronic submissions of financial information from persons who are under obligations to submit financial information under section 215(1) of the Code, in such form and manner as may be specified by Regulations;
- (c) accept, in specified form and manner, electronic submissions of financial information from persons who intend to submit such information;
- (d) meet such minimum service quality standards as may be specified by regulations;

- (e) get the information received from various persons authenticated by all concerned parties before storing such information;
- (f) provide access to the financial information stored by it to any person who intends to access such information in such manner as may be specified by regulations;
- (g) publish such statistical information as may be specified by regulations; and
- (h) have interoperability with other IUs.

In pursuance of this provision, the IBBI (Information Utilities) Regulations, 2017 (IU Regulations) came into force from April 1, 2017 onwards, under which technical standard is stipulated for adherence by registered entities. The provisions for registration of IU are set out under the IU Regulations.

The technical standards are required for 18 items as listed in the IU Regulations. These items cover the process for registration of users, standard terms of service, unique identifier for each record and each user, submission of information and verification process, data integrity, security of information, interoperability among IUs, and Application Programming Interface for access of information as per consent framework.

The users have to register with an IU. The registration of users covers the following processes as specified in regulation 18 of IU Regulations:

- (1) A person shall register itself with an IU for-
 - (a) submitting information to; or
 - (b) accessing information stored with any of the IUs.
- (2) The IU shall verify the identity of the person under sub-regulation (1) and grant registration.
- (3) Upon registration of a person under sub-regulation (2), the IU shall intimate it of its unique identifier.
- (4) A person registered once with an IU shall not register itself with any IU again.
- (5) An IU shall provide a registered user a functionality to enable its authorised representatives to carry on the activities in sub-regulation (1) on its behalf.
- (6) An IU shall-
 - (a) maintain a list of the registered users; the unique identifiers of the registered users; and the unique identifiers assigned to the debts under regulation 20 of IU Regulations.
 - (b) make the list under clause (a) available to all IUs and the Board.

A Technical Committee has been constituted to suggest a detailed technical standard for the Board to notify through regulatory provision, with close interactions with concerned functionaries and stakeholders before making their recommendations. The technical standards are expected to ensure and enforce reliability, confidentiality and security of financial information to be stored by the IUs. It has also been stipulated that an IU should adopt robust data governance standards to take care of complete integrity of the database. In order to establish a single version of truth, there should be unfettered access to data among the IUs, while each IU is free to maintain its own repository of mutually exclusive and exhaustive data.

STATE OF NON-PERFORMING ASSETS

The IU receives data on debt and related documents from banks. The Reserve Bank of India (RBI) also receives data on credit from banks, which include data on asset quality. Data on recovery of non-performing assets (NPAs) by scheduled commercial banks through various channels for the year 2018-19 and 2019-20 are reported in RBI's Report on Trend and Progress of Banking in India. The total number of cases referred for recovery was 43.76 lakh in 2018-19 and 61.35 lakh in 2019-20. The corresponding amount was ₹ 7.26 lakh crore and ₹ 7.42 lakh crore respectively. The amount recovered was ₹ 1.19 lakh crore and ₹ 1.73 lakh crore respectively. Of the four, namely, (i) Lok Adalat (ii) DRTs (iii) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and (iv) IBC alone accounted for the recovery of 45.7% and 45.5% during the two years. It clearly shows the importance of bankruptcy code for expeditions resolution of insolvency cases.

Another channel through which banks sell assets to clean up balance sheets is Asset Reconstruction Companies (ARCs). Financial assets securitised by ARCs amounted to ₹ 4.31 lakh crore as on March, 2020. Banks remain involved in recovery of assets sold to ARCs through their participation in security receipts. This option on disposing off stressed assets is exercised by banks considering the alternatives on the type and realisable value of assets under such a choice. The National Asset Reconstruction Company as a bad bank will be a major player when it starts its operation.

The high incidence of NPAs has many consequences on delivery of credit and credit discipline. The credit-Gross Domestic Product (GDP) ratio of India stood around 55% at end March, 2020 and was showing a declining trend. In fact, the large borrower accounts (exposure of ₹ 5 crore and above) accounted for 79.8% of NPAs at end of September, 2020. As a consequence of high NPA, the net interest margin in India is around 3%, much higher than the rate in Western Europe and United States. Such high cost is a factor in international competitiveness on pricing for goods and services produced in India.

The landscape on credit discipline has implications much beyond. Way back in 1983, on my way back from Patna to Kolkata by train, I heard a co-passenger saying, it is foolish to pay back loans taken from banks. I was taken aback and was very surprised. He explained that when someone defaulted on bank loan, the concerned bank files a suit to recover the amount when all other avenues fail. The court could take many years to pronounce judgement, which could be contested and referred to higher levels. In the process the defaulter had the opportunity to roll over the money many times, earn a much bigger sum, and then return the amount with penalty, if all options are exhausted. Thus, willful default was considered gainful by some people. Hence, time is of essence in the resolution of insolvency, willing or otherwise. In this connection, India's record on enforcement of contracts is very poor, and its ranking is one of the lowest in global context. Under such a backdrop, the provisions under the Code and their enforcement through a time bound process has improved the situation greatly. However, it still takes time, leaving some scope for further improvement.

INSTITUTIONS AND GOVERNANCE

We are under the grip of a legacy system which is a prisoner of very slow and inefficient process of dispensation of justice due to various factors, such as onus of conclusive proof, inadequate infrastructure, overburdened judiciary and various forms of delaying tactics. The way the recent cases of prominent defaulting fugitives are handled abroad shows how justice can be denied by delaying tactics. On the other hand, a country like Singapore is a classic example of how quickly the cases can be resolved. As an illustration, the media reported that when a case was filed in the courts of Singapore by an Indian lady on default on payment of her dues under some pretext, the judge charged the complainant for delay in filing of the case while giving his judgement against the defaulting party, fixing him for trying to dishonor contract under frivolous pretexts, in no time. In India such kinds of delaying tactics by defaulting parties are widespread because civil suits hang in courts for years without proper accountability. There is an urgent need to deal with such recalcitrant practices comprehensively to significantly improve investment climate and promote an honest and committed class of enterprise.

In the last 50 years Singapore has reached a level of economic development, which is envied by even western developed countries. A major factor contributing to this is high level of efficiency in dispensation of justice. While Singapore is a small island, the ability of China to enforce contracts even when local governments may not be functioning so smoothly tells a story. The number of judges per one million people in China far outstrips those of India. We need to come out with an objective assessment of costs of such inefficiency in resolution of cases in India. It will be a huge amount, consuming a considerable percentage of GDP due to such inefficiency. It will require only a small fraction of such amount to appoint adequate number of judges and develop information technology-based systems and processes to provide clarity and to make them accountable on delay in dispensation of judgment. However, it is also well known that the onus on irrefutable documentary evidence poses major hurdle on resolution. Though we are making rapid progress, the disquiet still remains. The establishment of IU is definitely a very significant step in this direction. The performance of NCLT as Adjudicating Authority for the resolution of insolvency through its branch network throughout the country is working well. The experience on disposal of cases and the factors contributing to hurdles are also monitored for suitable steps to achieve the objective.

In the broader context on boosting business and investor confidence to contribute to broad based economic development promoting efficiency, the role of institutions and governance is paramount. As Olson (1996)¹ said:

The large differences in per capita income across countries cannot be explained by differences in access to the world's stock of productive knowledge or to its capital markets, by differences in the ratio of population to land or natural resources, or by differences in the quality of marketable human capital or personal culture. (...) The only remaining plausible explanation is that the great differences in the wealth of nations are mainly due to differences in the quality of their institutions and economic policies.

As per a World Bank study, a country's income per head rises many times if governance improves, denting rent seeking and inefficiency.² The need for well-functioning, efficient institutions and governance is paramount for spurring economic growth.

The clear message is we must act decisively to improve institutions and governance to raise potential for growth by rooting out inefficiency at all levels. The continuing effort of both Securities and Exchange Board of India (SEBI) and RBI putting in place rules, regulations, business intelligence, reporting systems, monitoring mechanisms and so on to develop systems and processes supporting timely compliance has made a major difference for escaping from the legacy of the past. The banking industry has also come a long way in putting in place information technology driven business operations and monitoring systems. This was supported and supplemented by institutional mechanism like credit rating agencies, depositories, default rating agencies along with credit scores. Even when these institutions were helping banks to assess risks in lending and pricing products based on empirically evaluated proposals, the transition process brought out a few serious chinks. The huge NPAs of the banking sector is a major one. This revelation on high level of NPAs is the result of rigorous evaluation of portfolio of loans based on asset quality norms. Though this has seriously affected capacity for financial intermediation by banks, with consequent impact on the economy, the situation has gradually improved, as borne out by the declining trend rate of NPAs. The initiative on Central Repository of Information on Large Credit (CRILIC) and development of public credit registry by RBI taking advantage of 'Hadoop' as part of Big Data technology are important steps towards bringing about greater discipline in the monitoring of credit. This is reinforced by recent imposition of penalty on banks by RBI for failing to adhere to reporting norms of CRILIC. There are other data sources like MCA21 and SARFAESI Act. SEBI also has a mature database management system as a component of its Data Warehouse. It may be possible to establish a means for conformation of these different databases at periodic intervals for extraction of valuable information on defaults and check for coherence in submitted data. As RBI is represented in the board of IBBI, its feasibility could possibly be discussed. In this connection following suggestions may be considered.

CONFORMED DIMENSIONS ON INTEGRATION OF VARIETIES OF INFORMATION

The regulatory institutions, as mentioned above, have specific requirements for effectively discharging their functions. Hence, they need to independently maintain many other details along with credit data. For example, RBI data includes type of assets, namely, standard, sub-standard, doubtful and loss assets along with many other dimensions used for economic analysis. If these independent databases are integrated using conformed dimension as a common key, this will have the possibility to throw up much valuable insights for analysis from broader economic perspective. The database of IU includes KYC which is a distinct possibility for this mapping, but other databases should also have this as a key for such conformance. MCA21 data relate to reporting by corporates as debtors while IU data relate to banks as creditor. Hence, the matching exercise will reveal data

on indebtedness from sources other than banks. As the resolution process covers this other segment also as claimant of resolution proceeds, a mapping of databases will serve such purpose. This will save time for early resolution of cases.

In addition to commercial banks, non-banking financial companies, micro-finance institutions, cooperatives and others also extend sizeable amount of credit. It is desirable to bring these institutions under reporting system to improve credit discipline across the board. But this is not an easy task. There are many contentious issues including political stance on regulation of cooperatives. However, all these institutions are mostly computerised. Hence, it may be possible to set standard for maintenance of data by them which can be compatible for access, if and when required. This is expected to indirectly help in improving credit discipline.

Assessment and Prospects

IBBI has been conceived to steer the process for timely resolution of insolvency through IBC. At present about half of the total amount at stake gets resolved through this process. There is a limit on the time allowed for such resolution of cases steered through rules, regulations, and judicial process. IU has been conceived to collect, process and maintain authenticated data as credible evidence for such resolution. In a short span of four years the present IU, National E-Governance Services Ltd., has built a well-designed system to effectively discharge this role, catering to the needs of both creditors and debtors on authenticated data. The technical standard for development and deployment of technology was laid down by IBBI based on the recommendation of the technical committee set up by it. The system is functioning well. The next issue is to bring about greater efficiency in the process through fixing factors adversely affecting early resolution.

The early detection of incidence of insolvency is important to control deterioration and mitigate losses safeguarding interest of stakeholders. In this effort there is an important role on developing information system throwing light on incipient insolvency and the causal factors there on. Towards this end, it is desirable to provide enough muscles for reporting of cases and related documents to IU by both creditors and debtors. In addition, one can think to examine the feasibility to integrate important elements of credit information across the board, as indicated above, which is technologically feasible at this stage of development. In such a case IUs would get to know the super space of indebtedness along with various dimensions of filed data maintained by different regulators and resolution authorities. This will be a major gain for analysis of systemic causal factors on insolvency and policy formulation.

CONCLUSION

In the next step it should be ensured that the creditors and debtors report their data in time which is also complete in all respects. At present there is a mandate for submission of these data by banks. However, the debtors are not under such mandatory obligation to provide other relevant data impinging on indebtedness and possible source of insolvency. The corporates are however

under obligation to report such data under MCA21. There is need to link IU and MCA21 data to know about indebtedness beyond banking system. As the other stakeholders are also claimants of resolution proceeds, this data is expected to serve well the cause of developing a system for near irrefutable financial information needed for expeditious resolution of dispute and insolvency. The ultimate aim should be to gradually close escape routes for those preferring intentional default exploiting weakness in the existing system for their undeserving pecuniary gains.

The use of Artificial Intelligence, machine learning and deep learning will provide the intelligence needed proactively to inculcate desired credit discipline. The adage that 'prevention is better than cure' is the spirit we look forward to. This will not only go a long way to prevent intentional default but improve credit climate many folds. This is a broad issue, the feasibility for which may have to be examined at highest level of coordination.

IBBI has done very well in the last five years of its operation. Its importance in the resolution of bankruptcy for corporate cases is growing, making it a very important institution. The timely resolution of insolvency through strict enforcement of contract remains a central concern at this stage, the extent of success of which will be watched with keen interest to raise India's ratings globally. There is a need for credit discipline across the board for a healthy credit environment. There are other credit providing institutions and new players creating their own space in the lucrative credit market. The overhang of liquidity internationally is chasing opportunity to enter this market through such channels. We need to take advantage of them for benefiting from evolving opportunity for much higher investment, raising credit-GDP ratio. This would pave the way for vast optimality in use of human and material resources along with demand, creating advanced technology for competitive advantage, ensuring sustained high economic growth.

NOTES

¹ Olson M. (1996), "Distinguished Lecture on Economics in Government: Big Bills Left on the Sidewalk: Why Some Nations are Rich, and Others Poor", *The Journal of Economic Perspectives*, 10(2), pp. 3-24.

² Kaufman and Kraay (2008), "Order in the jungle", *The Economist*, 13 March.

INTERPLAY OF IBC WITH LAW ON LIMITATION

Akaant Kumar Mittal¹

Limitation has been one of the fiercely contested issues during the adjudication of an application seeking initiation of the corporate insolvency resolution process (CIRP) under the Insolvency and Bankruptcy Code, 2016 (Code/IBC). The burden of proof falls on the applicant invoking the CIRP, to *prima facie* show the existence of a legally recoverable debt, which includes the burden to prove that the debt is not barred by limitation.²

When the IBC came into force, there were several related issues regarding the applicability of Limitation Act, 1963 (the Act) to the proceedings under the IBC, namely:

- (a) Whether there is a continuous cause of action in case of default of debt so as to prevent any imposition of limitation period?
- (b) Whether the Act is applicable?
- (c) If yes, then when does it start operating?
- (d) And if no, then whether the doctrine of delay and laches and prescription apply?

Subsequently, the legislature vide amendment inserted section 238A to the IBC and the rulings of the Supreme Court (SC) in *B.K. Educational Services*³ and *Vashdeo R. Bhojwani v. Abhyudaya Coop. Bank Ltd.*⁴ went on to settle the above-mentioned issues.

In brief, the position of law is that the provisions of the Act shall apply to the applications filed under the IBC and an application under section 7, 9 or 10 of the IBC has to be filed within a time period of three years from the date of default and there is no continuing cause of action once the default takes place.

CURRENT QUAGMIRE

Now the current problem is arising out of the position that since the Act applies to the applications under the IBC, then which are the provisions of the Act that become relevant. The prominent amongst them are the following, entailing a lot of judicial discourse already up to the SC with no conclusive position as of yet:

- (a) Section 18 of the Act which provides for the ‘Effect of acknowledgment in writing’;
- (b) Section 19 of the Act which stipulates the ‘Effect of payment on account of a debt or interest on legacy’ and;
- (c) Section 14 of the Act, which states ‘Exclusion of time of proceeding *bona fide* in court without jurisdiction’.

Applicability of sections 18 and 19 of the Act

To avoid overlapping and repetition of issues, the paper deals with the interplay of sections 18 and 19 of the Act with the IBC conjointly.

Time and again, the courts have been confronted with the issue of whether an application seeking initiation of resolution process is within the limitation or not. It is a settled law that the statute of Limitation only bars the remedy but does not extinguish the debt.⁵ It was in that vein that the issues of pending litigations, acknowledgement by partial payments, or offers of one-time settlement (OTS) are relied on to show that the debt alleged to have been defaulted upon, is not time-barred. The rationale opted is that the right to remedy under the IBC came up only in the year of 2016 and therefore, it can be shown that the debt is not barred under the then existing laws, then the National Company Law Tribunal (NCLT) should not reject any application under section 7, 9 or 10 of the IBC on the ground that the debt was barred by time.⁶

When the invoices were dated in 2011, the National Company Law Appellate Tribunal (NCLAT) took note of the partial payments made till 2014 as well as the *factum* of a suit being filed by the creditor in the same year seeking recovery of the remaining amount, to conclude that the debt is still subsisting.⁷

In instances, when there is a balance confirmation by the debtor⁸, or partial payment is made by the debtor⁹, or payment of interest¹⁰, or an offer of OTS¹¹, or a debt settlement agreement between the debtor and creditor¹², the NCLAT has held that the debt is not time-barred. However, whether the balance sheet or annual reports of a corporate debtor (CD) constitutes an acknowledgement of debt was answered in the negative. In the case of *V. Padmakumar*¹³, a five-member bench of the NCLAT by a 4:1 majority had held that a reflection of debt in a balance sheet or annual return of the CD could not be treated as an acknowledgement in terms of section 18 of the Act.

Clearly, the issues of limitation and acknowledgment of debt continued to plague the courts in the matters under the IBC and an inconsistent position of law existed. Section 238A of the IBC

stipulates that, ‘*the provisions of the Limitation Act, shall, as far as may be, apply to the proceedings or appeals before the Adjudicating Authority, the National Company Law Appellate Tribunal...*’

In other words, the IBC is clear that all the relevant provisions of the Act shall be applicable while adjudicating an application, or a claim under the IBC. The SC has already settled the same holding that the phrase ‘as far as may be’ means that the provisions of the Act would apply *mutatis mutandis* to proceedings under the Code in the NCLT-NCLAT.¹⁴

Coming to the provisions of sections 18 and 19 of the Act, which provide:

Section 18 - Effect of acknowledgment in writing.

(1) Where, before the expiration of the prescribed period for a suit or 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.

Section 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.

Section 18 of the Act requires acknowledgement of liability to be ‘made before the expiration of the prescribed period’ and to be in the form of, or in writing signed by the party against whom such right is claimed, in order to be effective to extend limitation.¹⁵ The fact that a debtor has acknowledged that there is debt is sufficient to restart the period of limitation.¹⁶ It is however essential that a person either making acknowledgement of liability or a person making the payment must make acknowledgement or payment by his own writing signed by him or in writing at least signed by him and such acknowledgment must be before the expiration of the existing period of limitation.¹⁷ In other words, there must be a written acknowledgement containing an admission of a subsisting liability, and a mere admission of past liability is not sufficient to constitute such an ‘acknowledgement’.¹⁸ On the other hand, to attract the application of section 19, two conditions are essential (a) the payment must be made within the prescribed period of limitation; and (b) it must be acknowledged by some form of writing, either in the handwriting of the payee himself or signed by him.

The issue of section 18 was explicitly a matter of issue in the case of *Babulal Vardharji Gurjar*.¹⁹ In this matter the appellant before the NCLAT argued that the default took place in July, 2011

and the application under section 7 being filed in March, 2018 was barred by limitation. The respondent, in turn, contended that there is a continuous cause of action. The NCLAT noted the proceedings undertaken by the respondent-creditor before the Debt Recovery Tribunal (DRT) under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and the same were pending. The financial creditor (FC) also brought on record a letter dated July 31, 2018 issued by the appellant seeking an OTS with the creditor-bank. Based on a culmination of these factors, the NCLAT found that the claim is not time-barred as well.

However, when the matter in *Babulal Vardharji* went into appeal before the Apex Court²⁰, the Apex Court set aside the order of the NCLAT. The Apex Court held that since the date of default is July 8, 2011, therefore, on account of the Act, the application under section 7 is time-barred. The Apex Court also specifically discussed the reliance made by the NCLAT on the pendency of the application under section 19 of the Debt Recovery Tribunal Act of 1993 and the fact that CD had made a prayer for OTS in July, 2018. The Apex Court on these grounds stated that ‘noticeably, though the Appellate Tribunal has referred to [these factors]..., [but the NCLAT] has not recorded any specific finding about the effect of these factors.’²¹

While the court sought to answer if section 18 of the Act is applicable, in the end, it seems to have confined its findings only to the facts of the case. It stated:

...even if it be assumed that the principles relating to acknowledgement as per section 18 of the Limitation Act are applicable for extension of time for the purpose of the application Under section 7 of the Code, in our view, neither the said provision and principles come in operation in the present case nor they inure to the benefit of respondent no. 2 for the fundamental reason that in the application made before NCLT, the respondent no. 2 specifically stated the date of default as ‘8.7.2011 being the date of NPA’...

... [i]n other words, even if section 18 of the Limitation Act and principles thereof were applicable, the same would not apply to the application under consideration in the present case, looking to the very averment regarding default therein and for want of any other averment in regard to acknowledgement...²²

Therefore, it is submitted that the ruling in *Babulal Vardharji*²³ still leaves the issue of applicability of section 18 of the Act unaddressed. The Apex Court has overlooked (a) the acknowledgment of debt on account of the OTS offer, (b) the pending litigation before DRT, (c) the differentiation that NCLAT made between the limitation in filing the application *vis-à-vis* the time-barred of the debt amount. The NCLAT applied Article 137 to the filing of an application under the IBC to only hold that the application itself is barred on account of the law of limitation. Regarding the bar on the debt amount itself, the NCLAT analysed that all due attempts are being made to recover the debt amount before the appropriate forum (before the IBC was enacted).

The Apex Court had the opportune occasion to categorically put to rest any debate on the applicability of section 18 of the Act to extend limitation for an application under section 7 or 9 of the IBC. However, the same is now a missed opportunity. The court could have also addressed the issue of whether the time spent in the pending or prior proceedings before the DRT can be excluded from the

calculation of limitation for filing an application under the IBC (for seeking initiation of resolution process).

Nevertheless, the ruling in *Babulal Vardharji* formed the basis of the NCLT ruling in the case of *Lampex Electronics Limited v. AMI Tech (India) Private Limited*²⁴ and a Calcutta High Court (HC) ruling in *Gouri Shankar Chatterjee v. State Bank of India*.²⁵

In *Lampex Electronics*, an operational creditor (OC) filed an application seeking to initiate CIRP against the CD on the ground of default in payment. The application was filed on May 17, 2018, which the debtor argued was outside the three-year limitation period as the claim of the creditor was based on the invoices raised on the debtor in 2014. The creditor relying on section 18 of the Act argued that a fresh limitation period commenced from August 25, 2015, as there was an acknowledgment of liability executed by the debtor on this date. The NCLT, amongst other reasons, rejected the application by relying heavily on the SC’s decision in *Babulal Vardharji* to hold that section 18 is inapplicable since the nature of proceedings before the NCLT is an application for resolution of debt and not a suit for recovery.

The Calcutta HC in *Gouri Shankar*²⁶ quashed an application filed by the FC on the ground that section 18 exclusion is not available to the creditor to reset the limitation time period.

In this case, the AA had admitted the application of the bank made under section 7 of the IBC. The debtor challenged the same before the HC, submitting, that while the account of the debtor was classified as a non-performing asset (NPA) in August, the application was filed in the August, 2020, hence the bar of the Act was applicable. The bank, in turn, had asserted that the bar of limitation did not apply as the CD had made acknowledgements in its balance sheets, acknowledgements as in section 18 of the Act, for the period of limitation to get extended. The HC, in frightfully incoherent reasoning, relied on *Babulal Vardharji* to hold that the application of the creditor was barred by limitation and the NCLT could not have exercised jurisdiction. While the HC completely overlooked the remedy of appeal available to the aggrieved debtor to challenge the order of the NCLT before the NCLAT, it found complete justification in exercising writ jurisdiction under Article 226 of the Constitution. While the HC correctly takes note of the distinction between a wrongful exercise of jurisdiction *vis-à-vis* an absence of jurisdiction, it completely misapplies it.

The ruling however stands set aside by the Apex Court in *Asset Reconstruction Company v. Bisha*²⁷ on the grounds of section 18 of the Act being applicable to the applications seeking initiation of CIRP under the IBC.

Even otherwise, as discussed in detail earlier, the Apex Court in *Babulal Vardharji* did not reject the applicability of section 18 to the applications under the IBC. Section 18 covers within its ambit not only ‘suits’ but ‘applications’ as well. Therefore, the NCLT in *Lampex Electronics* made an error in its conclusion that section 18 does not apply to an application under the IBC since it is different in nature (as it seeks resolution of debt) from a ‘suit’ which is for recovery of money.

Curiously, a little after the ruling in *Lampex Electronics*, the NCLAT ruling in *Rajendra Narottamdas Sheth v. Chandra Prakash Jain*²⁸, provides us with a more useful reference point to understand the interplay between sections 18 and 19 of the Act with the IBC.

In *Rajendra Narottamdas*, the account of the debtor was declared as an NPA on September 30, 2014 and the FC filed an application seeking initiation of CIRP against the debtor on April 25, 2019.²⁹ The debtor claimed that the application is time-barred as it was beyond the three-year limitation period that commenced on the date of the NPA.³⁰ The FC argued that the limitation period got extended on account of section 18 of the Act by relying on the documents showing acknowledgments of debt by the CD in writing. The creditor also placed relied on the Statements of Accounts showing various installments paid on account of debt and interest, even after the declaration of NPA to invoke the application of section 19 of the Act.³¹

The NCLAT referred to the following undisputed facts where: (a) the CD had issued Balance Confirmation Letter dated April 7, 2016 and acknowledged the debt, (b) the account statements showed regular credit entries after April 7, 2016 till May, 2018; and (c) the CD issued a letter dated November 17, 2018 giving details of amounts repaid till September 30, 2018 and acknowledging amount outstanding in respective accounts as on that date. On the basis of these facts, the NCLAT held that the benefit of sections 18 and 19 were attracted and the application by the creditor was not time-barred.³²

As in numerous cases prior to the ruling of *Rajendra Narottamdas*, the issue of balance confirmation, payment on account of interest, or principal amount, or offer of OTS are all issues that the Act accounts for in its provisions. The position of law on the applicability of section 18 started to attain some modicum of certainty when the SC in *Sesh Nath Singh v. Baidyabati Sheoraphuli*³³ stated:

68. we see no reason why section 14 or 18 of the Limitation Act, 1963 should not apply to proceeding under section 7 or section 9 of the IBC.

88. ...under section 9 of the IBC, is default on the part of the corporate debtor, and the provisions of the Limitation Act 1963, as far as may be, have been applied to proceedings under the IBC, there is no reason why Section 14 or 18 of the Limitation Act would not apply for the purpose of computation of the period of limitation.

The reference to section 18 however may only be termed an *obiter* since this question is yet to be completely put to rest by the SC. In this case, the provision of section 18 neither was relevant nor into consideration, as the matter was pertaining to section 14 of the Act which forms the subject matter of the subsequent part of this paper.

However, in a decision dated March 26, 2021, the Apex Court in *Laxmi Pat v. Union Bank of India*³⁴ seems to have put to rest this issue. The (corporate) guarantor/CD argued that the date of default was in the year 2010 when the account of the principal borrower was declared NPA. The respondent creditor – bank, in turn, submitted that on account of the time-to-time acknowledgments of debt given by the principal borrower and even the (corporate) guarantor/CD, the last of which was given on December 8, 2018, meant that the debt is not time-barred.

The court, firstly, addressed the purport of *Babulal Vardharji* with respect to the issue of whether section 18 of the Act applies to an application under the IBC. It put to rest that in that ruling the SC had not ruled out the application of section 18 of the Act to the proceedings under the IBC, if the fact situation of the case so warrants.

Subsequently taking note of the provision of section 238A of the IBC, the court opined that once the provisions of the Act have been made applicable to the proceedings under the IBC, as far as such provisions may be applicable, there remains no reason to exclude the effect of section 18 of the Act to the proceedings initiated under the IBC. Therefore, it was directed that a fresh period of limitation be computed from the date of acknowledgment of a debt by the principal borrower and/or the corporate guarantor, including in particular the last communication dated December 8, 2018. Resultantly, the application of the FC under section 7 of the IBC was found to be within the limitation by granting the benefit of exclusion of time period under section 18 of the Act.

The same also formed the basis for the SC ruling in the matter of *Asset Reconstruction Company (India) Limited v. Bishal*³⁵, where the court set aside the five judges ruling of the NCLAT in the case of *V. Padmakumar*³⁶, which had held that entries in balance sheets would not amount to an acknowledgement of debt for the purpose of extending limitation under section 18 of the Act. The court relied on the observations in *Sesh Nath Singh* (supra) and the categorical position laid down in *Laxmi Pat* (supra) to firstly conclude that section 18 of the Act applies to the proceedings under the IBC.

Then, the Apex Court went on to discuss that how entries in a balance sheet may amount to an acknowledgment for the purposes of section 18 of the Act. While the implication of this decision may be a matter of discussion since accounting rules, if conservative, may require recognition of claims even if the CD is contesting the same. Therefore, even when a dispute is under contest for a period of over three years, still the balance sheet of the company may show under the head of contingent liability of the notes in the balance sheet. Just to clarify any such doubt, the court was cognisant of the same and even noted this circumstance when the entry in a balance sheet may not necessarily mean an acknowledgment of liability, stating:

16. ... this judgment holds that though the filing of a balance sheet is by compulsion of law, the acknowledgement of a debt is not necessarily so. In fact, it is not uncommon to have an entry in a balance sheet with notes annexed to or forming part of such balance sheet, or in the auditor's report, which must be read along with the balance sheet, indicating that such entry would not amount to an acknowledgement of debt for reasons given in the said note.

22. ... the statement of law contained in *Bengal Silk Mills* (supra), that there is a compulsion in law to prepare a balance sheet but no compulsion to make any particular admission, is correct in law as it would depend on the facts of each case as to whether an entry made in a balance sheet *qua* any particular creditor is unequivocal or has been entered into with caveats, which then has to be examined on a case by case basis to establish whether an acknowledgement of liability has, in fact, been made, thereby extending limitation under Section 18 of the Limitation Act.³⁷

With the rulings in *Laxmi Pat* and *Asset Reconstruction Company*, it is submitted that the issue of the application of section 18 of the Act to the applications seeking initiation of resolution process under the IBC is settled unequivocally and put to a categorical end. As regards if the reasoning in *Laxmi Pat* is to be accepted, then the ruling of the NCLAT in *Rajendra Narottamdas* shows the way ahead for the application of section 19 of the Act to the IBC.

If the reasoning in *Sesh Nath*³⁸, *Laxmi Pat*³⁹, and *Asset Reconstruction Company*⁴⁰ is to be accepted that the 'provisions of Limitation Act have been made applicable to the proceedings under the Code, as far as may be applicable', then clearly section 19 of the Limitation Act can be used to extend limitation period. To that effect, the ruling of the NCLAT in *Rajendra Narottamdas* shows the way ahead for the application of section 19 of the Act to the IBC.

Applicability of section 14 of the Act

Whether pendency of a prior litigation reset the limitation, was answered in the recent ruling of the SC in *Sesh Nath v. Baidyabati Sheoraphuli Co-Operative Bank*.⁴¹ It is pertinent to note here that in the case of *Babulal Vardharji*, the SC had taken note of the proceedings filed before the DRT in terms of the SARFAESI Act. However, opining that since the NCLAT did not render a specific finding on the ramification of the pending proceedings before the DRT *vis-à-vis* the calculation of limitation time period, the SC did not decide on the same.

While the court in *Sesh Nath* intends to put to rest the issue of applicability of section 14(2) of the Act to the applications under the IBC, it ends up leaving open more doubts than provide a modicum of certainty *vis-à-vis* the issue of relevancy of pending litigation. Section 14(2) stipulates:

Section 14. Exclusion of time of proceeding bona fide in court without jurisdiction.

(1) ...

(2) In computing the period of limitation for any application, the time during which the applicant has been prosecuting with due diligence another civil proceeding, whether in a court of first instance or of appeal or revision, against the same party for the same relief shall be excluded, where such proceeding is prosecuted in good faith in a court which, from defect of jurisdiction or other cause of a like nature, is unable to entertain it....

In *Sesh Nath*, the CD availed cash credit facility from the FC. On default of repayment, the FC declared the account of the CD as NPA. On failure to discharge the debt, action under the SARFAESI Act was initiated against the debtor. The debtor in turn challenged the proceedings under the SARFAESI Act by way of a writ petition before the Calcutta HC. The HC passed an interim order restraining the FC from proceeding under this Act on *prima facie* satisfaction that the FC being a co-operative bank cannot initiate proceedings under the SARFAESI Act.

Due to the interim order of the HC, the FC was unable to proceed further under SARFAESI Act. Hence, the FC resorted to section 7 of the IBC. The appellant challenged the order of NCLT before NCLAT but the challenge was dismissed.

Before the NCLAT, it was argued that the account of the CD had been declared NPA on March 31, 2013, whereas the application under section 7 of IBC had been filed on August 27, 2018, i.e., after almost five years and five months from the date of accrual of the cause of action, and was therefore barred by limitation. The NCLAT examined the issue of limitation and held that the respondent had *bona fide*, within the period of limitation, initiated proceedings against the CD under the SARFAESI Act and was thus entitled to exclusion of time under section 14(2) of the Act.

Resultantly, the NCLAT excluded the period of about three years and six months till the date of the interim order of the HC, the period during which the FC had been proceeding under the SARFAESI Act. Consequently, it was held that the application of the FC under section 7 of the IBC was within limitation.

In appeal before the Apex Court, one of the issues was whether section 14 of the Act can be relied upon by the FC while filing an application under section 7 of the IBC.

The Apex Court firstly held that the proceeding under the SARFAESI Act qualifies to be a 'civil proceeding' for exclusion of time under section 14 of the Act. Interpreting section 14 liberally and more broadly, the court held that the section 14 exclusion is available to a creditor filing an application under section 7 of the IBC. Resultantly, the order of the NCLAT was upheld.

It is noteworthy that even before the Apex Court decided the appeal in *Sesh Nath*, the NCLAT in a Five-Judge bench ruling in *Ishrat Ali v. Cosmos Cooperative Bank*⁴² had held that its decision in *Sesh Nath* was erroneous in law. In *Ishrat Ali*, the conflict regarding the applicability of section 14 to the IBC came up for consideration before the NCLAT. The NCLAT departing from its earlier decision in *Sesh Nath*⁴³ and had held that proceedings initiated by a financial institution under section 13(4) of the SARFAESI Act does not constitute a 'civil proceeding' and therefore, could not be excluded under section 14(2) while calculating the period of limitation. The court went on to state that:

21. An action taken by the 'financial creditor' under section 13(2) or section 13(4) of the 'SARFAESI Act, 2002' cannot be termed to be a civil proceeding before a Court of first instance or appeal or revision before an Appellate Court and the other forum ...

[i]n an application under section 7 relief is sought for resolution of a 'corporate debtor' or liquidation on failure. It is not a money claim or suit. Therefore, no benefit can be given to any person under section 14(2), till it is shown that the application under section 7 was prosecuting with due diligence in a court of first instance or of appeal or revision which has no jurisdiction.

Through a careful analysis of the judgment, it could be noted that the NCLAT conclusively and authoritatively decided the issues, however without substantiating its findings with a reason. Even otherwise, the reasoning and the ruling of the Apex Court in *Sesh Nath* already held that the decision in *Ishrat Ali* was unsustainable since a proceeding under the SARFAESI Act does qualify as a civil proceeding.

Penumbral issue still unresolved

The most important aspect of section 14 (2) and its interplay with the applications under the IBC is whether section 14 can be pressed into if the proceedings by a bank under the SARFAESI Act were within the proper jurisdiction.

As noted earlier, the HC passed an interim order restraining the FC from proceeding under the SARFAESI Act on *prima facie* satisfaction that the FC being a cooperative bank cannot initiate proceedings under the SARFAESI Act. Due to the interim order of the HC, the FC was unable to proceed further under SARFAESI Act. Hence, the FC resorted to section 7 of the IBC.

Interestingly, prior to the *Sesh Nath* ruling, the Apex Court in a constitutional bench ruling (comprising also of Banerjee, J. who authored the present *Sesh Nath* ruling) *Pandurang Ganapati Chauhan v. Vishwasrao Patil Murgud Sahakari Bank Limited*⁴⁴, addressed the question of applicability of the SARFAESI Act to the cooperative banks. The Apex Court applying the ‘doctrine of pith and substance’ observed that Entry 45 of List I (Banking) is of the widest amplitude and includes cooperative banks recovering their loans by invoking the provisions of the SARFAESI Act.

While in *Sesh Nath*, the Apex Court does not refer to the ruling in *Pandurang Ganapati*, however the issue of whether section 14 can be used by banks (who are legally entitled to pursue remedy under the SARFAESI Act) to contend that the time spent in the prior SARFAESI proceedings should be allowed to be excluded while calculating the period of limitation, remains open.

It is also imperative to see that in the judgments in *Ishrat Ali, Babulal Vardharji* discussed above, the courts have extensively discussed the issue of classifying SARFAESI proceedings as ‘civil proceedings’, however, the discourse concerning the applicability of section 14 to exclude the time period exhausted in pursuing remedy before the DRT in terms of the SARFAESI Act is conspicuously absent.

The same will not be unprecedented. Whether pendency of a prior litigation before a prior forum can reset the limitation was answered by the NCLAT in *Basab Biraja Paul*.⁴⁵ The appellants herein had claimed that the debt is time-barred and proceedings before the DRT would not save the limitation. In this case, a loan was given in 2012 and the account of the appellant was classified as a NPA in March, 2013. The appellant argued that section 14, of the Act, (given above), only saves the period of limitation when former proceedings suffer from some defect, for instance, defect of jurisdiction. The same allows exclusion of time-lapsed when proceedings in a wrong jurisdiction are undertaken. The appellant submitted that the provision under section 14 of the Act does not apply when the law contemplates two proceedings on the same cause of action, and both are proper. In such a case, it was argued that the proceeding before the DRT being valid could not be excluded from the purview of calculating limitation for filing cases under the IBC.

It is to be noted that while the proceedings before the DRT were pending, the creditor issued a notice in August, 2016 under section 13(2), SARFAESI Act for the alleged default and called for

repayments. The appellant in March, 2018 had even offered an OTS to the creditor.

The NCLAT repelled the arguments of the appellant and in categorical terms held:

12. The financial creditor had moved DRT in 2014 which was a relief available at that time. We do not agree with the argument of the Appellants that section 14 of Limitation permits exclusion of time of proceedings bona fide in a court when the court was without jurisdiction, and so pursuing relief in proper court will not be helpful. It would be strange to say that if you prosecute relief in wrong court, it would save limitation but if you prosecute relief in right court, you cannot resort to additional relief which becomes available later. In our view, when the financial creditor was pursuing its remedies in proper forum, there was continuous cause of action existing and it cannot be said that the debt became time barred. The IBC was enforced in 2016 and the additional remedy became available. Financial Creditor resorted additionally to it and the Application was filed under section 7. It could not be said to be time barred.⁴⁶

[Emphasis added]

However, the ruling of the SC in *Gaurav Hargovindbhai Dave*⁴⁷ renders this defense to a nugatory. In this case, the respondent-debtor was declared as an NPA in 2011 and the creditor bank on account of the same initiated proceedings under the SARFAESI Act in 2012. The DRT dismissed the application of the creditor in 2016; however, the HC remanded the matter back. During that time, the creditor bank-initiated action under the IBC and the NCLT applied the limitation law pertaining to the mortgaged properties that allowed for 12 years’ time-limit and held that the application under section 7 is maintainable. The SC, however, held that it is only Article 137 that is applicable, and, negating any prior litigation as well as the fact that the creditors were duly pursuing all the remedies that were available to them, held that the application is time-barred.

It is submitted that the reasoning of the SC completely loses sight of the object of the law of limitation, which is aptly encapsulated by the following observations of the SC in one of its ruling:

...[t]he, principle which forms the basis of this rule is expressed in the *maxim vigilantibus, non dormientibus, jura subveniunt* (the laws give help to those who are watchful and not to those who sleep). Therefore, the object of the statutes of limitations is to compel a person to exercise his right of action within a reasonable time as also to discourage and suppress stale, fake or fraudulent claims...⁴⁸

It is submitted that the discourse of the SC on IBC and the applicability of limitation law need to cater to the above objective, and the fact that pending litigations have been negated in *Gaurav Hargovindbhai Dave*⁴⁹ in counting the limitation period seems to do exactly the opposite.

The ruling by the Apex Court in *Sesh Nath* however marks a fresh life to the relevancy of pending or past litigation duly undertaken by a creditor based on the available legal remedies available to it at that time.

CONCLUSION

Initially, when the IBC was stated to be a ‘complete Code’ in itself, reference to the Act seemed incongruous. While insertion of section 238A and rulings of the Apex Court in *B.K. Educational*

*Services*⁵⁰ and *Vashdeo R. Bhojwani*⁵¹ settled the issue of calculating limitation applicable to an application seeking initiation of resolution process by referring to Article 137 of the Act, a hyper technical and narrow view hindered the application of other relevant provisions of the Act.

The law of Limitation seeks to enforce the principle *vigilantibus, non dormientibus, jura subveniunt*, i.e., the laws give help to those who are watchful and not to those who sleep. The defenses and exclusions in the Act under sections 5, 14, 18 and 19, amongst others are precisely to prevent any rigorous application of the Limitation Law that may ironically end up circumventing the principle mentioned.

The Apex Court while reiterating the applicability of the Act to the applications seeking initiation of resolution process under the IBC has set out the interpretative standards for future references. The missed opportunities of *Babulal Vardharji* which was subsequently followed by the tribunals, and the HCs now stand settled conclusively by the ruling in *Laxmi Pat*. Similarly, the erroneous determination by the NCLAT in *V. Padmakumar* of the limitation issues concerning the acknowledgment of debt under section 18 by virtue of entries in balance sheets of a company was equally enigmatic. While correcting this error, the Apex Court reiterated the position settled in *Laxmi Pat*, putting a conclusive end to the issue of the application of section 18 of the Act to the applications seeking initiation of resolution process under the IBC.

Similarly, the reasoning of Apex Court in *Laxmi Pat* and the ruling of the NCLAT in *Rajendra Narottamdas* show the way ahead for the application of section 19 of the Act to the applications seeking initiation of CIRP under the IBC.

It is equally worthwhile to note that *Sesh Nath* was the need of the hour to decide on the ambiguities caused by the NCLAT ruling in *Ishrat Ali*. While *Ishrat Ali* had held that proceedings under the SARFAESI Act do not constitute ‘civil proceeding’ to attract the application of section 14 of the Act to the applications seeking initiation of resolution process, the Apex Court in *Sesh Nath* categorically corrected the error in *Ishrat Ali* and settled that the proceedings under the SARFAESI Act constitute civil proceedings. However, the considerable findings in *Sesh Nath* like the earlier judgments of NCLAT, the Apex Court missed the opportunity to decide on the jurisprudence of ‘wrong forum’ and whether time taken in pursuing legal remedy before a valid and proper forum (be it a civil court or a DRT under the SARFAESI Act) will also be excluded from the calculation of limitation time period in terms of section 14 of the Act.

Undoubtedly, the jurisprudence on the relation between the Act and the IBC will continue to evolve in the future, and we will see a variety of interpretations and understandings and for that, the reasoning in *Sesh Nath* would be certainly instructive. Many such issues require to be dealt with on a case-to-case basis without curtailing the scope of the investigation or preliminary inquiry. The surging clarity on long unsettled issues bodes well for the seamless and consistent application of the law in the adjudication of applications under the IBC.

NOTES

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² *Radha Exports (India) Pvt. Limited v. Respondent: K.P. Jayaram and Ors.*, Civil Appeal No. 7474 of 2019, Decided on: 28.08.2020, para 36.

³ *B.K. Educational Services (P) Ltd. v. Parag Gupta and Associates*, (2019) 11 SCC 633: (2018) 5 SCC (Civ) 528.

⁴ *Vashdeo R. Bhojwani v. Abhyudaya Coop. Bank Ltd.* (2019), 9 SCC 158: (2019) 4 SCC (Civ) 308.

⁵ *Bombay Dyeing & Mfg. Co. Ltd. v. State of Bombay*, 1958 SCR 1122; *Bhimsen Gupta v. Bishwanath Prasad Gupta*, (2004), 4 SCC 95.

⁶ *GupShup Technology India (P) Ltd. v. Interpid Online Retail (P) Ltd.*, 2019, SCC 1015; *Prowess International (P) Ltd. v. Shyam Steel Industries Ltd.*, 2018 SCC 937; *Jord Engineers India Ltd. v. Valia & Co.*, 2018 SCC 925; *Fernas Construction India (P) Ltd. v. RVR Projects (P) Ltd.*, 2018 SCC 459; *O.A.A Ananthapadmanaban Chettiar v. Sri Mahalakshmi Textiles*, 2018 SCC 722; *Marg Ltd. v. Tata Capital Financial Services Ltd.*, Company Appeal (AT) (Insolvency) No. 219 of 2018, order dated September 25, 2018 (NCLAT); *Brijesh Kumar Agarwal v. Punjab National Bank*, 2018 SCC 305; *Black Pearl Hotels (P) Ltd. v. Planet M Retail Ltd.*, 2017 SCC 294.

⁷ *Sumit Aggarwal v. Silvertoan Papers Ltd.*, 2019 SCC 596.

⁸ *T. Johnson v. Phoenix ARC (P) Ltd.*, 2019 SCC 244.

⁹ *Good Luck Traders v. Valley Iron & Steel Co. Ltd.*, 2019 SCC 953.

¹⁰ *Neha Himatsingka v. Himatsingka Resorts (P) Ltd.*, 2018 SCC 784.

¹¹ *Shashi Mohan Garg v. International Asset Reconstruction Co. (P) Ltd.*, 2019 SCC 316; *Om Prakash Pandey v. SBI*, 2019 SCC 1243.

¹² *Agarwal Coal Corpn. Ltd. v. Shriram Cement Ltd.*, 2019 SCC 33.

¹³ *V. Padmakumar v. Stressed Assets Stabilisation Fund (SASF) & Anr.*, Company Appeal (AT) (Insolvency) No. 57 of 2020.

¹⁴ *Sesh Nath Singh & Anr. v. Baidyabati Sheoraphuli Co-Operative Bank Ltd.*, Civil Appeal No. 9198 of 2019.

¹⁵ *Laxmiratan Cotton Mills v. Aluminium Corporation of India*, AIR 1971 SC 1482: (1971) 1 SCC 67; *Laxmi Pat Surana v. Union Bank of India and Ors.*, Civil Appeal No. 2734 of 2020.

¹⁶ *Shalini Publicity Creative (P) Ltd. v. Dena Bank*, 2019 SCC 91, para 7.

¹⁷ *Laxmi Pat Surana v. Union Bank of India and Ors.*, Civil Appeal No. 2734 of 2020.

¹⁸ *Valliamma Champaka Pillai v. Sivathanu Pillai*, (1979) 4 SCC 429.

¹⁹ *Babulal Vardharji Gurjar v. Veer Gurjar Aluminium Industries Co. (P) Ltd.*, Company Appeal (AT) (Insolvency) No. 549 of 2018.

²⁰ *Babulal Vardharji Gurjar v. Veer Gurjar Aluminium Industries Pvt. Ltd. and Anr.*, 2020 SCC OnLine SC 647.

²¹ *Ibid*, para 11. [Additions Made]

²² *Ibid*, para 33.

²³ *Ibid*.

²⁴ *Lampex Electronics Limited v. AMI Tech (India) Private Limited*, C.P. No. 1810/IBC/MB/2018.

²⁵ *Gouri Shankar Chatterjee v. State Bank of India*, C.O. 1257 of 2020.

²⁶ *Ibid*.

²⁷ *Asset Reconstruction Company (India) Limited v. Bishal Jaiswal and Anr.*, Civil Appeal No 323 of 2021.

²⁸ *Rajendra Narottamdas Sheth and Ors. v. Chandra Prakash Jain and Ors.*, (2021) 164 SCL, p. 8.

²⁹ *Ibid*, p.3.

³⁰ *Ibid*, p. 4.

³¹ *Ibid*, p.8.

³² *Ibid*, pp. 24-27.

³³ *Supra* Note 14

³⁴ *Supra* Note 17

³⁵ *Asset Reconstruction Company (India) Limited v. Bishal Jaiswal and Anr.*, Civil Appeal No 323 of 2021.

³⁶ *Supra* Note 13

³⁷ *Asset Reconstruction Company (India) Limited v. Bishal Jaiswal and Anr.*, Civil Appeal No 323 of 2021, paras 16 and 22.

³⁸ *Supra* Note 14, paras 67 and 68.

³⁹ *Supra* Note 34

⁴⁰ *Supra* Note 13, paras 7 and 8.

⁴¹ *Supra* Note 14

⁴² *Ishrat Ali v. Cosmos Cooperative Bank*, 2020 SCC 843.

⁴³ *Supra* Note 14

⁴⁴ *Pandurang Ganpati Chaugule v. Vishwasrao Patil Murgud Sahakari Bank Limited*, (2020) 9 SCC 215.

⁴⁵ *Basab Biraja Paul v. Edelweiss Asset Reconstruction Co. Ltd.*, 2019 SCC 472.

⁴⁶ *Ibid*, para 12.

⁴⁷ *Gaurav Hargovindbhai Dave v. Asset Reconstruction Company*, (2019) 10 SCC 572.

⁴⁸ *Bharat Barrel & Drum Mfg. Co. Ltd. v. ESI Corpn.*, (1971) 2 SCC 860.

⁴⁹ *Supra* Note 47

⁵⁰ *Supra* Note 3

⁵¹ *Supra* Note 4

SECTION 29A OF IBC: A KEY FEATURE

Akhil Gupta

There is near unanimity in corporate and banking circles that introduction of the Insolvency and Bankruptcy Code (Code/ IBC) in 2016 was one of the most transformational reforms in India in recent times. The reason is simple. It is common knowledge that in India many promoters of large private companies traditionally believed that they had complete immunity from any action against them because of prevalence of ‘Too big to fail’ syndrome. Even the promoters of smaller private companies were virtually assured of no serious coercive action by lenders as the lenders were reluctant to step in, not having the expertise to manage the companies. The result was that despite large scale and repeated defaults, the promoters were virtually assured of controlling and running the defaulter company eternally. Introduction of IBC suddenly shattered that myth in one fell swoop.

The Code is fairly unambiguous that the erstwhile promoters who had several opportunities of restructuring their debts with banks in terms of framework provided by the Reserve Bank of India (RBI) before their company being admitted under IBC, cannot be made eligible for getting another chance by bidding for the company under IBC process. However, unfortunately, time and again the IBC process has been derailed with attempts on part of some promoters surreptitiously trying to regain control of their company directly or indirectly, by participating in bids under IBC process. What is most unfortunate is that some Courts have been allowing the same, leading to unnecessary litigation and waste of precious time for resolution of such cases. The recent judgement by National Company Law Tribunal (NCLT) in case of Dewan Housing Finance Corporation Limited directing the committee of creditors (CoC) to consider bid of erstwhile promoter even when there were bids from credible bidders is a case in point (However, within days this order was stayed by National Company Law Appellate Tribunal).

I have no doubt that the Courts while allowing promoters’ bids to be considered have the noble intention of protecting the interest of creditors by introducing ‘more competition’. However, with

all due respect, I feel that permitting promoters to be able to bid for their company once it has been admitted in IBC, would seriously jeopardise the transformational change of attitude brought by IBC where promoters know that unless they set their house in order, they will lose the company. It could thus unwittingly derail the discipline that has started to show in promoter led companies in India and once again bring our country to a stage where the general belief could be that ‘bigger the defaulter, bigger the safety net around him’.

It is also true that many of these cases are victims of genuine business and operating environment and circumstances or regulatory policies. Take companies engaged in telecom services like Aircel, Reliance Telecom or Videocon who were clearly victims of adverse business environment. However, the moot point is that if these promoters have resources to bid in IBC, why could they have not pumped that capital as additional equity in the company and secure a restructuring of debts with creditors – both operational and financial, before letting the company go to NCLT for insolvency. Apparently, the intent would be to try and get full control of the company at lower consideration. This intention by no means deserves any sympathy from our courts.

Under the IBC, a resolution process aims to resurrect a company which has been rendered insolvent for whatever reason. It also provides for ineligibility of promoters to bid for their company in a resolution process under section 29A. Given the fact that he may lose his company forever, the promoters are seen to have been finding means to resist this loss leading to avoidable delays in the process. However, there has not been a single instance where such resistance has ultimately succeeded. Rule of law has ensured that the law takes its own course, and consequently several companies have changed hands through the IBC process.

It is important to point out that the Government has already introduced ‘pre-packs’ insolvency resolution framework for corporate micro small and medium enterprises, where the promoters (other than those charged with fraud) have been mandated to put up a legally binding resolution plan before the commencement of process under IBC. Such proposal would be put to bid as part of IBC process under a ‘Swiss Auction’, with the resolution plan submitted by original bidder (who could be the promoter) acting as the base bid. This is a practical and reasonable approach where:

- (a) genuine promoters could legitimately try and retain control of their distressed companies in a fair and transparent manner;
- (b) the interest of creditors could be protected by maximising their recoveries due to Swiss Auction; and
- (c) The company would get the benefit of protection from new claims for earlier period under IBC, thereby making the business sustainable and viable.

A formal legal adoption of this process for all companies on the verge of being referred to NCLT under IBC would help in saving many distressed companies, their employees, interest of other stakeholders and precious capital invested in such companies.

There is also a general belief and a genuine disappointment among all the supporters of IBC that the speed of resolutions so far has been seriously hampered on account of several promoters of companies admitted in NCLT trying to directly or indirectly stall the proceedings on some pretext or the other. As stated earlier there has so far not been a single case where such interventions have succeeded. However, as the saying goes ‘justice delayed is often justice denied’. This is more so for companies under insolvency which by very nature are invariably gasping for breath when they are admitted in NCLT and who thereby need resolution and new innings urgently. There is thus an urgent need for all stakeholders including the Government, the judiciary, bankers’ associations and the industry associations to confer and find ways of arriving at quick resolutions for cases under IBC.

Two aspects need particular deliberation. One, that the attempts by either promoters or some of the creditors to stall proceedings must be summarily rejected other than in exceptional circumstances. Two, that once the process laid down under IBC in evaluating the bids and their acceptance by CoC are achieved, there should be no further forum to again evaluate whether the accepted bid was ‘fair and equitable’. I feel that with repeated evaluations, while it may be possible to extract a bit more from winning bidders, the consequent delay in resolution may turn out to be the case of ‘operation successful but the patient dead’.

It is thus imperative that appropriate amendments be made to IBC making the erstwhile promoter groups ineligible to bid in IBC process directly or indirectly, removing any ambiguities that may exist in prescribing the process for rules for bids and evaluation thereof in a watertight manner. This is an urgent requirement in the interest of our economy from a long-term perspective.

PROMOTER'S PARADISE LOST

Madhavi Goradia Divan and Sahil Monga

A feudal mindset has characterised corporate culture in India for far too long. Corporate businesses are ever so often, run as personal fiefdoms identified much too closely with the promoter family. Some of the largest Indian companies publicly traded on the stock exchange are treated by promoters as heritable commodities that get passed on from generation to generation with a divine right for sons (sometimes, but seldom daughters) to run.¹

The first and most fundamental principle in company law that students of law are taught is that a corporation is an independent legal entity, separate from its own promoters. Yet in the Indian corporate culture, this distinction has remained blurred. Under the failed legal regime of the past, the promoter family of a company had the right to manage, and even to mismanage without consequences. So even if the promoters ran the company to ruin and took with it the creditors, shareholders and other stakeholders, the promoters remained firmly in the saddle. Notwithstanding a declaration of 'sickness' under the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the promoters remained in charge. Oftentimes, the promoters' continuation in management served as an opportunity for them to siphon away assets and squeeze the company dry, leaving little or nothing for the other stakeholders.

The regime that preceded the enactment of the Insolvency and Bankruptcy Code, 2016 (Code/IBC) included laws such as SICA and Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI). Under those laws, the promoters of the defaulting company continued to remain in control of the company and could drag the process on for years on end, without consequences. With the passage of time, the value of the net worth and assets of sick companies suffered an irreversible depletion.² Allowing defaulting promoters to retain their stranglehold over the management without consequences was tantamount to rewarding them for driving the company to ruin. It was a failed regime because it ended up rewarding mismanagement.

The IBC dealt a huge shock to this well entrenched culture of corporate complacency. Under the IBC regime, once the corporate insolvency resolution process (CIRP) kicks in, creditors acquire control and the promoters are automatically displaced.³ The recommendations of Bankruptcy Law Reform Committee (BLRC) report which form the basis of the IBC, acknowledges; ‘Control of a company is not divine right.—When a firm defaults on its debt, control of the company should shift to the creditors. In the absence of swift and decisive mechanisms for achieving this, management teams and shareholders retain control after default’.⁴

While moving the IBC in the Parliament, Mr. Arun Jaitley, the then Finance Minister, stated on the floor of the House:

One of the differences between your Chapter 11 and this is that in Chapter 11, the debtor continues to be in possession. Here the creditors will be in possession. Now, SICA is being phased out, and I will tell you one of the reasons why SICA didn't function. Under SICA, the predominant experience has been this, and that is why a decision was taken way back in 2002 to repeal SICA when the original Company Law amendments were passed. Now since they were challenged before the Supreme Court, it didn't come into operation. Now, the object behind SICA was revival of sick companies. But not too many revivals took place. But what happened in the process was that a protective wall was created under SICA that once you enter the BIFR, nobody can recover money from you. So, that non-performing investment became more non-performing because the companies were not being revived and the banks were also unable to pursue any demand as far as those sick companies were concerned, and therefore, SICA runs contrary to this whole concept of exit that if a particular management is not in a position to run a company, then instead of the company closing down under this management, a more liquid and a professional management must come and then save this company. That is the whole object. And if nobody can save it, rather than allowing it to be squandered, the assets must be distributed — as the Joint Committee has decided — in accordance with the waterfall mechanism which they have created.⁵

(Emphasis supplied)

The IBC displaces the presumption of feudal entitlement and the ‘divine right to run’ the company. It strikes at the smug complacency of those who treated companies like family *jagirs*. The ousting of the management immediately upon the commencement of the CIRP and the takeover by an Interim Resolution Professional (IRP) was nothing short of revolutionary. The fear of being tossed out of management in a single stroke, it is hoped, will have a long-term deterrent effect. Promoters now know that that they will have to keep the company well managed and default-free if they wish to remain in control. The apprehension of losing control over their companies has prompted promoters to settle or resolve their dues. The spectre of displacement thus engenders a culture of responsible credit behaviour on the part of borrowers.

In one of the early judgments delivered by the Hon’ble Supreme Court (SC) on the IBC, in the matter of *Innoventive Industries Ltd. v. ICICI Bank Ltd.*⁶ the Apex Court noted: ‘...we thought it necessary to deliver a detailed judgment so that all Courts and Tribunals may take notice of a paradigm shift in the law. Entrenched managements are no longer allowed to continue in management if they cannot pay their debts.’

Indeed, CIRP under the IBC proceeds on the fundamental basis that a company’s identity, its interests and destiny are not synonymous with that of its promoters. The steady rule of corporate jurisprudence laid down in the old English case, *Salomon v. A. Salomon and Co. Ltd.*⁷, is that a company is an independent legal personality, and there exists a corporate veil which separates the company from its promoters and shareholders.

The IBC is a unified code, an umbrella legislation that seeks to tie together the disparate strands of the erstwhile insolvency and bankruptcy regime. The avowed object of the IBC is to ‘consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals’. The IBC introduces a new regime not only for corporate insolvency resolution but also for insolvency resolution of individuals and partnership firms. Prior to the enactment of the IBC, corporate insolvency was addressed through the winding up of companies under the Companies Act, 1956 which in turn was substituted by the Companies Act, 2013. Individual insolvency has been governed by the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920. The former is applied to the erstwhile Presidency Towns, namely Kolkata, Mumbai and Chennai, while the latter applies to the rest of India. Even today, most of individual insolvency continues to be governed by those archaic colonial laws.

In order to give the CIRP under the IBC more teeth, it was necessary to ensure that the promoters of corporate debtors (CDs), who stood as personal guarantors (PGs) to the staggering loans that their companies were able to amass, were brought into the insolvency net. While the IBC is a comprehensive regime that takes within its sweep both corporate as well as individual insolvency, apart from that relating to partnership firms, it has been brought into force in staggered stages. In December, 2016, the Government enforced corporate insolvency dealt under Chapter II of Part II of the Code. Over a period of about three years of working the Code the results were extremely encouraging. In *Swiss Ribbons v. Union of India*⁸, the SC upheld the constitutional validity of the IBC. In this landmark judgment, the SC acknowledged the strides made by the Code:

121. We are happy to note that in the working of the Code, the flow of financial resource to the commercial sector in India has increased exponentially as a result of financial debts being repaid. Approximately 3300 cases have been disposed of by the adjudicating authority based on out-of-court settlements between corporate debtors and creditors which themselves involved claims amounting to over INR 1,20,390 crores. Eighty cases have since been resolved by resolution plans being accepted. Of these eighty cases, the liquidation value of sixty-three such cases is INR 29,788.07 crores. However, the amount realised from the resolution process is in the region of INR 60,000 crores, which is over 202% of the liquidation value. As a result of this, Reserve Bank of India has come out with figures which reflect these results. Thus, credit that has been given by banks and financial institutions to the commercial sector (other than food) has jumped up from INR 4952.24 crores in 2016-2017, to INR 9161.09 crores in 2017-2018, and to INR 13,195.20 crores for the first six months of 2018-2019. Equally, credit flow from non-banks has gone up from INR 6819.93 crores in 2016-2017, to INR 4718 crores for the first six months of 2018-2019. Ultimately, the total flow of resources to the commercial sector in India, both bank and non-bank, and domestic and foreign (relatable to the non-food sector) has gone up from a total of INR 14,530.47 crores in 2016-2017, to INR 18,469.25 crores in 2017-2018,

and to INR 18,798.20 crores in the first six months of 2018-2019. These figures show that the experiment conducted in enacting the Code is proving to be largely successful. The defaulter's paradise is lost. In its place, the economy's rightful position has been regained. The result is that all the petitions will now be disposed of in terms of this judgment. There will be no order as to costs.

(Emphasis supplied)

The law on corporate insolvency thus met with considerable success in a relatively short span of time. But that was not enough. It was necessary to invoke insolvency proceedings against PGs to CDs, usually their own promoters on whose strength companies were able to borrow staggering sums of money. The ground reality is that many of the companies that ran aground over the years, have enjoyed huge credit from banks and financial institutions on the strength of the personalities of their promoters. Take these examples. Reliance Communication Ltd. and Reliance Infratel Ltd. obtained loan of ₹ 1,200 crores from the State Bank of India (SBI) on the strength of personal guarantees issued by its high-profile promoter Mr. Anil Ambani. The proportion of the outstanding loans is truly staggering. Among the notorious debtors are Mr. Sanjay Singhal, former promoter of Bhushan Power and Steel Ltd. and his wife Ms. Aarti Singhal who had furnished personal guarantees to the tune of ₹ 24,550 crores to facilitate loans from a consortium bank led by the SBI. Punj Lloyd's promoter, Mr. Atul Punj made a personal guarantee for a loan of ₹ 3,000 crores extended by the SBI to his construction company.⁹ In the case of Amtek Auto, there were dues of over ₹ 12,000 crores guaranteed by the company's former promoter Mr. Arvind Dham.¹⁰ Mr. Naresh Goyal stood PG for a loan of ₹ 11,261 crores to Jet Airways.¹¹ Mr. Kapil Wadhwan executed personal guarantees for a ₹ 85,000 crore loan to Dewan Housing Finance Limited (DHFL).¹² Mr. Venugopal Dhoot made personal guarantees for a ₹ 90,000 crore loan to the Videocon group.¹³ Mr. Sabbineni Surendra, stood PG for a loan of ₹ 2,130 crores to Hyderabad Coastal Projects.¹⁴ Mr. E Sudhir Reddy, Managing Director of Iragavarapu Venkata Reddy Construction Limited (IVRCL), an infrastructure company based out of Hyderabad, gave a personal guarantee for a ₹ 1,250 crore loan to IVRCL.¹⁵ In December 2020, the Central Bureau of Investigation (CBI) booked *inter alia* Mr. E. Sudhir Reddy for an alleged fraud of worth over ₹ 4,800 crores against a consortium of banks.¹⁶ For the law to have real teeth, it was necessary to bring defaulting promoters who acted as PGs into the dragnet.

The Government took steps in that direction by singling out a sub-category of individuals, namely PGs to CDs and bring into force, the insolvency regime that would apply to them. PGs to CDs are a special class of individuals to whom the IBC applies. From the very inception of the Code, Parliament was cognisant of the obvious link between insolvency resolution relating to CDs and its guarantors.

Section 60 of the IBC specifically provides for a synchronous resolution of CD's insolvency with that of its PGs before the Adjudicating Authority (AA). The ruling of the SC in *Embassy Property Developments Pvt. Ltd. v. State of Karnataka & Others*¹⁷, recognises the direct co-relation between

these two facets of insolvency resolution and the importance of a simultaneous and synchronised resolution. Analysing the interplay between section 5(22) (which defines the term 'personal guarantor'), section 60 and section 179 of the Code, the SC emphasised the object of coordinated insolvency resolution of a CD and its PGs before a single forum. The court observed:

33. Sub-section (4) of Section 60 of the IBC, 2016 states that the NCLT will have all the powers of the DRT as contemplated under Part III of the Code for the purposes of sub-section (2). Sub-section (2) deals with a situation where the insolvency resolution or liquidation or bankruptcy of a corporate guarantor or personal guarantor of a corporate debtor is taken up, when CIRP or liquidation proceeding of such a corporate debtor is already pending before NCLT. The object of sub-section (2) is to group together (A) the CIRP or liquidation proceeding of a corporate debtor, and (B) the insolvency resolution or liquidation or bankruptcy of a corporate guarantor or personal guarantor of the very same corporate debtor, so that a single forum may deal with both. This is to ensure that the CIRP of a corporate debtor and the insolvency resolution of the individual guarantors of the very same corporate debtor do not proceed on different tracks, before different fora, leading to conflict of interests, situations or decisions.

34. If the object of sub-section (2) of Section 60 is to ensure that the insolvency resolutions of the corporate debtor and its guarantors are dealt with together, then the question that arises is as to why there should be a reference to the powers of the DRT in sub-section (4). The answer to this question is to be found in Section 179 of the IBC, 2016. Under Section 179(1), it is the DRT which is the adjudicating authority in relation to insolvency matters of individuals and firms. This is in contrast to Section 60(1) which names the NCLT as the adjudicating authority in relation to insolvency resolution and liquidation of corporate persons including corporate debtors and personal guarantors. The expression "personal guarantor" is defined in Section 5(22) to mean an individual who is the surety in a contract of guarantee to a corporate debtor. Therefore the object of sub-section (2) of Section 60 is to avoid any confusion that may arise on account of Section 179(1) and to ensure that whenever a CIRP is initiated against a corporate debtor, NCLT will be the adjudicating authority not only in respect of such corporate debtor but also in respect of the individual who stood as surety to such corporate debtor, notwithstanding the naming of the DRT under Section 179(1) as the adjudicating authority for the insolvency resolution of individuals. This is also why sub-section (2) of Section 60 uses the phrase "notwithstanding anything to the contrary contained in this Code".

(Emphasis supplied)

The provisions of section 60 of the Code indicate that PGs to CDs were always treated as a distinct class of individuals from other individuals. As far back as November 23, 2017, an amendment was carried out to section 2 of the IBC, carving out a separate category of individuals who were governed by the Code *viz.* 'personal guarantors to corporate debtors'. Individual insolvency is addressed in Part III of the Code while corporate insolvency is addressed under Part II. Given the obvious correlation between insolvency of CD and its PGs, the Parliament segregated 'PGs to CDs' from the other categories of individuals.¹⁸ This enabled the freeing up of PGs to CDs from the rest of individual insolvency which was not yet ready for a complete roll out. The original intent of Parliament, as borne out by section 60, was always clear- that these matters have to be dealt with together and in a coordinated fashion.

On November 15, 2019, the Ministry of Corporate Affairs (MCA) issued a notification (November, 2019 Notification) under section 1(3) of the IBC, enforcing the provisions of the Code in so far as they relate to PGs to CDs. This was followed by a circular that was issued by the Ministry of Finance (MoF) directing public sector undertakings (PSUs) to invoke the personal guarantees issued by promoters/managerial personnel of corporates.¹⁹

Curiously, despite these enormously empowering developments, weaponising public sector banks reeling under deep debts against PGs, there was relative inertia on the ground. It took a public interest litigation to propel banks and financial institutions into action. In *Saurabh Jain v. Union of India*²⁰, the public interest petitioner alleged that despite the circular issued by the MoF, the public sector creditors were dragging their feet resulting in staggering losses to the public exchequer and the common citizenry. The SC by its order dated July 20, 2020²¹ permitted the petitioner to withdraw the petition and approach the MoF with a representation in this behalf.

Once the issue gained attention, public sector banks were propelled into action. Personal guarantees began to be invoked across the country. The SBI alone served demand notices aggregating to more than ₹ 39,000 crores to individuals who had signed as guarantors for credit provided to corporate entities.²²

The writing was on the wall. It was becoming harder for the PGs to now escape the noose. Around this time, an unknown PG, one Mr. Lalit Kumar Jain, filed a writ petition in the Delhi High Court²³, challenging among other provisions, the constitutional validity of the Government of India's November, 2019 notification, bringing into force the provisions relating to PGs to CDs. No sooner had the petition been filed that the Delhi High Court issued a stay order²⁴ which prevented insolvency proceedings from going ahead. Lo and behold, that order was followed by a spate of new petitions. The second petition was filed by the high-profile, Mr. Anil Ambani against whom the SBI had a claim of ₹ 1,707 crore. The stay order was replicated in his case²⁵ and in other cases that followed. It became obvious that if the stalemate continued, the CIRP would lose the momentum it deserved.

In the meantime, similar writ petitions sprang up elsewhere in the country in different High Courts (HCs), including the HCs in Delhi, Telangana and Madhya Pradesh. It became clear that these petitions would take their own time to be decided in these different HCs. The outcomes which might vary from HC to HC would then be challenged before the SC. In all likelihood, the process was likely to take a few years and thus the Government's attempt to further empower and energise the process of CIRP by bringing PGs into the net, would be on indefinite hold. It was in these circumstances that the Insolvency Bankruptcy Board of India (IBBI), the regulator under the IBC took the step of moving the SC, seeking transfer of these multiple petitions which were pending in different HCs across the country to the SC.²⁶ The IBBI's case was that if the law of CIRP was to be taken to its logical conclusion, it was necessary to delink the insolvency resolution process relating to PGs to CDs from the larger category of individuals under individual insolvency under Part III of the Code and allow insolvency relating to PGs to CDs to proceed alongside CIRP. The transfer petitions were allowed in October, 2020²⁷ and this achieved an expeditious hearing of the constitutional challenge

to the enforcement of the insolvency law relating to PGs to CDs. The indefinite delay that might have resulted from the pendency of cases in multiple HCs was thus averted.

The primary grievance of the petitioners in the batch of writ petitions challenging *inter alia*, the validity of the notification bringing the law relating to PGs to CDs into force, was that the Government could not have singled out one category of individuals, namely PGs to CDs and brought into effect the Code to cover them alone. In other words, it was the contention of the petitioners that section 1(3) of the Code which empowers the Central Government to appoint different dates to bring into force different provisions of the Code, did not empower the Government to split up individual insolvency by enforcing the Code in an allegedly piecemeal manner. That is to say, either the provisions be enforced to apply to all 'individuals and partnership firms' as envisaged under Part III of the Code or to none. In *Lalit Kumar Jain v. Union of India*²⁸, the SC emphatically rejected that contention, recognising that the Parliament had made its intentions very clear when it provided under section 60 of the Code that the insolvency regime relating to CDs and their PGs must be resolved harmoniously and before the same forum. The court also noted that the Code had been brought into effect in stages, and there was therefore no impediment in bringing into force only one segment of Part III. The court held:

123. It is clear from the above analysis that Parliamentary intent was to treat personal guarantors differently from other categories of individuals. The intimate connection between such individuals and corporate entities to whom they stood guarantee, as well as the possibility of two separate processes being carried on in different forums, with its attendant uncertain outcomes, led to carving out personal guarantors as a separate species of individuals, for whom the Adjudicating authority was common with the corporate debtor to whom they had stood guarantee. The fact that the *process of insolvency* in Part III is to be applied to individuals, whereas the process in relation to corporate debtors, set out in Part II is to be applied to such corporate persons, does not lead to incongruity. On the other hand, there appear to be sound reasons why the forum for adjudicating insolvency processes - the provisions of which are disparate-is to be common, i.e. through the NCLT. As was emphasized during the hearing, the NCLT would be able to consider the whole picture, as it were, about the nature of the assets available, either during the corporate debtor's insolvency process, or even later; this would facilitate the CoC in framing realistic plans, keeping in mind the prospect of realizing some part of the creditors' dues from personal guarantors.

(Emphasis supplied)

The ruling is a very significant one, for many reasons. It is a shot in the arm for creditors who can now move for insolvency resolution against PGs. Often times, in the CIRP, banks and financial institutions have to take substantial haircuts in the interests of expeditious insolvency resolution. The knowledge that they can now invoke insolvency resolution proceedings against PGs, for the remainder amount after haircut in the CIRP, will enable them to take quick and decisive decisions. From the standpoint of PGs too, it may help them resolve matters in a synchronous manner once and for all along with the resolution process of the companies which they once ran, rather than have the sword of insolvency dangling over their heads indefinitely. The ruling thus paves the way for the opportunity for quick and coordinated settlements with promoters.

The enforcement of provisions under the Code relating to PGs to CDs marks a significant change in the general law relating to guarantees. Under section 128 of the Indian Contract Act, 1872 (Contract Act) the liability of a guarantor under an independent contract of guarantee runs co-extensively with the liability of the principal debtor. Under section 133 of the Contract Act, any variance in the terms of the contract between the principal debtor and the creditor has the effect of discharging the guarantor as to transactions subsequent to such variance, if it was made without the guarantor's consent. Under section 31 of the Code, once the resolution plan is approved by the AA, it becomes binding on all the stakeholders including the CD and the guarantor. One of the grounds of challenge in the writ petitions before the SC was that a resolution under section 31 of the Code, amounts to a variance in the terms of the contract between the debtor and the creditor and therefore has the effect of altogether absolving the PGs to the CD. However, this issue had already been resolved by the SC in a previous case, *SBI v. V. Ramakrishna*²⁹ where the SC held that once the AA was satisfied that a resolution plan, duly approved by the committee of creditors (CoC), met the requirements of the law and took effect, it binds all stakeholders including the guarantors. The Apex Court held that section 31(1) makes it clear that the guarantor cannot escape payment as the resolution plan, which has been approved, may well include provisions as to payments to be made by such guarantor.

Another issue of significance relating to the rights and liabilities of a PG to a CD came up for consideration before the SC in the matter of *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta & Others*.³⁰ The issue pertained to the availability of a right to recover with a PG from its CD upon successful resolution of the CD's insolvency.

The liability of a PG to repay the debt of a principal debtor arises out of an independent contract of guarantee. A guarantor is co-extensively liable with the principal debtor under section 128 of the Contract Act. Under section 140 of the Contract Act, when a PG pays any amount towards the outstanding liability to the creditor, he steps into the shoes of the creditor and he is invested with a right of subrogation, that is to say all the rights which the creditor had against the principal debtor are now vested in him, including the right to make recoveries. However, upon successful insolvency resolution of a CD under the Code, the right of subrogation may not be available to its guarantors. The rationale is simple. If guarantors were permitted to initiate or pursue recovery proceedings against the successful resolution applicant (RA) after its resolution plan is approved or implemented, it would disrupt the resolution and have the effect of warding off potential RAs. Unless RAs are assured of being able to run the business after resolution without the spectre of claimants from the past, there would be no takers who come forward to rescue the ailing CD. This would jeopardise the prospects of resolution for the CD, relegating it inexorably towards liquidation. Such an outcome runs contrary to the very object of the Code which is to rescue and revive ailing companies.

In *Committee of Creditors of Essar Steel India Limited* case, the SC clarified that a successful RA cannot suddenly be faced with 'undecided' claims after the resolution plan has been accepted as this would throw into uncertainty amounts payable by the successful RA. In *Lalit Kumar Jain* too, the court acknowledged that resolution under the insolvency process will not absolve the guarantor. It held:

136. In view of the above discussion, it is held that approval of a resolution plan does not *ipso facto* discharge a personal guarantor (of a corporate debtor) of her or his liabilities under the contract of guarantee. As held by this court, the release or discharge of a principal borrower from the debt owed by it to its creditor, by an involuntary process, i.e. by operation of law, or due to liquidation or insolvency proceeding, does not absolve the surety/guarantor of his or her liability, which arises out of an independent contract.

While guarantors may complain that when they executed their guarantees they did not bargain for the consequences under the Code, the ruling ushers in a new and much needed accountability from guarantors, usually promoters of CDs. No longer will their personal wealth be beyond the reach of banks. Indeed, the debtor's and the promoter's paradise is lost.

NOTES

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¹⁹ *Saurabh Jain & Anr. v. Union of India & Ors.*, W.P.(C)No. 679/2020.

²⁰ *Ibid.*

²¹ *Ibid.*

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²³ *Lalit Kumar Jain v. Union of India, Ministry of Law and Justice & Others*, W.P. (C) No. 4849/2020.

²⁴ *Ibid.*

²⁵ *Anil Dhirajlal Ambani v. State Bank of India & Others*, W.P. (C) No. 5712 of 2020.

²⁶ Disclosure: the author appeared for the IBBI in the transfer petitions before the Supreme Court.

²⁷ *Insolvency and Bankruptcy Board of India v. Lalit Kumar Jain and Others*, (2020) 10 SCC 703.

²⁸ (2021) SCC Online SC 396.

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PART III QUEST FOR EXCELLENCE

PROMOTING COMMON GOOD AMIDST ANTI-COMMON BEHAVIOUR OF STAKEHOLDERS: ROLE OF COMMITTEE OF CREDITORS

Sudhaker Shukla and Kokila Jayaram

‘Treating the limited assets of the insolvent debtor as a common pool problem is often used to explain the need for and raison d’être of insolvency law. The second theory is the less well known theory of anticommons. Anticommons can arise in situations where there is a joint good or resource, to which several parties have a legal interest and the parties have it within their power to effectively block the use by others.’

Dr. R. J. de Weijts¹

COLLECTIVE ACTION AND THE IDEA OF COMMONS

The idea of commons originated with an essay written by British economist William Forster Lloyd in 1833, where he discussed an example of the effects of overgrazing on common land in Britain followed by the Garrett Hardin’s 1968 study - ‘Tragedy of the commons’.² The word and the idea became the starting point for understanding the issues; and to find solutions to degradation of natural resources and the environment. It was after this that the word ‘commons’ came to refer ‘common pool resources’ and ‘common property’. The global goal of ‘sustainable

development' owes its genesis to this idea. It led to the study of human behaviour under socio-economic and political settings, collectively failing in fostering the objectives of common good.

People work together while they deal with the different kinds of commons. They work towards a common goal or objective to solve a common problem. Just like in sharing a resource, issues arise in working collectively. Collective action became the point of convergence. Research on breaking down the workings of collective action includes the development of theoretical explanations, experiments, real world empirical studies and the construction of dilemma's emerging from game theory. The new institutional economics approach to study collective action has been predominantly used to better understand the underlying principles and applications.

The role of law, rules and norms in dealing with problems of heterogeneous nature, was recognised and so evolved the idea of 'institutions' under the new institutional economics school of thought. The framework of commons was subsequently extended to deal with urban commons and knowledge commons. In the present-day, access to information, distribution and ownership of informational resources and technology are considered as digital commons. This emerging area further traverses financial commons and the application of commons to businesses and business ethics as well. Fournier, 2013³ explores the idea of commons as a social process of organisation and production under the aegis of a capitalist system, to address the failure of markets and states with the increasing 'commodification' and 'enclosure' of goods and services. The study extends the idea to processes of organising 'for the commons' and 'of the commons' building on the earlier studies of organising 'in commons'. While suggesting that the relationship between commons and capitalism remains ambivalent, the study emphasises that capitalism's dependence on the commons may become even more pronounced as it falls into ever deeper ecological and economic crises.

The field of commons and collective action has extended itself to several domains of economics, sociology, behavioural sciences, and business. The predominant approach of study, however, remains the institutions approach, developed from and for the sustainable use of common pool resources as designed and developed in Ostrom (1990)⁴ and built upon by several others since then.

The study of common pool resources and application of the collective action principle for successful and sustainable management of resources has been ongoing since the 1970s. The organisation of collective action in areas of irrigation water management, forest produce collection and development of forestry has been practiced in India traditionally and has been co-opted into Government schemes and programmes. Extensive research is available in these areas of policy making analysing the application and impact of collective action. Application of collective action has been attempted in domains of finance and credit since the decade of 1990. The hugely successful self-help group movement and the associated micro-finance system was built on collective action among women at the grassroots. This system has expanded financial inclusion in the country and has helped participating women/families to improve their incomes, financial position and overall well-being.

This paper is an attempt to understand the working of collective action in the insolvency domain. Consequent to this introductory section the paper is organised into three sections: (i) earlier attempts

at collective action for resolution of stress; (ii) collective action in the insolvency space, which includes the application of collective action design principles to the mechanism in the Insolvency and Bankruptcy Code, 2016 (Code/IBC), and (iii) the actual working of collective action mechanism under the Code.

EARLIER ATTEMPTS FOR RESOLUTION OF STRESS AND THE USE OF COLLECTIVE ACTION

The Reserve Bank of India (RBI) has made several efforts to create a functional stress resolution process. The RBI's regulatory approach has evolved over time and has been a 'carrot and stick approach which has ensured that the borrowers have maintained their skin in the game' (FSR, 2017)⁵.

The corporate debt restructuring scheme introduced in 2001, brought together lenders to deal with stress instead of acting unilaterally. It was made available for assets under consortium-based and multiple-lending arrangements. It also included common legal documentation and a voting process to ensure collective action. It provided 180 days for completion of a restructuring process. Subsequently, the Framework for Revitalising Distressed Assets in the Economy was laid down in January, 2014 with the objective of addressing coordination problems in large, consortium accounts, and envisaged constitution of the Joint Lenders' Forum (JLF). Bankers had the option to form a JLF where there is any interest/principal overdue from a debtor in cases where they desire. Setting up the JLF was mandatory in accounts with more than ₹ 100 crore in aggregate exposure. The JLF was empowered to follow a corrective action plan, which included a three-step sequential process—rectification, restructuring and recovery. A key constraint of this framework was that the dissenting creditor's exception hampered the restructuring process. Inherent agency and incentive failure issues constrained the JLFs from achieving the very objective for which they were envisioned for.

The RBI then introduced the Strategic Debt Restructuring (SDR), which permitted lenders to require change in ownership or management. However, the SDR did not bring expected results as there were a very few stakeholders to subsequently take over such companies from banks (FSR, 2017)⁶. Subsequently, the RBI introduced the Scheme for Sustainable Structuring of Stressed Assets (S4A) to deal with debts more than ₹ 500 crore that may need deep restructuring. The S4A guideline also gave the JLF option to reduce equity of promoters and change the management to a third party. All these efforts build on each other but included the fundamental principle where all the lenders worked together. The JLF is the institutional mechanism that carried forward collective action operationalised through an agreement incorporating the broad rules for functioning of the JLF. Functioning of the JLF was further strengthened in May, 2017 to reduce the anti-common behaviour potentially thwarting common and collective action. The threshold level of approval was reduced to 60 % from the earlier 75 % to enable successful collective action. Dissenting lenders can exit by complying with certain conditions within the stipulated time or adhere to the decision of the JLF, hence allowing a 'cram down'. All participating banks are bound by the decision of the JLF. The RBI has also issued advisories and instructions to smoothen the issues of coordination.

In June, 2019 the RBI introduced the Prudential Framework for Resolution of Stressed Assets (Prudential Framework) giving fresh directions to lenders on the resolution of stressed assets and withdrew all the earlier schemes. The Prudential Framework laid out certain fundamental principles like early recognition and reporting; flexibility to lenders in designing the resolution plan; disincentives for delaying resolution; clear definition of financial difficulty and the signing of inter-creditor agreement (ICA). It aimed at ensuring early resolution of stressed assets in a transparent and timebound manner, with collective action clauses. Unlike earlier schemes, flexibility was given to banks to formulate the ground rules in dealing with borrowers who have exposures with multiple banks and to implement resolution plans that are tailored to internal policies and risk appetites.⁷ It ensured collective action with specific voting thresholds for various decisions including the invocation of resolution plans and put in place measures that will bring in requisite discipline for such collective action by creditors.⁸ The principle of collective action is embedded in the ICA also. The ICA provides the rules for finalisation and implementation of a resolution plan and decisions are made through a voting process in the JLF. The decisions so made are binding on all lenders under the terms of the ICA.

The emphasis on collective action by lenders has increased with every new scheme the RBI introduced. The approach has been to enable cooperation amongst lenders and to strengthen collective action by addressing specific challenges like information asymmetry and reducing anti-commons behaviour.

COLLECTIVE ACTION IN BUSINESS RESTRUCTURING AND INSOLVENCY

Collective action in insolvency

The United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency (UNCITRAL, 2005)⁹ defines ‘Insolvency proceedings: collective proceedings, subject to court supervision, either for reorganization or liquidation’. It goes on to describe it as a ‘legal mechanism to address the collective satisfaction of the outstanding claims from assets (whether tangible or intangible) of the debtor’. We find usage of terms such as ‘collective negotiations’, ‘collective view’, ‘enforcement of the collective rights of creditors’, ‘collective interest of creditors/collective benefit of all creditors’, ‘collective disadvantage of all creditors’, ‘collective aims/collective goals’, ‘collective bargaining’, ‘collective choice’, ‘collective value of assets’ and ‘collective action’. It becomes clear that collective action is core to the spirit and fundamental to the operational aspects of an insolvency regime. The Guide refers to collectivisation in an insolvency proceeding at several levels and to different degrees as a part of the comprehensive insolvency framework it suggests.

Views of the Bankruptcy Law Reform Committee

While considering the problem of assessing viability in an insolvency resolution process the Bankruptcy Law Reform Committee (BLRC)¹⁰ stated that though there is no fixed or unique approach to this, under ideal situations it would be the outcome of a collective decision. It recognised collective mechanism for resolving insolvency as one of the core features of most well-developed bankruptcy and insolvency resolution regimes. It proposed a law ensuring a collective process to assess viability and to establish a negotiation process for creditors. It envisaged a first phase in the resolution process for collective negotiation to rationally assess the viability of the debtor. It aimed to create a framework that incentivised collective action over individual recovery in order to realise higher economic value in the first phase. It emphasised greater flexibility to allow individual action in the subsequent phase of bankruptcy or liquidation while incentivising collective action in the second phase also. The BLRC, however, provided for individual action in the liquidation process and provided a waterfall mechanism for entitlement of stakeholders participating in the collective process. Collectivisation is also enabled through the formation of a liquidation estate which is held in trust by the Liquidator.

Collective action under the Code

From the views of the BLRC it is evident that the insolvency framework it recommended envisaged ‘collective action’ to be its central principle along with ‘resolution’ and ‘value maximisation’. The Code, in its spirit, upholds this principle though the word ‘collective’ is not included in the text of the legislation. The Code puts in place a framework knit together from debt recovery laws and collective action laws (Ravi, 2015)¹¹. The principle of collective action is operationalised through the institution of the committee of creditors (CoC) towards achieving the objective of value maximisation. It holds the life of the corporate debtor (CD) in its hands along with it, the fate of employees and workmen in the company. The satisfaction of dues of the other creditors, those who are not part of the CoC also depends on the CoC. It is obvious that the CoC is required to act in a fair and transparent manner. It is the CoC *Dharma*¹² to maximise value with fairness and balance the interest of non-participating stakeholders as well.

The creditor-in-control approach of the corporate insolvency resolution process (CIRP) while strengthening the creditors’ rights puts the financial creditors (FCs) in a unique position *vis-à-vis* other stakeholders. The FCs are decision makers, the decisions, however, are ought to be made representing interest of all other stakeholders and are not on the basis of their own qualified interests. The Code hence places them in a position of ‘trust’ and hence the power vested in the CoC has to be exercised with caution, reason and fairness. The CoC is a creation of statute (*Numetal Ltd. v. Satish Kumar Gupta & Anr.*)¹³. Its powers and duties are provided in the Code making it a statutory institution and it discharges a public function. It is designed (and expected to act) as a responsible, empowered and accountable institution and shall not be guided by anti-common interests. Anti-common behaviour and such action by members of CoC works against the basic feature of maximisation of value and fostering distributive justice.

The Code clearly details the duties of CoC without ambiguity. Given the complex and dynamic nature of businesses, the role of CoC is a difficult one. However, the Code has empowered the CoC with the services of a capable and trained Resolution Professional (RP) to conduct the process under its guidance. The role of the CoC in helping keep the CD as a going concern and in assessing viability of the business is crucial to the entire insolvency process in search of liquidation remote solutions. The CoC is at a vantage position to decide on meeting the needs of the company to remain as a going concern including raising interim finance. The CoC also decides on what and how expenses are to be made and approve the process cost. It also decides the professional fees for the services of the Insolvency Professional (IP) it chooses to conduct the process. In addition, the CoC makes the decision to retain or replace the IP.

Assessing viability of the business is done by the CoC at two levels; one an *ex-post* analysis of financial position of the debtor's business when the insolvency proceeding is initiated, to understand the reasons for insolvency; and two an *ex-ante* evaluation of the feasibility and viability of a resolution plan in addressing the cause of insolvency and putting the CD back in business in a sustainable manner. Such assessment forms the basis for the identification of criteria that prospective resolution applicants (RAs) have to meet and construction of the evaluation matrix on which resolution plans are evaluated.

The CoC carries out its functions through its meetings and these meetings are a sacred ritual. Recognising the need for sanctity of these meetings the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) provides in detail, the manner in which these have to be conducted.

Ritual of the CoC meetings and voting

The meetings are convened and chaired by the RP in his/her capacity as Interim Resolution Professional (IRP) or RP, as the case may be. The notice period for a meeting is specified at five days, which the CoC can reduce to not less than 24 hours (48 hours if there are a class of creditors). The notice should contain the time, date, and venue of the meeting; and matters to be discussed in the meeting along with all relevant documents should be shared with the participants. The notice should be shared with all its members- the unrelated FCs including the authorised representative of a class of creditors; members of the suspended Board of Directors or Partners of the CD and operational creditors (OCs) or their representatives if their aggregate dues is not less than 10% of the debt. The notice can be shared electronically also. The notice should contain the details of how participants who choose to attend the meeting using electronic/audio and visual means can do so. The notice should also list the agenda items that are required to be voted upon separately. Where participants authorise other persons to attend on their behalf, information regarding the same has to be shared with the RP in advance.

Quorum of at least 33% of the voting rights are present either in person or by video conferencing or other audio and visual means is required for conduct of a meeting. If this is not achieved the meeting

stands adjourned to the same time and place on the next day. The CoC has the power to modify the quorum requirement. The quorum requirement is to be maintained throughout the conduct of the meeting.

The CoC exercises its power of decision making through the process of voting. The Code provides that the thresholds for general decision making in the CoC should not be less than 51%. Instances involving significant actions that impact the working of the CD or the CIRP *inter alia* include raising of interim finance; creating security interest on assets of the CD; change in ownership or capital structure; amend constitutional documents of the CD; change management of the CD or its subsidiary; appointment of statutory auditor or internal auditor and replacement of a RP require a higher threshold of 66%. Where the CoC decides to accept the applicants' request for withdrawal which has the effect of terminating the CIRP midway requires a still higher threshold of 90%. These are statutory requirements to which the CoC is bound.

The solemnity of decisions the CoC is required to make warrants the process of voting be done in a manner that is beyond doubt and is uncompromising of the integrity of the process. The amount of detailing that the CIRP Regulations provides is a reflection of the importance of the voting process.

Instructions regarding the process and manner of voting are to be communicated as part of the notice. The RP is required to share the decision on all items at the end of the meeting along with voting decisions of the members. Minutes are to be circulated within 48 hours of the meeting. The RP has been tasked with the responsibility to provide secure system for voting through electronic systems. The CIRP Regulations go to the extent of describing the requirements of a secured system of electronic voting in detail. Where the CoC includes an authorised representative for a class of creditors, the CIRP Regulations provides for his working with the creditors and the RP. He participates and votes in the CoC meetings after taking views of the class of creditors and longer time limits to accommodate the voting of creditors in a class.

APPLYING THE DESIGN PRINCIPLES OF COLLECTIVE ACTION TO CoC

Institutions of collective action are extensively discussed in Ostrom (1990)¹⁴ where the design principles for organisation of collective action have been laid down. These principles have since been tested empirically on several common resource regimes and extended to other domains. The eight broad principles are divided into three groups namely, (i) first three principles that provide the structure and working framework; (ii) second set of three principles that deal with efficiency and effectiveness of the collective action institution and (iii) the seventh principle of external agency. The eighth principle is not of significance in the context of Indian jurisdiction as it is relevant in a group insolvency situation where multiple CoCs are functioning for respective entities and one overarching decision-making creditor forum is also provided for. In such situations, there are two or more levels of decision making amongst creditors necessitating the coordination between levels

becoming a relevant consideration. The Code presently does not include provisions for dealing with group insolvency situations and hence this principle does not require further detailing.

Before attempting to apply the principles, certain fundamental differences need to be highlighted. The principles were defined for collective action in the resource regime and focus on regimes that originate in society as a common pool resource sharing system that continues to exist for as long as the resource is in use. The insolvency regime is put in place by legislation. The entire mechanism is a creation of a statute that exists in the context of a specific company undergoing CIRP and exists for the period of the process only.

The membership of the CoC is defined by law, leaving no room for discretion. Similarly, the Code also distinguishes the role of the CoC in the resolution process. It has also empowered the CoC in terms of all significant decisions and provided the assistance of the IP to conduct the process and manage the affairs of the CD. Despite the elaborate regulations in terms of the functioning of the CoC, the Code provides some bounded flexibility for the CoC to manage its workings. The CoC as a collective action institution has the first three principles designed into it by law, providing a clear structure and working framework.

The Code goes a measure forward in providing clear disincentives for anti-commons behaviour. Creditors who have secured rights over the CDs assets are prone to move away from cooperation and take up individual recovery action. Such moves are outlawed as all financial creditors are mandated to participate in the CoC and the moratorium in place under section 14 of the Code protects against all proceedings, suits including recovery measures. Another key design aspect of the Code is that any difference in kind of charge or priority of security interests of creditors in the pre-insolvency period is negated. All secured creditors are accorded the same priority in the waterfall provided under section 53.

For facilitating successful collective action, the Code was amended in 2018 to reduce the threshold for approval of a resolution plan from 75% to 66%. This measure to prevent anti-commons behaviour, in a few instances hasn't yielded desired results. There are instances where the CD is sent to liquidation as even the 66% voting threshold is not met despite the availability of resolution plan(s). The provision of Code under section 30(2) of the Code is expected to provide a shield against any anti-commons behaviour that may defeat the fairness principle for distribution by way of protecting the rights of OCs and dissenting FCs. This protection, oftentimes, acts as an incentive for creditors to dissent and recover the minimum assured payment instead of assenting to a resolution plan on merits. In such instances, creditors are inclined to dissent where the expected realisable value of a proposed resolution plan is closer to the liquidation value of assets, thereby prioritising self-interest over common good. Similarly, in opposite situations, in cases where expected value from resolution plan(s) is much above the liquidation value, on pure consideration of avoiding in landing in the category of dissenting FC, almost all CoC members tend to vote to available resolution plans in affirmation with or without any consideration of merits of eligible plans so received.

CoC is the decision-making body in the CIRP. The Code and the courts have left a wide ambit of commercial and business decisions to the CoC. The RP chairing the meetings of the CoC serves as a means to address coordination issues in the CoC and ensure adherence to objective and timelines of the CIRP. The RP, however, has no monitoring role over the CoC and in fact, he is under the supervision of the CoC. Functioning of the CoC lacks any other mechanism of monitoring. The Code does not provide a mechanism for sanctions against the members of a CoC for any omission or commission. Voting mechanism which is the instrument of decision making is hard wired in law, along with the threshold levels of voting share required for specific decisions. There exists a lacuna in envisaging instances of conflicts within the CoC that stymies the CIRP as also the non-functioning of the CoC. The second set of three principles are apparently deficient in the design of the CoC. This has become evident in the working of the CoC as will be discussed in the next section.

The third set includes the role of external agents, the courts and the regulator – Insolvency and Bankruptcy Board of India (IBBI) in this case. The Code places the Adjudicating Authority (AA) in the role of enforcing the Code and the AA also acts as the conflict resolution mechanism. IBBI has supervisory function over IPs and powers to prosecute contraventions to the Code by stakeholders.

The following table summarises the application of principles to collective action to the insolvency process:

Collective action design Principle	Extended to institution of CoC under the Code
Clearly defined boundaries	Clearly defined role for the creditors provided by law
Congruence between appropriation and provision rules and local conditions	Congruence between the responsibilities and powers of the CoC provided in law and strengthened by the courts
Collective choice arrangements	Internal rule making freedom available with the CoC but put to limited use
Monitoring	Dependent on the courts
Graduated sanctions	
Conflict resolution mechanisms	
Role of external agents	Oversight of the courts and the regulator to a limited extend
Multiple layers of governance	Limited relevance for insolvency resolution process in individual companies. More relevant in group insolvency situations.

WORKING OF THE COLLECTIVE ACTION MECHANISM

The Code places the CoC in control of the insolvency process. The courts have subsequently sanctified the decision-making power of the CoC. CoC's decision with requisite voting share in relation to the resolution plan is sacrosanct. The approved plan as stamped by the court is binding on all stakeholders including the dissenting creditors. The choice of resolution plan has been placed

under the ambit of the ‘commercial wisdom’ of the CoC and is unchallenged. The Hon’ble Supreme Court (SC) reiterated in its judgement in the *K. Sashidhar v. Indian Overseas Bank & Ors.*¹⁵, case held that,

... the commercial wisdom of CoC has been given paramount status without any judicial intervention for ensuring completion of the stated processes within the timelines prescribed... the legislature has consciously not provided any ground to challenge the “commercial wisdom” of the individual financial creditors or their collective decision before the adjudicating authority. That is made non-justiciable.

The courts have reiterated the primacy of the CoC’s commercial wisdom on several occasions and restrained from interfering with its decision or commenting on the plan on merit. The ambit of commercial wisdom *per se* is a matter beyond the scope of this paper. The working of the CoC in fulfilling the objective of the Code and in the exercise of its commercial wisdom has been left wanting.

By end of June 2021, 394 CIRPs ended with approval of resolution plans. These processes took on average 406 days, but this is after the courts have excluded the delays that are excludable. The total time taken, without excluding any delays due to litigation is 459 days. Until end of June 2021, there were 1349 CIRPs in which liquidation was ordered and such orders were issued after 383 days since commencement of CIRP. The Code provides a time-bound process as a means to preserve and maximise value for the creditors. When creditors contribute to the delay in the CIRP, they often work against their own best interests. Being in control, the CoC bears the larger share of responsibility for delays in processes.

The AA, in several instances, pointed out the deficiencies in the decision-making process of the CoC. At times, the representatives of creditors participate in the meetings with no authorisation to make decisions. They are in mere attendance whereas the decisions come from higher hierarchy in their respective institutions. They act as glorified representatives and are not empowered with adequate decision-making powers. This calls into question not only the competence of the participating representatives¹⁶ but also puts question mark on its role as part of the CoC from the perspective of the financial institutions approach. The indecision of the CoC leads to delay in the process militating against the CoC’s sole purpose. The court called such creditors, ‘*speed breakers and roadblocks obviously cause obstacles to achieve the targets of speedy disposal...*’¹⁷

On the other hand, there are instances where the CoC uses its power to take steps that are clearly in violation of the Code and regulations and is detrimental to the collective process of resolution. CoC seems to bear its weight on IPs conducting the CIRP while deciding on the distribution of proceeds, on inclusion of expense as part of the CIRP cost, in attempting to decide the categorisation of creditors etc. The CoC overreaching and clearly working against the need for being unbiased and fair. The National Company Law Appellate Tribunal (NCLAT)¹⁸ observed that,

It is surprising and interesting to note that Members recorded that “despite the Order passed by Hon’ble NCLT Allahabad the CoC is of the view that they no longer wish to continue

M/s BVN Traders in the category of the “Financial Creditor” in the CoC and want to review their decision in this regard.” “No Longer wish”? This is strange. This is the danger due to which collating is not left to CoC..... Thus CoC sat in Appeal over Impugned Order and passed resolutions to the contrary, which cannot be said to be legal.

The CoC have also in several cases acted purely in self-interest. Larger responsibilities of the CoC have been set aside in cases where the creditors approve settlement plan proposed by the promoter who is ineligible to submit a resolution plan under the Code. The AA observed that, ‘*This also raises doubt about the functionality of the CoC. Such an act of CoC can never be treated as an act of commercial wisdom.*’¹⁹ Similarly the NCLAT observed that,

This in itself raises eyebrows. This is further compounded by approval of the Restructuring Plan camouflaged as Resolution Plan emanating from an ineligible person which renders the role of the Committee of Creditors questionable. Such circumstances justify raising of inference of complicity.²⁰

Similarly, the National Company Law Tribunal (NCLT) noted how the CoC has acted beyond its powers by postponing the issue of expression of interest and delaying the CIRP all the while awaiting to settle with the erstwhile promoters on the basis of an uncertain proposal. In strong words it noted, ‘*... thereby CoC in this case has taken Law into its hands and not complied with applicable provisions of I&B Code and CIRP.*’²¹

The courts have reprimanded the FCs for taking their role lightly and has recorded its reprimand. The AA observed that, ‘*.functioning of these three banks prima facie do not adhere to the preamble of IBC..., therefore functioning of these three Banks in resolving bad loans deserves to be scrutinised by the RBI which is the regulatory authority for the Banking Sector.*’²² In another instance, the integrity of the CoC itself is questioned as despite clear conflicts of interests related party creditors are allowed to continue in the committee. The matter had to reach the Apex Court where the creditors finally accepted to act by the fundamental principle of the Code that the creditors have to be unrelated to the company and be free of any conflict of interest while acting as the CoC. The Hon’ble SC observed that, ‘*The objects and purposes of the Code are best served when the CIRP is driven by external creditors, so as ensure that the CoC is not sabotaged by related parties of the corporate debtor*’²³, while disallowing participation of creditors related to the CD in the CoC.

There are also several instances of omissions because the CoC does not take active interest in the process. The decision to raise interim finance is seldom made in favour of the business. It is probably as the creditors are apprehensive of putting more monies in a sinking ship. The CoC by using its power of approving expenses hinders other key activities like the conduct of a transaction order to determine the existence of avoidable transactions and marketing of the stressed assets in the market to enable value maximisation. The omission of the CoC to consider such decisions in favour of the CoC comes at a cost to the CD and value maximisation.

CONCLUSION AND WAY FORWARD

Members of the CoC are FCs and represent banks and other financial institutions. They have been exposed to collective action mechanisms under the earlier frameworks of the RBI. They are not new at this and are now more empowered by the Code and supported by the IP. However, the working of the CoC is found lacking in terms of competence and conduct, thus, adversely affecting outcomes for all stakeholders. The lack of a mechanism for monitoring the functioning of the CoC is apparent and so is the fact that despite having powers to manage its working, the CoC takes no efforts to devise internal mechanisms or timelines to run the process and reach a solution.

Similarly, the effects omissions of the CoC can be rectified only through the courts and any legal process is long drawn. There is no mechanism in the Code or the regulations for sanctioning the misdeeds and negligence of the CoC. The accountability of members in a CoC in their parent institutions is relevant only if the respective institution is made aware of the issues and done so in time. It is required that the accountability of members for their work in the CoC should be provided for in the Code and should be applicable over and above the sanction system of the parent institutions.

Another obvious gap is the absence of a mechanism to resolve any conflicts that arise in the CoC and to rein in the creditors in cases where the one with majority voting share rides rough shod over other minority creditors. The IBBI has opened a dialogue on developing a model code of conduct for the creditors / members of the CoC. It is high time that the sanctified powers of the CoC are balanced with commensurate accountability and responsibility.

As discussed in the earlier sections, the measures brought in to promote collective action need a more nuanced approach in implementation, for collective action to be successful. The present study provides the theoretical precepts for understanding how collective action happens under the Code and identifies concerns in its workings. It is, however, not exhaustive in the instances and circumstances analysed. Though it brings out clearly the deficiencies in design of the CoC as an institution of collective action, it requires to be expanded to include empirical studies and case studies to develop an in-depth understanding of issues and to present solutions.

NOTES

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³ Fournier V. (2013), “Commoning: on the social organisation of the commons”, *M@n@gement*, Vol. 16(4), pp. 433-453.

⁴ Ostrom E. (1990), “Governing the Commons: The Evolution of Institutions for Collective Action”, Cambridge University Press.

⁵ Financial Stability Report, Reserve Bank of India, December, 2017.

⁶ Supra Note 9

⁷ Functions and working of the Reserve Bank of India, Reserve Bank Staff College, November, 2017.

⁸ Statement of Developmental and Regulatory Policies, Reserve Bank of India, August 6, 2020.

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¹⁰ Report of Bankruptcy Law Reforms Committee, Vol. 1, November, 2015.

¹¹ Ravi A. (2015), “The Indian Insolvency Regime in Practice – An Analysis of Insolvency and Debt Recovery Proceedings”, Working Paper, Finance Research Group, Indira Gandhi Institute of Development Research, November, 2015.

¹² IBBI Quarterly Newsletter, April-June, 2018.

¹³ I.A. Nos. 98 and other IAs in C.P. (IB) No. 40 of 2017.

¹⁴ Supra Note 8

¹⁵ Civil Appeal No.10673 of 2018.

¹⁶ *M/s. Jindal Saxena Financial Services Pvt. Ltd. v. M/s Mayfair Capital Private Limited*, (2018), C.A. No. 523 (PB)/2018.

¹⁷ *SBJ Exports & Mfg. Pvt. Ltd. v. BCC Fuba India Ltd.*, (2018), C.P. 659/2016.

¹⁸ *Mr. Rajnish Jain v. Manoj Kumar Singh – IRP & Ors.*, (2020), Company Appeal (AT) (Insolvency) No. 519 of 2020.

¹⁹ *M/s. Andhra Bank v. Sterling Biotech Ltd. & Ors.*, (2020), M.A. No. 951/2019, MA 1519/2019 in CP (IB) 490 (MB) 2018.

²⁰ *Bank of Baroda v. Mr. Sisir Kumar Appikatla, & Ors.*, (2020), Company Appeal (AT) (Insolvency) No. 579 of 2020.

²¹ *STCI Finance Ltd. through Subhash Chandra Modi v. Parinee Developers Private Ltd.*, (2021), IA No. 264 of 2021 in Company Petition No. (IB) 4147/MB/2019.

²² *K. Sashidhar, Managing Director, Kamineni Steel & Power India Private Limited v. Kamineni Steel & Power India Pvt. Ltd. & Ors.*, (2017), CP (IB) No. 11/10/HDB/2017.

²³ *Phoenix ARC Private Limited v. Spade Financial Services Limited & Ors.*, (2021), Civil Appeal No. 2842 of 2020.

IBC : HOW DO WE REACH THE PROMISED LAND?

Uday Kotak

The Insolvency and Bankruptcy Code, 2016 (Code/IBC) has proven to be a landmark legislation in enabling resolution of entities that have entered into financial difficulty. That the young law has been regularly updated is a sign of the continuous learning process emerging out of the myriad types of cases, each with its own level of complexity. However, some facets may be further ironed for the law to truly achieve key aspects that it envisaged and stated in the Preamble – maximisation of value of assets of the entity in a time bound manner while balancing the interests of all stakeholders.

According to Insolvency and Bankruptcy Board of India's (IBBI's) January - March, 2021 quarterly newsletter, since inception, the ratio of cases that achieved closure of corporate insolvency resolution process (CIRP) through an approval of resolution plan to that by commencement of liquidation stood at 348:1277. This means that for each case that is resolved through a resolution plan, nearly four cases end in liquidation. However, in value terms nearly three-fourths of stressed assets are getting rescued.

The average recovery in liquidation cases has been a mere 3.5%. Such potentially sub-optimal realisation achieved under liquidation not only results in removal of a productive asset from the economy but also hurts all financiers, of which the debt capital providers have had to take a nearly 96.5% permanent write-off and equity capital providers have had to completely write-off their investment. One of the important aspects in recovery is also at what stage of stress the company arrives in the IBC process, similar to at what stage a patient arrives in the hospital. If the company has been sick for years, and the assets have depleted significantly, the IBC process may yield huge haircut or even liquidation. But at least some of these entities may have created and continued to

hold productive assets. For such entities a liquidation process may be against the purpose for which the IBC was set-up.

On the other hand, assets resolved under the resolution route have yielded an average recovery of 39%. This does not consider additional value that the same assets may further create in the hands of a suitable resolution applicant (RA). While IBC has been the best channel for recovery of non-performing assets (NPAs) of scheduled commercial banks, as highlighted by the Economic Survey 2020-21, the recovery rate may be partially skewed on account of certain large sized resolutions receiving a high percentage recovery. The recovery under resolution, excluding the top nine resolved cases from the 348 cases stands relatively low at 24%. The recent case of Videocon Group resolution has in fact resulted in a mere 4% recovery and a 96% haircut for the lenders. Such gross destruction of value strengthens the case for seeking resolution through alternative and sometimes ingenious mechanisms.

NEED FOR CONSIDERING ALTERNATIVE RESOLUTION MECHANISMS

With so few cases seeing the light of resolution, there is a need for decision makers, in the form of committee of creditors (CoC), along with Resolution Professionals (RPs) to think and consider alternate resolution methods, as against the cookie cutter approach of sale or liquidation which conforms to the approach of 'one-size fits all'. One example of such an alternate resolution method could be evaluating emerging platforms such as Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs). On account of more predictable distribution cashflows, such platforms appeal to a wider investor base, including large international pools of long-term capital in pension funds, endowment funds, sovereign wealth funds etc. In fact, part of the cash-flows generated over time may also help to complete some of the stalled projects that may have been the cause of the issue in the first place. That REITs and InvITs are governed under the regulatory framework of Securities and Exchange Board of India may provide additional comfort to the CoC in terms of oversight on ongoing operations of the platforms. There need to be certain enabling provisions in the Code that encourage the exploration of such alternate resolution methods as against undertaking a forced sale / liquidation.

Role of the Committee of Creditors

This brings up the next point on the role played by the CoC. The law has entrusted the CoC with the fiduciary role of extracting the best possible value for the troubled entity from potential RAs. Some of the recent cases however have brought a question on the role being played by the CoC and possible incentives for doing so. Somewhere, the role of accounting rules also comes at loggerheads with corporate finance rules. Banks, the largest constituent base amongst financial creditors, may have classified most of the troubled entities as NPAs. This creates potential grounds for mis-aligned incentives, as banks may be keen to offload such NPAs from the balance sheet to achieve an optically

better NPA ratio on an as-soon-as-possible basis. Further, the decision making may be driven more by the provisioning in the books rather than by the true value of the underlying asset(s). Hence, the value that may be realised in this process of offloading may not necessarily achieve top draw in the minds of such lenders. Additionally, interplay of individual creditor interests within a CoC's structure may take precedence over a larger common objective. There may be cases where the direction of resolution is determined by the lender with a disproportionately large vote share at the expense of other members of the CoC. The role of CoC members in such light needs more thought. It may be apt to think of a concept in line with section 241 of the Companies Act, 2013 (Companies Act) that provides certain protection to minority shareholder interests in the event of oppression and mismanagement. A construct for minority members of the CoC representing at least 10% of interest, similar to provisions under section 244 of the Companies Act, which may give certain rights for such members to raise their voice at an apt forum in extreme situations against the decision of the CoC may be considered.

In their fiduciary capacity, it is important that the CoC explore all avenues of extracting value from the defaulting promoters, including through an active pursuit of personal guarantees. The recent introduction of the Benami Transactions (Prohibition) Amendment Act, 2016 now provides an additional weapon in the hands of the CoC to pursue personal assets of defaulting promoters that may have been transferred. Realisation under IBC can be higher, if additional recovery happens through reversal of avoidance transactions and/or insolvency resolution of personal guarantors.

There is also a need for clarification in critical areas such as interim financing. Availability of adequate and timely interim finance can be crucial for the troubled corporate debtor (CD) to sustain its 'going concern' nature and preserve value. However, there seems to be resistance among CoC members in providing such much-needed interim finance, primarily due to lack of clarity on accounting guidelines. There is also an added reluctance to concede priority charge to any potential provider of interim finance. Lack of options have seen Interim Resolution Professionals / RPs seeking intervention of National Company Law Tribunal (NCLT) forcing CoC members to provide / enable interim finance. To address the matter, clear provisions governing interim finance, in terms of accounting policy, priority charge and guidance on lending rates may be required.

The resolution process under IBC, in spite of best intentions, has been plagued by numerous delays and stretching of timelines to well beyond the revised 330 days threshold set in the Code. As per IBBI, the average resolution time for the 348 resolution cases is 406 days (~1.3 years). Moreover, of the 1723 cases outstanding in IBC as of March, 2021, nearly 79% of cases have been pending for more than 270 days, the original timeline threshold. Such inordinate delays, not only result in potential value degradation for the CD but also leads to potential uncertainty in the minds of genuine RAs which may result in low participation in the resolution plan or low value bids or both. Such developments may further lead to undesired outcomes such as potential liquidation. However, some part of the problem can be addressed by the CoC committing itself to faster turn-around-times. This may be achieved by ensuring that senior and empowered members representing each of the CoC

creditors attend the meetings, such that most of the routine decisions can be taken at the meeting itself rather than through a time-consuming voting process.

Resolution Professionals

Under the IBC, RPs have been tasked with the job of being the administrative in-charge to ensure ‘going concern’ nature of the CD and also run various processes to assist the CoC. The nature of the job itself mandates that we have high quality of RPs who demonstrate high efficiency and high integrity and not leave it to matters of chance. With more than five years of the Code being in existence and with the emergence of many RPs on the scene, there is need to institute an accreditation process for RPs at regular intervals. Such an accreditation may be undertaken by the IBBI in-order to identify higher ranked RPs or a panel of RPs which may be tapped into for important resolution cases, with total debt above a certain amount.

Legal infrastructure

For the IBC to achieve a key tenet viz. resolution in a time-bound manner, there is an urgent need to strengthen the NCLT which forms a very vital cog in the IBC framework. The law rightfully recognised the large delays that previous bankruptcy processes were mired in and has envisaged to provide a resolution process within a threshold of 330 days. However, any law is only as good as its on-ground implementation and the infrastructure established to assist in the implementation. Unfortunately, the pace of expansion of the legal infrastructure to support the timely implementation of IBC is outrun by the case-load.

Timeline related challenges are faced right from the first step, viz. in getting matters admitted which only further snowballs into delays creeping into subsequent processes, some of which involve the legal infrastructure. ‘Time is of the essence’, a common term used in legal parlance, assumes even greater importance in the case of a troubled entity in its battle to preserve value of its assets.

There may be some thought required on how the judicial infrastructure can be expanded for IBC to deliver on its intent of timebound resolution. This may include significant additions in the specialised insolvency dedicated benches, which may also draw upon from the experience of retired insolvency experts for faster disposal of matters. NCLTs can also streamline processes by resorting to electronic case management systems, ensuring a cap on the number of adjournments. There is also a need to define nature of disputes that would be adjudicated by the judicial authority, such that procedural and mundane disputes do not end up clogging the NCLT bandwidth. Such matters of relatively lesser significance may be sorted out by quasi-judicial forums, similar to the concept of ombudsman for banks. This would also help to reduce frivolous litigations that are filed in large numbers to merely derail and delay the resolution process.

Other matters

The matter of using liquidation value (LV) of a stressed but operating entity as a benchmark for evaluating bids towards its resolution needs further attention. LVs by concept may be far depressed as compared to the actual economic value of the operating asset and its usage in such cases sets the resolution process up for a low recovery percentage. As an alternative, if the asset is operational and generating positive EBITDA (earnings before interest, taxes, depreciation, and amortisation) (even though it may have defaulted in meeting its financial obligations), usage of fair market value or at-most, distress value may serve as better benchmarks.

There is also a need to maintain an oversight on the ever-increasing CIRP costs, though some of it may be essential. Having too many advisors / consultants, especially when incentives are often aligned to longer time durations, lend towards increasing process delays and also contributes to reduction in the eventual pot made available for distribution / resolution to stakeholders.

There have been cases where NCLT approved resolution plans do not get implemented for lack of action or frivolous reasons put forth by the selected RA. Such instances have seen not only significant damage to the underlying business of the CD but have also negatively influenced the outcome of the resolution plan. Such adverse developments leave CoC members with no choice but to re-run the entire process resulting in loss of time, additional expenditure and potential loss of value. While the law prescribes punishment for such cases, there is need for stronger deterrents and stricter processes.

Experience at IL&FS

The Infrastructure Leasing and Financial Services (IL&FS) resolution process was not commenced under IBC, but under sections 241/242 of the Companies Act. Notwithstanding, the Government appointed new board of IL&FS has tried to borrow significantly from the robust governance framework of the IBC. Some key elements included running a comprehensive claims management process by an independent advisor, constituting CoC to consider and vote on the resolution value and appointing independent valuer agencies to provide fair market and liquidation values for benchmarking.

However, challenges posed by a complex corporate structure comprising of 347 entities under the IL&FS Group and an overarching objective to protect national assets as a ‘going concern’ and ensure value for all stakeholders through a fair and transparent process has required the new board to adopt a broad-minded approach to resolution, comprising of varied alternatives. Adopting a ‘horses for courses’ approach for different assets, the new board has adopted alternatives ranging from restructuring of loans to pursuing termination settlements to setting up an InvIT comprising of operating road assets. In the absence of an established legal framework to deal with group insolvency, the new board, through extensive deliberations with its advisors and the government, constituted a unique resolution framework which has been approved by the National Company Law

Appellate Tribunal. This resolution framework enables better recoveries for large creditor pools sitting at holding company levels. Such measures have been instrumental in not only preserving the ‘going-concern’ nature of national assets but also towards potentially achieving a much higher resolution value for group-wide creditors.

CONCLUSION

One needs to really compliment the IBC and the quick legislative changes brought from time to time in the last five years which have helped to give the bankruptcy resolution process much required teeth. One sees the fear in errant promoters of losing their company. IBC has helped to strengthen the position of creditors, weakened the hands of unscrupulous borrowers and poor managements and has brought about behavioral changes which will go a long way in transforming the corporate credit culture in India.

The author is confident that the openness to consider suggestions for further improving the existing Code will bring in an IBC 2.0 which should gather further momentum and fulfill objectives of being the most effective resolution process. This will go long in enabling the financial system to tide over the current challenge of resolving stressed assets and move ahead.

EASING THE RESOLUTION PROCESS

Aparna Ravi

The Insolvency and Bankruptcy Code, 2016 (Code/IBC) is now in its fifth year of operation and has seen a plethora of issues arise and get addressed during the corporate insolvency resolution process (CIRP). From the ‘Big 12’¹ to the resolution plans of real estate developers such as Jaypee Infratech Limited, to the recently approved resolution plans of the Videocon group of companies and Jet Airways, the IBC can count a number of milestones as part of its achievements.

Yet, as with any law in its developing phase, the outcomes from the IBC process have had their fair share of criticisms. These critiques centre on two broad and related observations: (a) many more CIRPs end in liquidation rather than resolution;² and (b) even where a resolution plan is approved, lenders have had to take very significant haircuts.³ Such outcome-based critiques are misleading to a large extent. For example, the purpose of the IBC is not to aid the resolution of unviable enterprises, which may be better off liquidated, and their assets put to better use. Similarly, the extent of haircuts cannot be viewed in isolation or a direct result of the IBC, as one would need to compare the haircuts accepted by creditors in a resolution plan with what creditors might have received in an alternative recovery mechanism as well as the time and costs involved.

However, these outcome-based critiques are nevertheless useful to the extent they lead stakeholders to consider how to make acquiring businesses and assets through the IBC more attractive to a wider range of market participants. One way is to provide prospective resolution applicants (RAs) with comfort on the predictability and certainty of the CIRP by addressing various implementation challenges, including delays, capacity constraints of the National Company Law Tribunals (NCLTs) and frivolous litigation. In this article, the author considers another aspect of encouraging more prospective RAs to use the IBC process—the nature of resolution plans currently permitted under the IBC. Is there room to provide greater flexibility in the types of resolution plans that may be arrived at in a CIRP, which might lead to more prospective buyers for assets through the IBC?

EVOLUTION OF RESOLUTION PLANS UNDER THE IBC – LAW AND PRACTICE

The report of the Bankruptcy Law Reform Committee (BLRC Report) was deliberately silent on the contents of a resolution plan and on the nature of the resolution to be arrived at by financial creditors (FCs). The BLRC Report sets out the rationale behind the IBC being non-prescriptive on the nature of a resolution plan as follows: *‘Law is not to provide guidance or limit the range of solutions that the creditors could come up with to turnaround a business.’*⁴ In other words, the BLRC considered the type of resolution as an issue to be determined solely by market participants and not constrained by the law. The BLRC Report further points out that the types of resolutions developed would evolve with time and depend on the circumstances of a particular case and, that the new legislation should, therefore, be open to all forms of keeping an entity as a going concern within the rest of the constraints of the law.

The position of the BLRC on the nature of resolution plans was largely reflected in the original enactment of the IBC. Similarly, the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations), as originally notified on November 30, 2016, did not contain significant restrictions on the nature of a resolution plan. Regulation 37 of the CIRP Regulations contained an indicative list of actions that a resolution plan could provide for and regulation 39 provided only for certain minimal features (such as that a resolution plan should provide for its implementation schedule and process of implementation) that a resolution plan must mandatorily contain.

However, with time, the CIRP Regulations have become more prescriptive on the process for arriving at a resolution plan, the nature of disclosures to be made by prospective RAs and the criteria that the committee of creditors (CoC) must consider in evaluating resolution plans. In addition to these types of changes that are intended to improve the transparency of the resolution process, various amendments to the IBC also began to impose boundaries on resolution plans. The most high profile of these amendments was the introduction of section 29A, which prevents certain categories of persons and entities from submitting resolution plans under the IBC. At the same time, it must be acknowledged that the intention of the IBC still appears to be to allow a wide range of resolution plan structures.⁵ Regulation 37 of the CIRP Regulations too has been further amended to include various other measures that may be included as part of a resolution plan, including changes in product portfolio or technology, changes in business model, changes in management and so on.

In addition to the text of the IBC and the CIRP Regulations, market practice, as well as judicial pronouncements, appear to have constrained the range of resolution plans permitted under the IBC. To date, the vast majority of resolution plans have followed one of two structures with minor variations. The first structure is one where the RA, either directly or through a special purpose vehicle (SPV), acquires a majority of the equity share capital of the corporate debtor (CD) through a combination of an equity infusion and a reduction in share capital of the CD. In some cases, the FCs might also receive a share in the equity of the CD, but the net result of this type of plan is one in

which the CD becomes a subsidiary of the RA or its related entities. The second structure is one in which the CD is merged with and into the RA or a SPV formed by, or at the direction of the RA. The very first resolution plan approved under the IBC, Synergies-Dooray Automotive Limited involved an amalgamation of the CD with the RA.⁶ While there may be minor modifications to these two structures, such as the combination of debt or equity instruments issued to the FCs, delisting (in case the CD is a listed company), or cases in which certain non-core assets of the CD are not acquired by the RA⁷, the broad structure of resolution plans has stayed within these contours.

CAN THERE BE A WIDER RANGE OF RESOLUTION PLANS?

The restrictions on resolutions plans under the IBC can be categorised into two buckets. In one bucket are restrictions or stipulations on the process to be followed in inviting and submitting resolution plans, requirements that a prospective RA must satisfy and the disclosures that it must provide about itself. The second bucket involves substantive restrictions on the structure that a resolution plan can assume.

Restrictions that fall under the first bucket, such as the process and disclosure requirements, are necessary to ensure that the process for submitting resolution plans is fair and transparent and that the CoC receive sufficient information on the track record of a prospective RA to make an informed decision on the merits of the various resolution plans received. This also forces the CoC to consider not just the RA’s financial proposal, but to assess the RA’s ability to turn around the business of the CD. While there may be a need to streamline some of the process and disclosure requirements in the interests of saving time and costs, these types of restrictions could generally be viewed as a necessary corollary to achieving one of the stated goals of the IBC, which is to maximise value for all stakeholders.

On the other hand, any requirements for a resolution plan that fall into the second bucket (other than the essential requirement that the resolution plan provides for continuation of the CD’s business as a going concern) should be viewed with caution as they impose barriers on the ability of market participants to come up with innovative options for resolution. While the IBC admittedly does not contain too many explicit barriers on the structure of resolution plans, as we saw in the preceding section, market practice as well as some of the language of the IBC and the CIRP Regulations appear to have placed artificial restrictions on the possibilities for a resolution plan. Below are some suggestions on providing greater flexibility to the CIRP and, as a consequence, to the structure of resolution plans.

Asset Sales

Apart from the narrow exception provided under regulation 29 of the CIRP Regulations that permits asset sales during the CIRP for a value of up to 10% of the claims received by the Resolution Professional (RP), the IBC does allow for piece meal sales of assets during the CIRP. At one level, this restriction on asset sales appears justified as it runs contrary to the larger goal of the CIRP of

preserving the business of the CD as a going concern. However, there are strong reasons to relax the restriction on asset sales during the CIRP. First, very often the CD may possess various non-core assets that may not be of interest to a prospective RA. It would be in the interests of the creditors to receive the proceeds from the sale of such assets before their value depletes further. In addition, divesting the CD of such non-core assets might also make the prospect of an acquisition more attractive for a prospective RA. Second, it is important to remember that asset sales do not only imply sales of disparate assets. In the United States, section 363 of the U.S. Bankruptcy Code allows for a Chapter 11 debtor to sell its assets outside the ordinary course with court approval. Section 363 has often been used to sell entire business divisions, such as the sale of the brokerage division of Lehman Brothers. This is, of course, not to say that asset sales under the IBC should be permitted so widely that they derail the entire process of obtaining and considering resolution plans. However, there is clearly scope within a CIRP to provide for far greater flexibility on asset sales as long as they further the broader objective of the IBC of maximising value and ensuring that the core business of the CD continues as a going concern.

A great example of the creative use of asset sales occurred during the CIRP of Jet Airways (India) Limited, where the RP applied to the NCLT, Principal Bench for permission to sell certain premises that were non-core assets of the airline company.⁸ The RP proposed to use the proceeds from the sale of these premises to clear residual dues owed to a creditor that would, in turn, free up six aircrafts that had been encumbered and were on the brink of being possessed. The case of Jet Airways is unique as, in the absence of a specific statutory provision permitting such an asset sale, the RP successfully relied on the significant value realisation from the sale to convince the Adjudicating Authority (AA) that the sale was in the best interests of all stakeholders. However, in the vast majority of sundry cases that do not involve such high-stake matters, it may not be easy to convince the AA to permit an asset sale that is not explicitly permitted under the CIRP Regulations. It is for this reason that the CIRP Regulations must provide greater scope for asset sales beyond regulation 29, to ensure that all types and sizes of CDs can consistently benefit from this flexibility.

Business Transfers

Can a resolution plan provide for the transfer of the assets or business of the CD, without the RA acquiring the legal entity of the CD? While regulation 37 of the CIRP Regulations states that a resolution plan may provide for *'transfer of all or part of the assets of the corporate debtor to one or more persons'*; a resolution plan under the IBC is defined as one that provides for the resolution of the CD as a going concern. This language has been interpreted to mean that the CD must continue to exist or be restructured or be subject to a merger or amalgamation. As a consequence, the general understanding is that a resolution plan cannot provide for a business transfer, where the legal entity of the CD is left behind as a shell entity and will therefore need to be dissolved.

The concern with business transfers under the IBC is understandable as they may allow the RA to cherry-pick the assets to be acquired and result in liabilities being left behind with the CD, without any clarity as to who is responsible for them. However, not allowing business transfers under the

IBC limits structuring flexibility for RAs. Tax and regulatory implications may, in some situations, make it more advantageous for a RA to acquire the business of the CD through a business transfer agreement. An added advantage of business transfers is that it could allow for different business divisions of the CD to be sold separately to different RAs.

The author believes that business transfers could be an acceptable form of resolution as that would still preserve the core purpose of the IBC, which is to ensure that the business of the CD continues as a going concern, irrespective of the legal entity. To address concerns over cherry-picking of assets, there could be stipulations that no liabilities can be left behind in CD, and that the RA and the CoC must mutually decide on how the CD is to be dissolved following the business transfer.

Turnaround and Sell

Another structure of a resolution plan that could be considered is 'turnaround and sell' structures, where a RA acquires the CD with an intent to sell the CD in the near future. Turnaround and sell structures could encourage a wider range of market players such as distressed debt funds to participate in the resolution process as RAs. While there is no explicit prohibition on such hold to sell structures in the IBC, the National Company Law Appellate Tribunal (NCLAT) stated in one case that

Resolution Plan should be planned for 'Insolvency Resolution' of the 'Corporate Debtor' as a going concern and not for addition of value with intent to sell the 'Corporate Debtor'. The purpose to take up the company with intent to sell the 'Corporate Debtor' is against the basic object of the 'I&B Code'.⁹

This case is an example of judicial overreach in the interpretation of the IBC, which places artificial constraints on the structure of a resolution plan where none are imposed by the statute or regulations.

Group Insolvency

The approval of a common resolution plan for the 13 entities that constitute the Videocon Group of companies marks the first consolidated resolution plan for a group of entities. While the stakeholders, in this case, are to be commended for successfully facilitating a consolidated resolution plan against great odds, the lack of specific rules or regulations governing the CIRP of enterprise groups remains a significant vacuum in the IBC. There are numerous situations where survival of one group entity would only be possible through a common resolution plan. For example, infrastructure projects are often structured through SPVs, each of which is responsible for different aspects of the project. In such a situation, all group companies would necessarily have to be part of the same resolution plan if there is to be any likelihood of their survival. Given the inherent complexities and multiple permutations that may be involved in the insolvency resolution of enterprise groups, rules and regulations governing these situations (which have been discussed by stakeholders on numerous occasions) are critical to the successful resolution of group companies in distress. Such a framework is also a necessity for providing comfort to prospective RAs bidding to acquire companies that form part of a group.

CONCLUSION

The IBC has now evolved to a stage where stakeholders are broadly familiar with the process and its functioning, with numerous examples of resolutions involving complex cases and debt in the order of thousands of crores. There have also been a number of amendments to the IBC and the CIRP Regulations aimed at fine-tuning the conduct of the CIRP and addressing practical challenges on the ground. While a number of these have been aimed at closing loopholes and addressing possible misuses of the IBC, it is equally important to make modifications that facilitate resolution. It is now time to address ways of making the CIRP easier and more attractive for RAs and go back to the BLRC Report's initial thinking of allowing limitless possibilities for resolution.

Further, while not specifically related to the structure of resolution plans, one area that has not received sufficient attention is the implementation of a resolution plan post its approval by the NCLT. Implementation is critical to complete the final leg of the RA's journey and, in practice, often takes significantly longer than the timeline provided in the resolution plan. This is also the phase during which the IBC interacts with a number of other laws and regulations, including sector specific regulations, under which approval for a resolution plan may be required. As the IBC enters its more mature phase, it would be critical to monitor not just how many CIRPs end up in resolution, but how many resolution plans actually end up being implemented according to the originally envisaged structure and timeline.

NOTES

¹ Twelve companies that underwent bankruptcy proceedings starting 2017. These were: Bhushan Steel Ltd., Lanco Infratech Ltd., Essar Steel India Ltd., Bhushan Power & Steel, Alok Industries, Amtech Auto Ltd., Monnet Ispat and Energy Ltd., Electrosteel Steels Ltd, Era Infra Engineering Ltd., Jaypee Infratech Ltd., ABG Shipyard Ltd, Jyoti Structures Ltd.

² IBBI Quarterly Newsletter, January- March, 2021. 2,653 CIRPs have closed under the IBC, of which 348 have ended in resolution, 411 have been withdrawn and 1,277 have ended in liquidation.

³ The NCLT observed in its order approving the resolution plan for the Videocon group that lenders were taking a 96% haircut on the dues owed to them. (In the matter of *Videocon Industries Ltd. & Ors.*, IA 196 of 2021 in CP (IB) 01, 02, 507, 508, 509, 510, 511, 512, 528, 560, 562, 563 and 564-MB-C-II-2018). There are also reports that the haircuts in the financial year 2021 were 60% on average as compared to 55% in prior years.

⁴ Report of the Bankruptcy Law Reform Committee, 2015, Vol. 1.

⁵ Report of the Sub-committee on Pre-Pack Insolvency Process, 2021 states at paragraph 1.18: '*A resolution plan envisages limitless possibilities of resolution and may entail a change of management, technology, or product portfolio; acquisition or disposal of assets, businesses or undertakings; restructuring of organisation, business model, ownership, balance sheet; strategy of turn-around, buy-out, acquisition, takeover; and so on.*'

⁶ *Synergies Dooray Automotive Limited*, NCLT Hyderabad Bench, August 02, 2017.

⁷ *Panyam Cements and Mineral Industries Limited*, M.A. No. 04-2021 in C.P. No. (IB) 187-7-AMR-2019.

⁸ *Jet Airways (India) Limited*, CP(IB) – 2205 – MB- 2019.

⁹ *Superna Dhawan & Anr. v. Bharati Defence and Infrastructure Ltd. & Ors.*, 2019, CA(AT)(Insolvency)195-2019.

TIMELY RESOLUTION OF INSOLVENCY IN INDIA: ASSESSING THE ROADBLOCKS

Neeti Shikha and Urvashi Shahi¹

A sound and efficient insolvency regime is important for better investment, innovation, economic growth, and cost of credit in the market. Insolvency regime has a direct bearing on allocation of resources in the economy.² Hence for overall economic growth and development, a robust insolvency ecosystem is extremely crucial. The World Bank and OECD have developed certain indicators to evaluate and compare the insolvency regimes of different nations. One of the key parameters is the time taken to resolve insolvency.³

As of 2015, insolvency resolution in India took 4.3 years on an average which was much higher when compared to other countries such as the United Kingdom (12 months) and the United States of America (18 months). The reason was poor enforcement mechanism, slow court process and staggered business rescue measures. Indian insolvency and recovery regime prior to the Insolvency and Bankruptcy Code, 2016 (Code/IBC) was multi-layered with multiple fora for adjudication which resulted in undue delay in resolution, conflicting judgments and erosion of investor's confidence.⁴ This emphasised the need to overhaul the then existing framework and bring in a unified code. Hence, on May 28, 2016, the Parliament enacted a consolidated framework, in the form of the IBC to provide a facilitative mechanism for resolution of stressed assets in a time-bound manner.

Section 12 of the Code⁵ provides for a specific timeline of 180 days for completion of a corporate insolvency resolution process (CIRP) from the date of admission of application which can be extended further by maximum 90 days on filing of an application. It further provides that the CIRP shall mandatorily be completed within a period of 330 days from the insolvency commencement

date, including any extension of the period granted under this section and the time taken in legal proceedings in relation to such resolution process of the corporate debtor (CD).

Also, the regulations provide a model timeline for each task in the process, which needs to be followed as closely as possible.⁶ Internal timelines within the CIRP are provided through regulation 40A. It is relevant to note, however, that while the statutory outer time limit cannot be extended, this does not apply to the internal timelines for the processes set by the committee of creditors (CoC), as long as those are within the statutory outer time limit.

According to the aforesaid regulation 40A, once the CIRP has commenced and the Interim Resolution Professional (IRP) has been appointed, the public announcement of CIRP to invite claims from creditors must be done within three days of appointment of IRP. Further, such claims must be submitted within 90 days of the CIRP commencement date. Moreover, the IRP, after collating and verifying the claims of creditors, will also constitute a CoC and file a report with the National Company Law Tribunal (NCLT). Within seven days of the submission of this report or within 30 days approximately from the CIRP commencement date, the CoC's first meeting will be held to appoint a Resolution Professional (RP) or confirm IRP as RP, as the case may be.

The RP is required to issue an Expression of Interest (EOI), inviting bids from the prospective bidders, within 75 days of the CIRP commencement date, following which the RP prepares a provisional list of such bidders and issues the requisite information to them, within 105 days of the CIRP commencement date. Furthermore, the RP allows a minimum of 30 days for the prospective bidders to submit a resolution plan and this deadline may further be extended by the RP, with the approval of CoC for reasons, *inter alia*, that the plans are not satisfactory. He can additionally issue another request for resolution plans (RFRP), for which the 30 days' timeline is not applicable. Once the resolution plans have been received, the CoC votes on its approval and then submits the same to the NCLT at least 15 days before the completion of the total 180 days, following which the resolution plan is approved by the tribunal.

It is worth noting that the Code is one of the very few laws in the world to provide for a time bound resolution of an insolvency process. Since the enactment of the Code, the time taken to resolve insolvency in India, as of 2019, has come down to 1.6 years on an average. However, we still have a long way to go as the best regulatory performance in resolving insolvencies is 0.4 years (Ireland).⁷

A study by Ernst & Young indicates that since 2018, the number of cases admitted under the Code has increased manifold.⁸ However, most of the cases have crossed the time prescribed by the Code. Of the 1,497 ongoing cases as on September 30, 2019, (57%) were ongoing for more than 180 days and 535 (35%) had crossed the 270-day timeline. It appears that the CIRP is not being completed in prescribed time which is a source of concern.

Though there have been a few empirical studies on the delay in CIRP under the Code, they pertain strictly to the delay at the end of Adjudicatory Authority (AA) in terms of workload and efficiency of the benches.⁹ In the entire IBC process, there are approximately 18 stages and most of these do

not involve the role of the AA. Hence, the earlier findings cannot be generalised to assess delay in the CIRP. In this light, this study provides an important insight in assessing the stage-wise delay in the CIRP and explores if there is any connection between delay and debt size or the sector of the CD. This paper is timely as it lays down some critical evaluations to identify and understand the weak link in the CIRP so that some structural as well as procedural changes may be adopted, where needed.

In the above background, this paper aims to understand the stage-wise delay in CIRP and explore the reasons for the same. It further aims to investigate whether some sectors are more prone to delay owing to business and other complexities. The paper is premised on the data findings done in one of the researches by the authors.

Two fundamental questions that the paper investigates are as follows:

(a) What stages of insolvency resolution process witnesses delay and whether this delay is witnessed even in those companies that have otherwise completed their insolvency resolution process in time?

(b) Is there any correlation between the sector or debt size to time taken for insolvency resolution under the Code?

In the following paragraphs, these two questions will be investigated. Findings are based on a separate study done by the authors wherein the authors had investigated 1189 companies (resolved companies =224 and liquidated companies =965 as of March, 2020) and studied various compliance forms such as CIRP Forms 1, 2, 3, 4, 5 and 6. It is beyond the scope of this paper to discuss the data findings and focus of this paper will be on what are the main reasons for delay as found in the study and suggesting a way forward.

TIMELY RESOLUTION OF INSOLVENCY PROCESS: UNDERSTANDING THE ROADBLOCKS

IBC has played a significant role in resolving abundant non-performing assets. The Code brought a paradigm shift in the insolvency regime in India. It reformed the existing institutional structure for insolvency and bankruptcy resolution and replaced the erstwhile regime with a modern and well-structured law.¹⁰ The country did not have any prior experience of a law for insolvency resolution that was proactive, incentive-compliant, market-led and time-bound. It replaced earlier multi-layered insolvency and bankruptcy procedures by consolidating insolvency of various entities in a single Code. It was envisaged as a cure-all solution for the resolution of distressed organisations in an orderly and time bound manner thus marking a significant departure from the previous regime that did not provide for a time-bound process.

Recovery rate under an insolvency procedure is a function of time, cost, and outcome.¹¹ Bankruptcy costs are likely to increase with the time that the firm spends in bankruptcy.¹² The amount of time consumed in bankruptcy proceedings is a proxy for indirect costs. The longer a bankruptcy process lasts, more detrimental its effects will be for businessmen.¹³

The Bankruptcy Law Reforms Committee (BLRC) also has noted that time is essence of the Code. The BLRC observed that:

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

Under the old regime, the prominent statutes that governed the resolution of non-performing assets were the Sick Industrial Companies Act, 1985 (SICA), the Recovery of Debts and Bankruptcy Act, 1993 (RDB Act) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act). It took as long as 4.3 years on an average to resolve an insolvency case during this regime. Data available from Eradi Committee findings clearly highlights the lack of successful resolution of sick companies under SICA which was only 19%.¹⁴ Another study shows that the abuse of SICA came down significantly after the introduction of SARFAESI Act.¹⁵ Though SARFAESI Act did expedite the recovery process to some extent, its effect was limited to realisation of secured assets. In addition, similar to the RDB Act, SARFAESI Act lacked any powers or provisions for considering restructuring and reorganisation. There were multiple instances where SARFAESI Act and RDB Act exercised parallel jurisdictions, leading to a complete confusion on primacy and ‘forum shopping’.¹⁶ Data also validates that the introduction of RDB Act had no impact on the attractiveness and misuse of the Board for Industrial and Financial Reconstruction (BIFR) forum.¹⁷ The aforementioned shortcomings resulted in enactment of the Code in 2016. Understanding the lacuna that existed in law previously, the new Code has stipulated fixed timelines to ensure timely resolution.

However, delayed timelines have been the biggest roadblock for realisation of promise into delivery for the Code. A survey-based study has indicated that the probability of case completion within 180 days is less than 5%, the probability of case completion within 270 days is 22% and the probability of case completion within 360 days is 45%.¹⁸ However, the results are not fully reliable as they are based on perception of different stakeholders captured through a survey.

The Organisation for Economic Cooperation and Development (OECD) has observed that delay in resolution proceedings can be attributed to multiple reasons. Slow judicial processes have been identified as a barrier to addressing the rise in non-performing loans.¹⁹ The World Bank notes that courts and the judges often act as an impediment to the efficient resolution of insolvency.²⁰ In this regard, the importance of a well-functioning adjudication process at the NCLT cannot be understated for the sound functioning of the IBC. Some scholars have suggested that limiting the involvement

of courts to where it is only necessary can raise aggregate productivity by facilitating the exit of non-viable firms (i.e., strengthening market selection) and to the extent this is achieved in a timely manner, release scarce resources to be re-deployed to more productive uses.²¹

The working of a country’s judicial system plays a non-trivial role in balancing the interests of those involved in a bankruptcy proceeding. Beyond the clear enumeration of equitable legal rights, there is a need for an efficient judicial system to enforce these rights, or at least to serve as a credible threat.²² Laws that trap businesses in lengthy court proceedings or impose penal provisions on bankruptcy muzzle risk-taking entrepreneurship.²³

Importance of availability of information for timely resolution of insolvency cannot be emphasised more. One of the keys to timely completion of an insolvency or bankruptcy process is quick availability of factual and undisputed information. Imprecise and ambiguous financial reporting often marks the bankruptcy environment.²⁴ Financially distressed firms could delay reports, this has been empirically proven.²⁵

Several theories explain why distressed firms could start delaying reports, such as the theory of selective disclosure and the obfuscation theory.²⁶ In the modern corporate world, corporate information is produced by information and control systems which record, organise, and summarise data in useful ways and then provide that information to those who will use it. Such systems enable management and the board, to exercise control in a complex and fast-changing world by identifying deviations from corporate plans and budgets and from corporate standards and policies. Distressed companies have internal conflicts and financial incentives to hide the reasons why they are not performing well.

Further, information asymmetry can impact timely resolution. This divergence of information can result in a sub-optimal solution towards resolution.²⁷ Insolvency regimes that do not provide sufficient cover for incumbent management increase the private incentives of management to hide the true financial state of the firm and gamble on resurrection.²⁸ Thus, in the Indian context, this becomes a great challenge as management of the CD is displaced with an outsider thereby creating greater incentive for insufficient information disclosure. Dismissal of management during restructuring can have largely adverse effect on the timely initiation of insolvency.²⁹ Given the frame of law in India, it becomes imperative that the CIRP is completed within the timeline and the weak links in making the timely resolution are addressed adequately

There is a rising concern of backlogs of cases admitted under IBC and this makes the adherence to timeline critical. For instance, the new admissions of insolvency cases between January to September, 2019 is 350 but the average rate of closures for the same quarter is 148, which is a cause of concern. While the literature has highlighted the three main reasons for delay as stated above, there exists a vacuum in scholarship to understand the stage-wise delay. This paper fills this gap and offers an insight into the stages that cause maximum delay in CIRP.

The step wise study of the CIRP was done to evaluate whether the scheme of the CIRP is aligned with the Code's objective of faster resolution and value maximisation. Also, considering that the CIRP involves multiple stages, it is important to investigate whether there is delay at any stage and if yes, what could be the cause of the delay.

ASSESSMENT OF DELAYS IN CIRP PROCESS

This part of the paper discusses delay caused at each of the 13 stages of CIRP. Its outcome will help us analyse the delay in the overall CIRP process.

As per section 9 of the Code, 14 days' timeline has been prescribed for admission of application. However, the average number of days taken for admission of applications under CIRP is 133 days.

80% of the total delay occurs at the following 4 stages -

- Date of Issue list of resolution applicants (RAs)
- Date of issue of RFRP
- Date of EOI
- Approval of resolution plan

Further, there are consistent delays in some stages irrespective of whether the company completed its resolution process within the time. It includes the followings:

- Admission of application
- Date of public announcement (T+3)
- Date of resolution to appoint RP (T+30)
- Issue of provisional list of RAs (T+100)
- Issue of RFRP (T+105)

Interestingly, for the companies that did not complete its CIRP within the timeline, the main delay occurs at the stage of issue of EOI, issue of final list of RAs and approvals of resolution plans. Issue of interest takes 75 days more than the prescribed timeline and the issue of the final list of RAs take almost 115 days more than the prescribed timeline. Approvals of resolution plan shows an inordinate delay of 270 days more than the prescribed timeline.

The main causes for delay are as follows:

(a) Inordinate delay from the side of AA: Admission of application for CIRP takes much longer than the prescribed timeline. This is the case for companies irrespective of whether they complete the insolvency resolution within the prescribed timeline of 270 days. In fact, 27.4% of the total delay is caused in taking approvals of the resolution plan from the CoC. It is important to note that most of the CDs get extensions at this stage. The grounds on which the court granted extension can be several.

Litigation is taking maximum time and there is an urgent need to develop the capacity of NCLT to reduce delay at two main stages i.e., admission and approval of resolution plan. A separate study

needs to be done to evaluate whether the delay is due to a smaller number of judges at NCLT or whether the productivity of judges is not up to the mark. The latter signifies the need for appropriate training as well as the need for providing conducive environment and support in form of backend administrative functions which are vital for efficient performance of judicial functions.

(b) Delay in appointment of RP: Pursuant to section 22 of the Code, the first meeting of CoC should be conducted within seven days of the constitution of CoC and the RP must be appointed in the same meeting. However, even though the first meeting is conducted well in time, the appointment of RP is delayed.

One needs to assess the reasons for this by evaluating the minutes of CoC meetings. Some Insolvency Professionals (IP) argue that if the IRP and RP are different individuals it leads to delay. However, this is not verified by data.

(c) Challenge with sale of distressed assets: Marketability and sale of stressed assets remains a big challenge in achieving resolution of stressed companies that come under IBC. While the issue of information memorandum is taking place within the prescribed timeline i.e., 54 days, issuance of EOI is significantly delayed in companies suggesting impediment from the side of CoC. A survey suggests that 60% of the time CoC asks for extension of prescribed time for expression of interest. This suggests that there is paucity of market players ready to bid under IBC.

If this delay is read in light of multiple issuances of EOI as observed in many cases it can be safely concluded that there is scarcity of good resolution plans, thereby resulting in the paucity of the RAs who could participate in sale of stressed assets. This clearly indicates that there needs to be concerted efforts made in developing the market for stressed assets in India. Also, it is trite to mention that if there is paucity of players in the market who could participate in CIRP, the restrictions of ARCs may not be entirely conducive for the overall growth of the Indian insolvency ecosystem.

According to the Reserve Bank of India's (RBI) Financial Stability Report, 2019, the gross non-performing assets (GNPA) ratio stood at 9.3% as of March, 2019. While the quantum of stressed advances reduced in March, 2019, the stressed asset market in India is still approximately USD 150+ bn, indicating significant potential for investments, either through IBC or mechanisms outside IBC such as the 'Prudential Framework for Resolution of Stressed Assets' provided for in the RBI circular released on June 7, 2019. There is immense potential for the stressed asset market to grow in India.

(d) Delay in issue of provisional list and final list of RAs: There is almost 30 days delay for the issue of the provisional list of RAs and in preparation of the final list of RAs. The delay may be due to the reason that between the issue of provisional list and final list, the prospective RAs whose application has been rejected based on the eligibility criteria such as contravention of section 29A etc. are given a chance to raise objection.

One way that delay could be curtailed is if the regulations provide that the decision of RP, who has been given the power to conduct due diligence to inspect the eligibility of prospective resolution applicants (PRA), be final. Any objections should be supported by relevant documents and must only be made on procedural grounds. Further, any writ challenging the decision of RP to reject a PRA should not stop the CIRP unless the court finds excruciating reasons based on documentary evidence.

(e) Non-cooperation by CD: Given that there has been a jurisdictional shift from the old insolvency regime wherein CDs enjoyed the control over the assets when the company underwent insolvency, the insolvency cases under IBC witness non-cooperation by CD. This has become a major cause of concern as it causes delay in insolvency. It is submitted that 79% of RPs are of the view that there is general inhibition in sharing information, 67% stated that it is tough to get financial and operational information about the company undergoing CIRP.

It is noteworthy that even after these impediments, the information memorandum is being prepared on time. This may point towards the poor quality of information memorandums. However due to lack of qualitative data no firm conclusion can be made.

(f) Difficulty in accessing information about the company and improper documentation model: Non-filing and non-compliance are also some reasons for delay in CIRP. This indicates lack of proper books. Almost 83% of RPs are of the view that companies lack proper documentation model for both statutory register and non-statutory register. It is worth noting that only 3% of the RPs filed the application under section 19(2) of the Code to take help of local authorities on grounds of non-cooperation by the CD.

Having seen above the general reasons for delay, two pertinent questions that arise is whether there are sectors which are more prone to delay and whether there is any relation to delay and debt size. While the former validates the scheme of law which aims to be sector agnostic, the second question looks into the reasonableness of the timeline provided under the law for resolution of insolvency.

IBC is seen as sector agnostic law and ideally law gives an equal timeline for every sector for resolving insolvency. However, companies from the service industry reflect more delays as compared to the non-service/manufacturing industry. This may be due to the intangible nature of assets for the service sector. Valuation and marketing of intangible assets is much more time taking than tangible assets. This is not in line with the survey findings which reflects 'real estate' as the sector most prone to delay.

Coming to the second question, on whether the delay in CIRP is attributable to the size of the debt, the amount of claim does not explain the variability in number of days taken and hence any relationship cannot be established between the two debt sizes and delay.

While there is no relation of size of debt with delay, it would be interesting to see if the composition of debt and number of stakeholders has any relation with delay or not.

One unrelated but pertinent question that arises is whether the companies are being pushed into liquidation due to delay in resolution. There are about 25% of the cases where CoC rejected a resolution plan on the grounds of high haircuts and since there was only one bidder, the company was pushed into liquidation. It is submitted that 'liquidation value' and 'haircut', 'down payment', 'one time settlement' and 'finance' are other reasons highlighted, which are related to the fact that CoC prefer either value above liquidation or are interested in upfront payments. The other noticeable reasons are 'plans lacking feasibility' and 'genuineness' or having 'compliance issues'. As regards the demands of the creditors in terms of recovery, 51% of the respondents of the survey admitted that 'less than 25% of haircut' remains the constant demand of the creditors.

Also, 74% of the respondents submitted that creditors are more interested in getting upfront payments as compared to suggesting the operational turnaround of the company. While most of the survey results suggest that companies are pushed into liquidation because of delayed timelines, however, the secondary data suggests otherwise. Nearly 80% of the CDs who received the resolution plans and /or even had the scope of having potential RAs were given an extension of 90 to 180 days on revival grounds.

To sum up, research indicates that the CoC focuses on the upfront payment and hence tends towards rejection of resolution plan where the haircut is high. That may be the reason why for everyone company being resolved, four seem to be pushed towards liquidation. However, there are other themes also which justify the rejection like plans lacking feasibility and genuineness. Also, given the fact that most of the companies which came under IBC in the first four years were baggage of the past from BIFR and had only scrap value³⁰, it would be difficult to make any firm conclusion based on the above.

Brouwer (2006) stated that the countries characterised by a creditor-oriented bankruptcy system (for example Continental European nations), are often biased towards liquidations.³¹ This is in contrast with common law countries, where bankruptcy laws are more debtor-oriented and thus provide a distressed firm with more opportunities for survival and reorganisations.³² While making any conclusive inference whether the CIRP is focused more on recovery than revival will be wrong given the want of qualitative data, the issue of higher upfront payment and which is also substantiated by the survey needs a deeper thought. It is beyond the scope of this research to delve into details in these aspects, but the underlying concern of assessment of plan for recovery and not revival needs to be given due concern.

As seen from the findings above, some stages faced constant delays in companies that underwent the CIRP, including those companies that completed its resolution within the prescribed time. These stages include admission of application, making a public announcement, issue of provisional list of RAs and appointment of RPs. In such cases, it will be worth revisiting the timeline and prescribing for a more realistic timeline. Technology can be used for bridging the information asymmetry which most often results in delay. In any case, it may be useful for the adjudicators to take note of this while granting extension of the timeline.

THE WAY FORWARD

It is seen that the model timeline as prescribed by Insolvency and Bankruptcy Board of India (IBBI) has not been adhered to, leading to delay in insolvency resolution process. Delay is happening at many stages highlighting concerns at the end of state agencies as well as market participants. As indicated in the literature, time is of essence and delay in insolvency resolution depreciates value of firm. Until now, there has been no study on the reasons for delay. In this regard, this study fills the existing gap in the literature as it, for the first time, studies the stage wise delay in CIRP. Especially in the Indian context, a study of this nature has not been done and hence this study will offer a good roadmap for future research. Moving forward, following points may be reconsidered by the policy makers to ensure that the Code remains a healthy business rescue regime:

(a) Building court's capacity: The data in the research analysis clearly suggests that maximum delay is taking place at the stages of admission of CIRP and approval of resolution plan by the AA. For securing the success of the Code, reducing delay in admission is most crucial. This clearly shows that there is a need to strengthen the capacity of the courts which could adjudicate cases of insolvency in a timely manner.

Existing literature has identified slow judicial processes as a barrier to addressing the rise in non-performing loans.³³ Courts and the judges often act as an impediment to the efficient resolution of insolvency.³⁴ Court involvement is important in guaranteeing the rights of different parties involved and can increase ex-post efficiency by acting as a coordination tool. Court involvement particularly for smaller firms that lack scale to cover the associated fixed costs comes with a cost and hence there is a need to reassess the usefulness of the role of courts in the CIRP in cases of smaller debt size.³⁵

Although some stages of a restructuring process require court involvement, most procedural steps – in principle – can be dealt with out-of-court schemes. Doing so could reduce the workload of the courts, enabling them to focus on a timely resolution of those difficult cases where court involvement is necessary.³⁶ Limiting the involvement of courts to where it is only necessary can raise aggregate productivity by facilitating the exit of non-viable firms (i.e., strengthening market selection) and to the extent this is achieved in a timely manner, releasing scarce resources to be re-deployed to more productive uses.

In this regard, it is suggested that a multi-track approach be adopted for insolvency resolution. Given that not all insolvency matters take 270 days for resolution, as some cases are of smaller nature, it will be useful to look at insolvency cases through the prism of a multi-track approach. In 1998, the Woolf Committee in England adopted a similar approach. The multi-track approach provides a flexible regime for handling cases and does not provide any standard procedure such as those in the small claims or claims in the fast track. Instead, it offers a range of case management tools such as standard directions, case management conferences and pre-trial reviews. These can be used in a 'mix and match' way to suit the needs of individual cases. Thus, the following three tracks could be suggested based on the default threshold -

- The fast tracks
- The small claims track
- The multi-track

Cross-country evidence suggests that some kind of specialisation in expertise of judges and bankruptcy practitioners does pay off, leading to faster and cheaper procedures and, therefore, better recovery rates.³⁷ Several jurisdictions such as the United States of America have specialised courts to look into the cases of insolvency, also known as Insolvency Courts. Given the potential of stressed asset market and restructuring in India, dedicated benches can be allocated to deal with cases of insolvency. This will help in quick adjudication and developing a uniform jurisprudence in this is a very vital subject area.

Further, taking guidance from the US, orientation for newly appointed insolvency judges can be done by two one-week programs. The initial, Phase I, orientation program would invite experienced bankruptcy judges to serve as mentors. This four-day program would be attended by NCLT judges with less than six months on the bench.

Phase II orientation program would be organised for Phase I classes of insolvency judges with less than 18 months on the bench. Participants would analyse the decision-making process, in theory and in practice; study the role of judges; assess case-management styles; consider key ethical dilemmas confronted by new judges; rule on simulated evidentiary issues; and examine best writing practices.

Further, constant delays in the implementation of the Code can be mitigated if, in addition to the mandatory overall timeline for CIRP under section 12 of the Code, mandatory timelines are inserted at every stage of such CIRP process under the Code.³⁸ For instance, at the stage of admission of application by NCLT, approval of resolution plan, and others. Insertion of such segmented timelines will seek to change the behaviour of courts in implementing such procedures strictly and not just keep the overall timeline in hindsight. An analogy can be drawn from the indirect taxation regime in India, where the pre-GST laws were framed to not facilitate the adjudication of demand notices under stringent schedules, as opposed to the present Goods and Services Tax (GST) law which has inserted the word 'shall' at numerous instances to ensure speedy adjudication.

(b) Strengthening documentation management system: It is submitted that the companies lack a proper documentation model for both statutory and non-statutory records. It is tough for RPs to get information pertaining to financial and operational aspects of the company. Record keeping is quintessential for the insolvency process to run smoothly. This issue needs to be tackled on two fronts: firstly, in the normal course of business when a company is a going concern, all the annual filings need to be electronically kept and updated. While the law mandates that there should be monitoring of the compliances, use of technology can make these monitoring processes simpler. Secondly, the Information Utility (IU) needs to be better utilised. Currently, there is only one such entity in India. There is a need to bring in more participants in the ecosystem. There are some entry barriers that may be prohibiting others to enter the market. It is beyond the scope of this research to deep dive into this question but what remains important to note is that to create a sound and

swift insolvency process, the law must allow interested players to enter. The rules need to focus on creating the right incentives. In this regard, IUs can provide vital infrastructural support.

Further, as per the scheme of the Code, once the application is admitted under either of the provisions of section 7 or 9 or 10 of the Code, the AA, under section 13 of the Code appoints the IRP for conducting the CIRP. It is significant to note that if section 13 is amended to reflect that the AA passes an order against the CD to provide all forms of financial information to the IRP (and RP, later on), then the CD would be compelled to cooperate and provide such information to the IRP/RP. Further, this must also be supplemented with the fact that any form of non-compliance by the CD with such a court order will hold them liable for contempt of court offense. The Hong Kong insolvency law also states that any form of non-cooperation by the CD with the IP will make it liable for contempt of court offense. Hence, such a transformation in the language of section 13 of the Code will go a long way in facilitating the provision of financial information by the CD to the IRP/RP.

Further companies could be encouraged to remain resolvable at all time. They should have a shelf prospectus kind of information memorandum updated on quarterly basis.

(c) Non-cooperation by CD: As part of the CIRP conducted under the Code, the CD does not fully cooperate with the RP and that is one of the major reasons for delay in the entire CIRP. However, it is also noted that, even though RPs have a recourse under section 19(2) of the Code to approach the courts to compel the cooperation by the CD, only 3% of the RPs have filed such an application and approached the courts on grounds of non-cooperation by the CD.

Section 19(2) is a section with wide import that does not provide what types of orders can be passed by the courts or the AA under the Code, except for effectively compelling the CD to cooperate with the RP. However, recently, the AA in the matter of *M/s. Educomp Infrastructure & School Management Limited (Petitioner-CD) and Mr. Ashwini Mehra, Resolution Professional v. Mr. Vinod Kumar Dandona, Suspended Director and Ors.*, held that the CD shall be held responsible for non-submission of the information as well as for non-cooperation with the RP and be liable for punishment under section 70 of the Code. Section 70 is a general provision penalising any parties who are liable for misconduct in the CIRP.

Jurisdictions such as Singapore, UK, Hong Kong and others, in their respective insolvency laws severely penalise any form of non-cooperation, on part of the CD, with the RP. However, noting the surprisingly low number of section 19 applications in India, we believe that the language of section 19 of the Code be accordingly amended to explicitly provide that non-cooperation on part of the CD with the RP will attract penalty.

Further, there is ambiguity regarding powers of RPs whether they can conduct private investigation in cases where there is avoidance transaction. Considering the fact that, in most of the contentious insolvency cases, fraud may be suspected, therefore, courts may be allowed to permit the RPs to carry out private investigation to investigate such transactions. Sufficient safeguards must be introduced to prevent any misuse. Currently, a few such orders have been passed but given that

law has not defined the periphery of courts power, much is being left to courts and judges' own pragmatism. Law should be certain and clear in this regard.

Private examinations are a powerful investigatory tool because they would enable the RP to question not only the ex-personnel of the CD but also the third parties, pertaining to their dealings with the CD.

(d) Building up a robust market for stressed assets in India: Given the size of stressed assets in India, there is huge potential for growth in the secondary stress market. It is clear from the above paragraph that substantial delay is witnessed at the stages of the issuance of EOI and RFRP. Further, the survey findings suggest that external factors such as marketability of assets is one of the critical causes contributing to delays in resolution of companies. As of today, if an investor is interested in acquiring any corporate asset undergoing CIRP under IBC, there is no one stop website where such an investor can visit to identify a target company which can suit the requirements of the investor in any given sector.

There is also a need to create a robust market for trading of stressed assets and to this extent, there is also a need to increase participation of players for the same. For this purpose, there is a requirement for e-platform wherein sale of such stressed assets can take place without much difficulty. This platform can be prepared on similar lines as InvestIndia (Government of India) specifically for stressed asset investment of companies undergoing CIRP. To make it more user friendly it can have filters such debt size, location, sector etc. Such a platform could lead to more transparency and better price-discovery.

Also, it is trite to mention that if there is paucity of players in the market who could participate in CIRP, the prohibitions in form of section 29A under the Code and restrictions of asset reconstruction companies may not be entirely conducive for the overall growth of the Indian insolvency ecosystem.

Thus, we see that while the Code has made the best attempt to ensure that insolvency resolution is completed well within time, the situation is dismal on the ground. As on September 2019, 57% of the ongoing cases had crossed 180 days' timeline and 35% had crossed 270 days. As seen above, the delay has occurred on a few stages that need the attention of both the regulator and legislature. 64% delay is caused in taking approval of the resolution plan from CoC and AA. In order to make sure that the Code is relevant both as a business rescue tool and as an insolvency resolution mechanism, it is imperative that the model timeline is adhered to as far as possible.

CONCLUSION

In conclusion, it is submitted that the IBC has indeed been a game changer in providing a timely resolution framework. The gap that exists between the letter of law and practice as seen in this study, can be redeemed if a pragmatic approach is adopted in strengthening the existing insolvency framework as suggested by this study.

NOTES

¹ This paper arises out of a grant received from IBBI under its Research Initiative. The full study done by the authors is available on the IBBI website. Data and information in this paper is true as on January, 2020.

² McGowan M. and Andrews D. (2016), “Insolvency Regimes and Productivity Growth: A Framework for Analysis”, OECD Economics Department Working Papers, No. 1309, OECD Publishing, Paris.

³ OECD List of Indicators.

⁴ Sharma A. and Thomas S. (2015), “Evolution of the bankruptcy framework for enterprises in India”, Working paper, FRG IGIDR.

⁵ Section 12, IBC.

(1) 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.

(2) 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] per cent. of the voting shares.

(3) 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 90 days.

⁶ *Arcelor Mittal India Private Limited v. Satish Kumar Gupta and Ors.*, (2019) 2 S.C.C. 1.

⁷ Time to resolve Insolvency (2015), World Bank data.

⁸ Evolving Landscape of Corporate Stress Resolution, EY Report, December, 2019.

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¹⁰ Sahoo M. S. & Guru A. (2020), “Indian Insolvency Law”, Vikalpa: The Journal for Decision Makers, Vol. 45(2).

¹¹ *Ibid.*

¹² Hotchkiss E. S. et al. (2008), Handbook of Empirical Corporate Finance, 262.

¹³ Welch I. et al. (2005), “The Costs of Bankruptcy: Chapter 7 Liquidation versus Chapter 11 Reorganization”, Journal of Finance, Vol. 58(3).

¹⁴ Report of the high-level committee on law relating to insolvency and winding up companies, Ministry of Law, Justice and Company Affairs, Government of India, 2000.

¹⁵ Pandey, A. (2016) “The Indian Insolvency and Bankruptcy Bill: Sixty Years in the Making”, Quadrature Capital LLC, Volume 8, Issue 1, January- June.

¹⁶ *Ibid.*

¹⁷ Supra Note 10

¹⁸ Gadgil S. et. al (2019), “Timely Resolution of Cases Under the Insolvency and Bankruptcy Code”, Journal of Critical Reviews, Vol. 6 (6).

¹⁹ McGowan M. & Andrews D. (2018), “Design of Insolvency Regimes Across Countries”, OECD Economics Department Working Papers No. 1504, 6 September.

²⁰ Cirmizi E. et.al (2010), “The Challenges of Bankruptcy Reform”, World Bank Policy Research, Working Paper No. 5448.

²¹ Datta P. and Shah A. (2015), “How to make courts work?”, The Leap Blog.

²² Perotti E. (2001), “Lessons from the Russian Meltdown: The Economics of Soft Legal Constraints”, William Davidson Institute Working Papers Series 379, University of Michigan.

²³ Supra Note 8

²⁴ Lukason O. (2019), “Bankruptcy Risk, Its Financial Determinants and Reporting Delays: Do Managers Have Anything to Hide? Risks”, MDPI, Vol. 7 (3).

²⁵ Edward A. et. al. (2010), “The value of non-financial information in small and medium-sized enterprise risk management”, The Journal of Credit Risk, Vol. 6 (28).

²⁶ Courtis J. (1998), “Annual report readability variability: Tests of the obfuscation hypothesis”, Accounting, Auditing and Accountability Journal, Vol. 11, 459. Whittred G., & Zimmer I. (1984), “Timeliness of Financial Reporting and Financial Distress”, The Accounting Review, Vol. 59, no. 2, 287.

²⁷ Martel J. (1991), “Bankruptcy Law and the Canadian Experience: An Economic Appraisal”, Canadian Public Policy 52, Vol 17, pp. 52-63.

²⁸ Supra Note 2

²⁹ Supra Note 2

³⁰ Shikha N. et. al. (2020), “Liquidation under IBC: Understanding the numbers”, *Financial Express*, 28 December.

³¹ Brouwer M. (2006), “Reorganization in US and European Bankruptcy law”, Journal of Law and Economics, Vol 22, pp. 5-20.

³² Supra Note 31

³³ Supra Note 15

³⁴ Supra Note 10

³⁵ Supra Note 2

³⁶ Franks Julian and Sussman Oren. (2000), “The Cycle of Corporate Distress, Rescue and Dissolution: A Study of Small and Medium Size UK Companies”.

³⁷ Supra Note 2

³⁸ As of now it is not mandatory to follow the internal timelines as prescribed by regulation 40A of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

INCREASING PARTICIPATION OF NON-FINANCIAL CREDITORS WHILE APPROVING RESOLUTION PLANS

Shreya Prakash¹

The corporate insolvency resolution process (CIRP) under the Insolvency and Bankruptcy Code, 2016 (Code/IBC) provides a framework for rescue of distressed businesses. During the CIRP, a committee of the debtor's unrelated financial creditors (FCs) takes decisions regarding the distressed debtor's viability and evaluates resolution plans for its revival. Interestingly, no other types of creditors or affected parties are allowed to vote on the resolution plan. The rights of non-FCs to participate in the process of deliberating on the resolution plan, through receipt of resolution plans and information, are also limited. However, the resolution plan is binding on all creditors, members, and other such stakeholders as well.

This article highlights the issues that this raises. It, first, explains the manner in which resolution plans are approved, and the rights of different stakeholders (particularly creditors) relating to approval of the resolution plan. Secondly, it examines the rationale for and the impact of limited rights of participation of non-FCs at this stage. Thirdly, this article discusses the impact of these limited rights of participation and argues that there is a need to enable greater participation of non-FCs at the time of approving a resolution plan. Finally, it suggests the manner in which this participation may be enabled.

While some of the arguments in this article may be extended to stakeholders other than creditors, for example, minority shareholders, this article does not address their rights of participation and limits itself to addressing participation rights of non-FCs only.

SCHEME OF THE CODE RELATING TO RESOLUTION PLANS

The CIRP is the only formal ‘rescue mechanism’ for non-MSME corporate debtors (CDs) under the Code. The CIRP is designed as a ‘creditor-in-control’ mechanism that is largely managed by an insolvency professional, called the Resolution Professional (RP), who is appointed by an Adjudicating Authority (AA) (which is the National Company Law Tribunal (NCLT) with jurisdiction), on the recommendation of a committee of FCs, *i.e.*, the committee of creditors (CoC). To create this CoC and to understand the nature of the CD’s liabilities, an extensive claims collection process² is run by an Interim Resolution Professional (usually appointed on the recommendation of the applicant, by the AA, while admitting an application for initiation of the CIRP). A moratorium on enforcement actions against debtors is also put in place while this continues.³ During the CIRP, the RP attempts to run the CD as a going concern.⁴ However, certain important decisions relating to the running of the business must be approved by the CoC.⁵ The purpose of all these different aspects of the CIRP is to ensure that a financially distressed CD that is economically viable is rescued with the best possible ‘resolution plan’.

The first stage of attempting this rescue is evaluating the viability of the debtor. This task is entrusted to the CoC. If the CoC determines that the CD is not viable, the CoC may choose to recommend its liquidation.⁶ However, if the CoC determines that the CD is viable, a marketing process is commenced.

As part of the marketing process, the RP invites persons to demonstrate that they are eligible to propose resolution plans, *i.e.*, to be resolution applicants (RAs). The eligibility criteria (which typically evaluates the prospective RA’s financial capability and ability to handle the business of the CD) are fixed with the approval of the CoC.⁷

Once eligible prospective RAs are shortlisted, they are provided an information memorandum and access to a data room, both of which contain important information about the CD, its assets, liabilities and business. Access to the information memorandum and data room enables these shortlisted prospective RAs to conduct due diligence on the CD. They are also provided a Request for Resolution Plans (RFRP) and Evaluation Matrix.⁸ This RFRP contains the minimum conditions that a resolution plan must comply with, and also explains the process for consideration and evaluation of the resolution plan. The Evaluation Matrix lays down the criteria on the basis of which resolutions plans submitted will be evaluated by the CoC. The Evaluation Matrix is approved by the CoC before it is provided to prospective RAs by the RP.⁹ Based on this, prospective RAs propose resolution plans. These plans must propose to rescue the business of the CD as a going concern and must meet minimum legal requirements set out in section 30(2) of the Code, read with regulation 38 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process of Corporate Persons) Regulations, 2016 (CIRP Regulations). All resolution plans are then placed before the CoC for voting.

The CoC must consider all resolution plans and simultaneously vote on them. The resolution plan that gets the highest percentage of votes of the CoC (subject to a minimum of 66% of the votes) is

considered to be the approved resolution plan.¹⁰ This resolution plan is then placed before the AA for its approval. The AA must approve a resolution plan after evaluating that it complies with the legal requirements under the Code and the regulations under it.¹¹

While the CoC votes on and approves the resolution plan, the plan is binding ‘*on the corporate debtor and its employees, members, creditors... guarantors and other stakeholders involved in the resolution plan*’.¹² Thus, while operational and other creditors, guarantors and members do not vote on a resolution plan, the plan is binding on them.

In addition to not being able to vote on a resolution plan, their rights to participate in the process are also limited. Unless the stakeholders are operational creditors (OCs) who are owed at least 10% of the CD’s debt, or members of the suspended Board of Directors, they are not entitled to participate in CoC meetings.¹³ If they are not entitled to attend the meetings of the CoC, they are also not statutorily entitled to a copy of the resolution plans, RFRP, Evaluation Matrix or Information Memorandum. While they are not statutorily entitled to know how their rights are affected before the approval of a resolution plan, if a resolution plan is approved, every claimant is provided the formula on the basis of which distribution to their class of creditors will be guaranteed.¹⁴

In some cases, those who have challenged the approval of the resolution plan have been granted access to some information by the AA on a discretionary basis.¹⁵ However, more recently, some AAs have refused to grant access to information, including resolution plans, citing the lack of a statutory entitlement for a resolution plan, and confidentiality concerns.¹⁶

The scheme of the Code then clearly empowers the unrelated FCs of the CD significantly by giving them valuable rights of participation in the marketing process for the resolution plan (including rights to fix criteria for evaluation, information rights, etc.) as well as by giving them the right to vote on a resolution plan. Non-FCs, however, do not have any right to vote on the resolution plan, and have limited rights to participate in the marketing process relating to the resolution plan or receive any information relating to the resolution plan.

RATIONALE AND SAFEGUARDS

The rationale for only giving unrelated FCs a right to vote on the resolution plan stems from a belief that only FCs would have the ability to assess the viability of the debtor and evaluate if the resolution plan would be able to resolve the debtor’s insolvency. This rationale was explained by the Supreme Court of India in *Swiss Ribbons v. Union of India*¹⁷, while upholding the constitutional validity of the provisions that give only FCs the ability to vote on a resolution plan, in the following manner:

44. Since the financial creditors are in the business of money lending, banks and financial institutions are best equipped to assess viability and feasibility of the business of the corporate debtor. Even at the time of granting loans, these banks and financial institutions undertake a detailed market study which includes a techno-economic valuation report, evaluation of business, financial projection, etc. Since this detailed study has already been undertaken before sanctioning a loan, and since financial creditors have trained employees

to assess viability and feasibility, they are in a good position to evaluate the contents of a resolution plan. On the other hand, operational creditors, who provide goods and services, are involved only in recovering amounts that are paid for such goods and services, and are typically unable to assess viability and feasibility of business.

A less discussed, but perhaps equally relevant rationale for not allowing anyone other than unrelated FCs to vote on a resolution plan, relate to logistics. This concern was discussed by the Insolvency Law Committee in its Report of 2020 in the following terms:

Further, the Committee noted that significant delays and increased costs have plagued the decision-making process in a CoC with a large number of creditors...Therefore, institutional capacity would need to be built under the Code to facilitate large CoCs to take decisions in an efficient and timely manner...¹⁸

Interestingly, there is little discussion on why, even absent voting rights, non-FCs are provided little to no participation rights. However, in the absence of this discussion, it may be assumed that a similar rationale was at play. Potentially, another consideration at play may have been preserving the confidentiality of sensitive information relating to the marketing process, and the resolution plan itself, which has surfaced as a concern in litigation relating to provision of resolution plans.

However, to offset this lack of participation, certain statutory safeguards have been provided in favour of other creditors and stakeholders. Specifically, regulation 38 of the CIRP Regulations, requires that OCs be paid before any FCs are paid. It also requires that a resolution plan contain a statement as to how it has dealt with the interests of all stakeholders (not just FCs).¹⁹ Moreover, section 30(2)(b) of the Code guarantees that OCs be paid either liquidation value or the amount that would have been due to them had the amounts to be distributed under the resolution plan been distributed according to the liquidation waterfall mechanism.

In addition to these statutorily guaranteed safeguards, courts have also held that a case-by-case consideration of what is equitably due to stakeholders other than FCs must be undertaken. In fact, in *Committee of Creditors of Essar Steel v. Satish Kumar Gupta*²⁰, the Supreme Court, while discussing how non-FCs are to be treated, expressly pointed out that the CoC must consider how a resolution plan balances the interests of all stakeholders. It also held that the AA would be able to review that the CoC has considered this adequately, in the following terms:

46. Thus, it is clear that when the Committee of Creditors exercises its commercial wisdom to arrive at a business decision to revive the corporate debtor, it must necessarily take into account these key features (as reflected in the Preamble) of the Code before it arrives at a commercial decision to pay off the dues of financial and operational creditors. There is no doubt whatsoever that the ultimate discretion of what to pay and how much to pay each class or subclass of creditors is with the Committee of Creditors, but, **the decision of such Committee must reflect the fact that it has taken into account maximising the value of the assets of the corporate debtor and the fact that it has adequately balanced the interests of all stakeholders including operational creditors...**

This being the case, judicial review of the Adjudicating Authority that the resolution plan as approved by the Committee of Creditors has met the requirements referred to in

Section 30(2) would include judicial review that is mentioned in Section 30(2)(e), as the provisions of the Code are also provisions of law for the time being in force. Thus, while the Adjudicating Authority cannot interfere on merits with the commercial decision taken by the Committee of Creditors, **the limited judicial review available is to see that the Committee of Creditors has taken into account the fact that the corporate debtor needs to keep going as a going concern during the insolvency resolution process; that it needs to maximise the value of its assets; and that the interests of all stakeholders including operational creditors has been taken care of.** If the Adjudicating Authority finds, on a given set of facts, that the aforesaid parameters have not been kept in view, it may send a resolution plan back to the Committee of Creditors to re-submit such plan after satisfying the aforesaid parameters...

IMPACT OF LIMITED RIGHTS OF NON-FINANCIAL CREDITORS

Given that non-FCs do not have participation rights, two types of concerns arise. First, that FCs who have participation rights will be rewarded (by unduly avoiding losses) at the expense of creditors who do not have participation rights. This means for example, that FCs will demand payments of penal interest, etc., be satisfied before OCs are paid any sums at all. Second, that FCs will lack incentives to ensure that RAs propose the most value-maximising resolution plans as long as their dues are adequately taken care of.²¹

While the safeguards provided under the Code do address these to some extent, their impact is still limited. For one, the legislative safeguards in regulation 38 of the CIRP Regulations only require priority of payment in time, and a statement that the interests of stakeholders are met. Typically, this statement is included as a boiler plate in resolution plans, without clearly explaining how exactly in the context of the specific debtor, interests of stakeholders have been met.

Secondly, the legislative safeguard provided under section 30(2)(b) of the Code may not substantively address concerns that FCs who also have voting rights, will benefit at the expense of creditors who do not have participation rights as by design, FCs would be entitled to priority payouts. This is because even unsecured FCs have been given priority over unsecured non-FCs (other than employees and workmen) under the liquidation waterfall in section 53 of the Code. While higher payouts to FCs in these cases would not actually be at the expense of non-FCs given this waterfall, the impression for non-FCs would still be that the Code takes care of dues of FCs at their expense. Equally, this mechanism would also not incentivise FCs to choose a more value-maximizing resolution plan as long as their dues are paid. Arguably, non-FCs should adjust to this new priority regime *ex-ante*. However, as the Code is a relatively new legislation, and many non-FCs may not be 'adjusting' creditors, on a case-by-case basis, concerns still prevail.

Finally, the other safeguard requires the AA to determine if the rights of non-FCs have been considered adequately by the CoC. Since the AA is a quasi-judicial forum, which decides issues on an adversarial basis, there is a real concern that the concerns of non-FCs' may not be adequately protected unless they are able to appear before the AA. This could have some negative consequences.

Greater Litigation

Non-FCs may feel constrained to file applications before the AA to safeguard their rights. Arguably, litigation is inevitable whenever any creditor is crammed down. However, as non-FCs do not have participation rights, they do not have a way of knowing how they are being dealt with. This means that they have to assume that their rights are not being adequately safeguarded, and file applications before the AA in all cases in which they can afford it. Moreover, as they are not statutorily entitled to any information before the resolution plan is approved, they may approach the AA even to receive information. This would add to the case load before the AA and could contribute to delays in all CIRPs due to an overburdened AA.

Negative impact on decision making by the CoC and the Resolution Applicant

The CoC is entrusted with the task of evaluating not just the feasibility of the resolution plan, but also that the resolution plan is value maximizing and balances the interests of all stakeholders. While the CoC may benefit from deliberations with OCs to whom more than 10% of the value of the CD's total debt is owed, in practice, cases where a single OC is owed such a sum are likely to be relatively rare. Given this, the CoC does not have a forum to understand the concerns of non-FCs and insist that these are addressed as part of the resolution plan, even if they wish to do so to avoid litigation or approve a better resolution plan.

Equally, RAs who may have an interest in addressing the concerns of non-FCs, with whom they may want to maintain a long-term relationship, do not have a structured forum to interact with such creditors and understand how their concerns may be addressed by the resolution plan.

Given this inability to involve such stakeholders in a structured fashion prior to approval of the resolution plan by the CoC, decisions are taken in an environment of information asymmetry. These then may have to be changed following litigation, which could create completely avoidable uncertainty.

Mistrust in collective proceedings

Finally, since the CIRP is a collective process that is intended to bind all stakeholders of the CD, it is important to both ensure that the mechanism is fair and equitable, and also that it is perceived to be so. This is best ensured when the insolvency framework safeguards creditor interests by allowing them to effectively participate in insolvency proceedings, whether by giving them an opportunity to vote on the resolution plan, or otherwise.²² Failing this, there may be a '*deficit of trust and confidence among operational creditors in the final outcome of CIRP*'.²³

ENABLING PARTICIPATION OF NON-FINANCIAL CREDITORS

In this background there is a need to ensure greater participation of non-FCs in the CIRP.

Conferring Voting Rights

One way to do this may be to confer voting rights on such creditors. The rationale for excluding such creditors from voting on a resolution plan, arguably, does not apply in many situations. Many FCs, such as homebuyers, may lack both the sophistication to assess the viability of enterprises and the incentive to take 'hair-cuts', yet they are allowed to vote in a resolution plan as members of a class.²⁴ Moreover, where a CD does not have any FCs, OCs constitute the CoC²⁵, *albeit* very rarely. This means that even within the Code's current framework, there is an acceptance that non-FCs would have requisite capability to be able to vote on a resolution plan at least in some situations.

Moreover, it may be possible to balance the concerns of this rationale, while conferring voting rights on non-FCs. For instance, a model could be adopted in which a CoC consisting of FCs may be continued as it is at present. This CoC may take business decisions, such as those provided in section 28 of the Code and supervise the conduct of the marketing process through invitation of expressions of interest. However, for the resolution plan to be approved, 'class voting' may be conducted, with a cross-class cramdown being made available on certain conditions being met.

Admittedly, this would require a significant change in the structure and design of the Code. Given this, it may not be amiss to first test narrower measures to improve participation of non-FCs in relation to a resolution plan.

Window for Commercial Objections

An effective method may be to allow all affected non-FCs to receive relevant information relating to resolution plans and then to provide them a window to put forth their objections to resolution plans prior to these plans being approved by the CoC.

This would in essence involve:

(a)*Provision of information relating to resolution plans*: Specifically, all affected non-FCs, should be provided information relating to the proposed resolution plans in a specified format. This need not include confidential information, such as trade secrets, but should include a description of the broad contents of the resolution plan and information relating to how such affected non-FCs will be paid.

(b)*Window for Objections*: They should then be given a window to provide any objections to the resolution plans within a limited period, of 15 days. These objections should be communicated to the relevant RAs and should be considered by the CoC while they deliberate on all resolution plans placed for their approval.

(c)*Response to Objections*: Those who placed objections to the resolution plan that is ultimately approved by the CoC, should also be provided a response by the CoC and/or the RA. Such a response should explain whether the objections were taken into consideration, if they were addressed and the manner in which they were addressed and if they were left unaddressed, the

reasons for doing so. Where a resolution plan is not approved by the CoC, objections in relation to such a plan need not be addressed and communicated to the objecting creditors.

Admittedly, such an exercise may take some amount of time during the CIRP. However, if tailored correctly, it can run parallel with various other processes, such as evaluation of a plan's compliance with section 30(2) of the Code by the RP. The concern that non-FCs lack adequate sophistication to evaluate feasibility and incentives to take haircuts, even to the extent that they are valid, would not arise, as non-FCs would not be voting on the resolution plan. They would merely be providing their inputs that may be considered by the CoC and the RA, who may be comparatively more sophisticated. Finally, any concerns regarding 'confidentiality' also need not apply, as the information provided to affected creditors need not include 'confidential' information such as trade secrets, etc. Moreover, any risk that information regarding 'payouts' may be 'leaked' to competing RAs by non-FCs, is unlikely to be worse than the risk that such information may be leaked by retail FCs, such as bondholders, homebuyers, etc.

Such a mechanism would have various benefits. It will, first, provide non-FCs room for some participation in the CIRP. They would receive information relating to their interests, be given a chance to provide their inputs and be provided some explanation as to how their concerns have been considered. Secondly, where creditors are unaffected, they would know that the resolution plan does not affect them, as they would not receive any specific information relating to the plan. Equally, where creditors are affected, they would be given a chance to evaluate whether they have any objections to the resolution plan and have the chance to have their concerns addressed before a resolution plan is finalised. This would inevitably reduce litigation at least in some cases, where creditors are comfortable with how they are affected or where their concerns are adequately addressed. Even where concerns are left unaddressed, the CoC and the RAs would have had a chance to explain their position upfront, which would potentially reduce the time taken in litigation, as it would be clear how their commercial wisdom has been exercised and the AA need only address any 'legal' issues that arise. Finally, this exercise may result in a better resolution plan being approved. RAs would have a chance to evaluate any concerns brought up by the non-FCs and improve the resolution plan in that respect. The CoC would also have a chance to consider the concerns raised by non-FCs, and choose a resolution plan that is not legally infirm and addresses commercial concerns in the best way. This may also give greater comfort to the AA while it approves the resolution plan.

CONCLUSION

This article argues that participation of non-FCs at the stage of approval of a resolution plan should be enhanced for better outcomes in the CIRP. Their participation may be enabled by making structural changes to the scheme of the Code by giving them the right to vote on a resolution plan. However, even incremental changes, such as giving them a right to give their objections on proposed resolution plans may reduce litigation, improve decision making and increase trust in the CIRP.

NOTES

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² Sections 15, 18(1)(b), IBC.

³ Section 14, IBC.

⁴ Section 25(1), IBC.

⁵ Section 28, IBC.

⁶ Section 33(2), IBC.

⁷ Section 25(2)(h), IBC.

⁸ Regulation 36B, CIRP Regulations.

⁹ Regulation 36B, read with regulation 2(ha), CIRP Regulations.

¹⁰ Regulation 39, CIRP Regulations.

¹¹ Section 31, IBC.

¹² Section 31(1), IBC.

¹³ Section 24(3), IBC.

¹⁴ Regulation 39(5A), CIRP Regulations.

¹⁵ *State Tax Officer v. Satish Kumar Gupta*, (2019), SCC Online NCLT 6648.

¹⁶ *National Aviators' Guild v. Ashish Chhawariya* (2021), SCC Online NCLT 50.

¹⁷ 4 SCC 17, 2019.

¹⁸ Report of the Insolvency Law Committee, Chapter 1, para 10, February 2020.

¹⁹ Regulation 38(1A), CIRP Regulations.

²⁰ 8 SCC 531, 2020.

²¹ In the context of Administrative Receivership in the UK, in which an administrative receiver who owed duties primarily to the Qualified Floating charge Holder could manage and rescue the business of the debtor, similar concerns were raised in Armour et al. (2008), "Changing the Governance of UK Corporate Rescue: The Enterprise Act 2002", *European Company and Financial Law Review*, 135.

²² The World Bank (2015), *Principles for Effective Insolvency and Creditor/Debtor Regimes*, Principle C 7.1; UNCITRAL (2005), *Legislative Guide on Insolvency Law*, (2005) Recommendation 146.

²³ *Supra* Note 18

²⁴ Section 25A, IBC.

²⁵ Regulation 16, CIRP Regulations.

IBC, DELAYS AND INFORMATION ASYMMETRIES: CAN BLOCKCHAINS HELP?

Debanshu Mukherjee and Aditya Ayachit

The Insolvency and Bankruptcy Code (Code/IBC) fundamentally reoriented insolvency law as it existed in India at the time of its enactment in 2016, and marked a paradigm shift towards a '*predictable, market-led, incentive-compliant, and time-bound*'¹ legal mechanism for individual and corporate financial distress resolution. The Code, its subsequent amendments and evolving jurisprudence, have contextualised and adopted global norms and practices for insolvency management for India.² Further, designated authorities under the Code like Insolvency and Bankruptcy Board of India (IBBI) and judicial forums have also extensively built upon the provisions of the Code in regulations and case law and substantially contributed towards a more predictable, fair, streamlined, and value maximising insolvency and bankruptcy framework for India's growing and maturing economy.

Yet, various bottlenecks remain that continue to impair the speedy working of the Code resulting in delays. For instance, recent studies³ highlight a substantial prevalence of stage-wise delays in various aspects of the corporate insolvency resolution process (CIRP) including in critical stages like admission of CIRP by the adjudicating authority (AA) (taking nearly 6 to 12 months or at least more than 90 days – as opposed to 14 day period prescribed under the Code); invitation of expression of interest (taking on an average 100 days from commencement of CIRP, in contrast with the prescribed 75 day period); issuance of provisional and final lists of resolution applicants (RAs) (facing average delays of 75 plus days over the mandated timeframes); and resolution plan approval (facing a staggering 100 plus days average delay over and above the mandated period). Additionally, the data published⁴ by IBBI suggests that out of the 4376 CIRPs admitted since the inception of

the Code, 1723 CIRPs are still ongoing as of March 31, 2021. Out of these, a staggering 79% have been ongoing for at least 270 days.⁵ Similarly, out of the 1037 ongoing liquidation proceedings initiated under the Code as of March 31, 2021, 26% of the liquidations have been pending from at least two years and 43% have been pending from between one to two years.⁶ Another important metric to consider is the high number of new insolvency proceedings being initiated under the Code with approximately 1000 plus new CIRP applications being filed before the AA in each quarter⁷, which amplifies the effects of such delays. Anecdotal evidence also indicates that procedural delays are beginning to affect stakeholder sentiment about the efficacy of IBC, which should be deeply concerning to the policy-makers, lest India's insolvency system slips back to its pre-IBC decrepit state.

On the 'need for speed' in context of financial distress resolution, the Bankruptcy Law Reforms Committee (BLRC) in its report had noted that: '*Speed is of essence for the working of the bankruptcy code... The longer the delay, the more likely it is that liquidation will be the only answer... When delays induce liquidation, there is value destruction...*'⁸ Similarly, the Insolvency Law Committee (ILC) constituted in 2020 also recognised that '*delays cause uncertainty for investors and have the potential to hinder a value maximizing insolvency resolution*'.⁹ Scholarly literature drawing from experiences of other jurisdictions also points out that a prolonged and drawn-out restructuring process can result in a reduction of recovery rates for creditors¹⁰, erosion of firm value and increased costs.¹¹

Given the high incidence of delays, the large number of new proceedings and the pivotal significance of completing insolvency processes in an efficient and timebound manner, it is critical to examine the underlying reasons contributing to such pendency and think about institutionalised and permanent solutions targeted at streamlining existing processes and addressing such roadblocks.

INFORMATION ASYMMETRY AND PROCEDURAL DELAYS

Information asymmetry and lack of access to reliable financial information about the corporate debtor (CD) undergoing insolvency is often a major cause of procedural delays, as concerned stakeholders (like resolution professionals (RPs) and creditors) have to run from pillar to post to ascertain the financial position of CD and procure relevant information regarding its debts and defaults. Recent studies flag that this informational gap is typically caused by factors like abysmal and incomplete record keeping and non-cooperation, by CDs.¹²

Another factor for delays is the limited availability of verified financial information about a CD's debts and defaults. Consequently, creditors have to adduce lengthy documentation (like contracts, financial statements, demand notices etc.) before the AA and RPs (e.g., during the stage of admission of CIRP or claim submission) to substantiate their claims. This ultimately adds to the length of the insolvency process as authorities have to parse through this unstructured information to ascertain veracity of alleged debts and claims, which in case of larger insolvencies could be very time-taking.

For addressing some of these informational gaps, the legislative outlook in India has been forward-looking. The BLRC in its report specifically recognised the acuteness of this problem and noted that '*asymmetry of information is a critical barrier to fair negotiations, or ensuring swiftness of the process*'.¹³ To eliminate informational gaps, the Code specifically mandated the creation of 'regulated information industry' of Information Utilities (IUs)¹⁴ for ensuring availability of reliable financial information. Remarking on the benefits of a robust IU industry, the ILC has similarly remarked that '*increasing reliance on information utilities would help in addressing the delays at the admission stage that arise from information asymmetry and the need to verify the occurrence of default*'.¹⁵

As such, the Code allows¹⁶ financial creditors (FCs) to submit financial information¹⁷ and information regarding the asset on which security interest has been created to IUs and also allows operational creditors (OCs) to submit financial information, and mandates IUs to accept such information. Moreover, the AA (National Company Law Tribunal) in various administrative orders has also attempted to require mandatory filing of default records of IUs as a precondition of CIRP initiation.¹⁸

However unfortunately, the IU industry has so far not taken root in India adequately and presently there is only one entity registered as an IU with the IBBI.¹⁹ More importantly, the practice of creditors submitting financial information relating to debts and defaults to IUs has not attained widespread prevalence, due to which the benefits of IUs for the larger insolvency eco-system have largely been limited. Moreover, even judicial authorities have ruled that neither FCs nor OCs are mandatorily required to submit financial and other prescribed information to IUs due to which such creditors have limited impetus of furnishing this information to IUs.²⁰ Similarly, even the administrative directions by the AA requiring mandatory filing of default records with IUs for new CIRPs have also now been withdrawn, diluted or set aside.²¹ Thus even though it is widely recognised that the current reliance during insolvency proceedings on records not stored with IUs needs to be phased out, and FCs and OCs need to be incentivised (if not obligated) to submit information to IUs²², the current state of the law and on-ground practice leaves much to be desired on this front.

Separately, studies²³ indicate that in later stages of CIRP, absence of mechanisms and systems providing a single-window view of the stressed assets of the CD discourages and hinders potential investors (particularly funds)²⁴ from participating in the resolution process (as RAs).²⁵ It is also likely that liquidation proceedings under the Code also get delayed due to such information gaps. Lack of investor sentiment ultimately prevents timely selection of RAs and approval of the resolution plan, which leads to delays contributing to firm value erosion and high costs.

OBJECTIVE AND LIMITATIONS

In this article, the authors assess if blockchain technology can be feasibly harnessed to ease some informational bottlenecks impacting the insolvency resolution process under the Code and identify some areas where blockchain can enable seamless information exchange between stakeholders and modernise IU operations and functioning.

The authors' analysis however comes with certain caveats. Firstly, while backbone solutions like blockchain can likely be leveraged to ease systemic inefficiencies, blockchain alone cannot altogether eliminate existing bottlenecks. As such, there is really no substitute to sustained efforts and targeted legal and market-based interventions (on part of insolvency regulators and market participants alike) to resolve aspects like stakeholder inertia in furnishing financial information to IUs, legal ambiguities in IU data provisioning requirements, complexity and length of judicial proceedings and inconsistent jurisprudence under the Code, the need to incentivise the growth of the IU and stressed asset industry etc. An analysis of such measures and interventions is not contemplated in this paper's scope, yet these remain critical for making on-ground difference in the prevailing scenario.

Another limitation of our analysis arises due to the nascency of blockchain technology itself, a lack of comparable applications of blockchain in insolvency frameworks of other countries and the technical underpinnings involved. This makes it difficult to provide specific examples of blockchain solutions that could work in the Indian insolvency context, and thus the limited goal of this analysis is simply to point in the right direction. The authors expect that for devising concrete blockchain based workflows under the Code, a much deeper study and real-world pilots and sandboxing would be required.

It is also difficult to predict potential pain-points, negative fallouts, unintended consequences and costs that could arise due to a wide-scale implementation of blockchain in the Indian insolvency context. A recent case in point relates to the Indian framework for unsolicited commercial communication (UCC).²⁶ Under this framework, industry actors were required to register commercial short message service (SMS) templates and also enable a 'distributed ledger technology' (DLT)²⁷ based scrubbing system to filter out messages that were non-compliant with registered templates. Upon implementation, the system worked a little too well and also scrubbed out large swathes of messaging and one-time password (OTP) traffic in India, which were not UCC. Such was the impact faced by industry actors that the operation of the regulations itself had to be suspended for a week to give stakeholders additional time for compliance.²⁸ In the authors view, negative fall-outs remain a key lookout area for insolvency regulators implementing blockchain solutions. However, the authors have not commented on this aspect. The authors have also refrained from delving into technical aspects of the blockchain systems and directed our focus only to the purported benefits resulting from the use of this technology.

Benefits of Blockchains

At a fundamental level, blockchains are a system of recording transactional information that employs 'cryptographic and algorithmic methods to record and synchronize data across a network in an immutable manner.' All blockchains are constituted by the same primary elements namely 'a ledger, a network, and consensus, that is unalterable by feasible means.'²⁹

Blockchain based systems are viewed as being beneficial in view of the positive outcomes they

enable.³⁰ These include: (a) decentralisation and disintermediation (which means that transactions can occur over blockchains without need of centralised intermediaries), (b) transparency and auditability (all members of the blockchain network have full visibility and access to the ledger in which changes get reflected in near real-time), (c) immutability and verifiability (blockchains are designed to be very difficult to tamper which curtails chances of fraud), (d) automation (blockchains can be coded and transactions can be made to self-execute on occurrence of specified contingencies, like delivery completion), (e) speed, costs and security (disintermediation and automation reduces transaction time and costs. Further the use of encryption techniques imparts blockchains a systemic resilience against cyber threats) and (f) tokenisation (physical assets can be tokenised through blockchains, and such tokens can be traded with ease on the blockchain at low transactional costs).

CHALLENGES OF IMPLEMENTING BLOCKCHAIN INITIATIVES IN INDIA

Despite such benefits, implementing blockchain solutions specifically in the Indian context can pose unique challenges. Niti Aayog in its recent report³¹ on blockchain strategies for India (Blockchain Report) has identified certain factors which have been recognised as being key to the success of blockchain initiatives in public and private domains in India.³² We believe that these factors would also be relevant for any future blockchain initiatives in context of insolvency resolution.

The first amongst these is the extent of work required for ensuring that data on a blockchain is authentic and reliable. In this regard, the Blockchain Report states that '*in order to maintain the sanctity of the blockchain network, and preventing retrospective changes to blocks, the business data at the time of blockchain implementation has to be the single-source of truth*'.³³ In fact, even use-cases that are conducive to blockchain solutions (e.g., use of blockchains for storing land transfer transactions) could be rendered untenable if reliable and undisputed information (e.g., regarding land records) is unavailable. Secondly, successful deployment of blockchain technology may require changes to traditional processes before blockchain can be implemented, and this could potentially result in stakeholder reluctance and inertia. Thirdly, blockchain systems cannot exist in vacuum and their commingling with widely used legacy data storage and verification systems is inevitable. Thus, blockchain systems need to be readily integrable with legacy mechanisms for ensuring larger adoptions. Fourthly, for fully realising the potential of blockchain solutions, legal and regulatory modifications may be required to ease any restrictive conditions and grant legal recognition to blockchain based recording and verification methods.

Additionally, due to certain inherent limitations, blockchain technologies may not be suitable and result in efficiency gains in all scenarios. As part of its analysis, the Blockchain Report poses a series of questions³⁴ that need to be addressed for ascertaining potential implementation of blockchains in specific scenarios. These include questions such as: (a) whether there is a compelling business

case to reduce intermediaries, (b) are there multiple stakeholders involved, (c) the nature of assets in question (digital or physical), (d) do multiple parties require shared write access, (e) is there a business need for high performance / rapid transactions, and (f) is there a need to store ‘non-transaction’ data etc.

Due consideration needs to be granted to such limitations and questions while assessing the potential of implementing blockchain solutions in context of the Indian insolvency framework. Notably existing bottlenecks (like unreliable financial data due to poor record keeping, stakeholder reluctance in shifting to new informational systems) are likely to have a critical impact in determining the feasibility of future blockchain initiatives in this sector. Having said that, since the formal financial sector already relies on sophisticated technology for recording transactions and loan-related information, it may be ripe for some sandboxing initiatives to test the suitability of adopting blockchain solutions, which could then be integrated into the insolvency system.

BLOCKCHAIN AND THE INDIAN INSOLVENCY FRAMEWORK

It is important to first assess if blockchain initiatives are even feasible in the Indian insolvency context. As seen above, certain attributes inherent to blockchain (e.g., trust, security, transparency, immutability and cost reductions) make it a superior method of recordkeeping which could aid the insolvency framework under the Code. However, this technology also has various inherent limitations due to which its utility as a backbone technology may be limited. For instance, currently blockchains can be used to efficiently store ‘transactional data’ but are not viewed as³⁵ viable means of storing high volume data sets. Thus, in context of a loan transaction undertaken by a CD facing CIRP, while a transaction record may be kept on the blockchain (with details like loan amount, date of disbursement, interest rate, due date, lender and CD information etc.), it may not be viable to store the underlying documents evidencing the transaction (like loan agreements) due to high costs and conversion timeframes.³⁶ In context of insolvency, this presents a twofold challenge. Firstly, without the underlying supporting documentation, a record of a transaction may be difficult to verify (by RPs or IUs). Secondly, without the security and cryptographic features of blockchains (lending a ‘block’ its so-called immutability), the underlying transaction documentation is prone to tampering and fraud. Thus, the benefits of blockchain technology may not be fully realised in this case.

Further, as noted above, merely migrating to blockchains does not offset the impact of other limitations like unavailability of reliable and undisputed financial data relating to debts and defaults due to reporting gaps or non-cooperation of CDs or stakeholder inertia in migrating to new blockchain based protocols, which would need to be addressed separately.

However, there certainly are some use cases in which exploring the potential of blockchain based initiatives may be worthwhile. Our discussion below focuses on two aspects – (a) integration of blockchain solutions in the current framework applicable to IUs, and (b) implementation of blockchain based asset management systems through which assets of CDs undergoing insolvency or liquidation may be uniquely identified, catalogued and seamlessly transferred.

Blockchain and IUs

The Code contains a detailed framework for regulation of IUs consisting of statutory provisions of the principal legislation³⁷, regulations³⁸ and guidelines³⁹. Under this framework, IUs are required to provide ‘core services’⁴⁰ according to specific technical standards. At present, such standards have been prescribed by IBBI for operations such as user registration, unique identifiers (for records and users), consent framework (for third party information access), and security and information preservation etc. Notably, these standards are intended to be technology and platform agnostic, and the guidelines note that the intent is to not give preference to any ‘*specific choice of technology or platform*’ so that each ‘*IU can exercise its own choice.*’⁴¹ This is critical as IUs can potentially implement and experiment with new technologies (like blockchain) for performing their functions under the Code without any in-principle restrictions. The guidelines also indicate that ‘*in order [to establish] a single version of truth... there should be unfettered access to data among the IUs.*’⁴² This also adds additional impetus to examine if blockchains can enhance data sharing and ‘interoperability’ amongst various IUs.

There appear to be two potential areas where blockchain solutions can further the legislative intent and result in better interoperability of different IUs. Under the IU regulations, ‘users’ can submit information to any IU and ‘*different parties to the same transaction may use different [IUs] to submit, or access information in respect of the same transaction.*’⁴³ The IU regulations further allow users to access information stored with an IU through any other IU. Presently, this functionality is envisaged to be enabled through an application programming interface (API)⁴⁴ mechanism. The working group report on IUs⁴⁵ states in this regard that:

IU industry shall use...a common API ...[which] should be published by the regulator... [By] having such a standard API.... customers will not be locked-in to any one IU.... This will also ensure that it is easy for IUs to accept information from other IUs or other repositories.

However, in a scenario involving multiple IUs (with their own financial databases and linked through a common API) and a need to ensure simultaneous share-write access, a common blockchain accessible to all IUs to record and view such transactional information may be a superior solution. As the Blockchain Report notes in another context,

...the features of blockchain make it favourable in processes requiring decentralized access, auditability, security, disintermediation, and programmability. While alternatives such as...centralized databases with distributed API access may also solve specific issues in processes at a lower cost, blockchain has the potential to solve these problems simultaneously.⁴⁶

Notably, in another context of UCC regulation, a similar approach has been adopted by telecom providers by recording of customer preferences and consent on a single blockchain which is accessible to all such entities.

A related benefit of implementing a common blockchain could be more robust identity management (for creditors, CDs and other users of IUs) and better transactional record keeping, by using blockchain to generate unique IDs for users and transactional records. The working group report on IUs touching upon the significance of these aspects states that:

...information about a debtor might be scattered across many IUs, and the system should be architected so that we can query all IUs and obtain a comprehensive picture of the liabilities of the debtor...It is essential that only one identifier should be used for identifying a person [as]...use of multiple identifiers will lead to fraud.⁴⁷

Similarly, the report also emphasises on the significance of assigning a unique ID to each debt, to enable a holistic view of a CD's liabilities and tracking by concerned stakeholders under the Code. The use of blockchains can make identity management (for persons and debt) more robust and efficient and enable a high degree of security and traceability to such records.

Blockchains and Stressed Asset Management

The efficiency gains noticed in other sectors by using blockchains in asset management (particularly real-estate) could potentially be replicated in the context of insolvency resolution as well, which could help in reinvigorating stakeholder interest in investing in stressed assets in India. The Code mandates concerned stakeholders (like RPs) to undertake identification, verification, preservation, valuation and record-keeping of a CD's assets. These actions are critical to assess the CD's financial position and ensure value maximisation. The effectiveness of subsequent stages under the Code (under both CIRP and liquidation) also depend on a comprehensive and accurate undertaking of this exercise.

The use of blockchain solutions for managing such stressed assets can likely have the potential to 'reduce costs, increase operational efficiency, improve transparency and facilitate a range of innovative investments.'⁴⁸ These can enable a more transparent record-keeping of a CD's assets with this information being available in real time to all concerned stakeholders in a tamper proof form, which could address key informational gaps and provide for an efficient insolvency resolution.⁴⁹

CONCLUSION

Given the current delays in the working of the Code due to informational bottlenecks, blockchain technologies could be explored by regulators as a technological means to bridge such gaps and bring speed, security and efficiency in current processes. That being said, sole reliance on blockchain solutions may not be adequate, and wider systemic and legal reforms and attitudinal changes would be necessary to resolve the bottlenecks and realise the full potential of this technology.

NOTES

- ¹ IBBI (2020), *Understanding the IBC: Key Jurisprudence and practical considerations -A Handbook*, p. 11.
- ² Kattadiyil B. and Mehboob CS. (2020), "Corporate Insolvency in India and Other Countries-A Comparative Study", *International Journal of Multidisciplinary Educational Research*, 7(9), for a broad comparison between the insolvency regimes in India (under the Code) and in other jurisdictions like US, UK, Germany, Singapore, and Australia.
- ³ Shikha N. and Shahi U. (2021), "Assessment of Corporate Insolvency and Resolution Timeline", IBBI Research Initiative – RP 1/2021.
- ⁴ IBBI Quarterly Newsletter, January-March, 2021.
- ⁵ Notably, the maximum permissible timeline for CIRP completion (after extensions) is 330 days.
- ⁶ The current timeline under the Code for completion of liquidation is two years. Earlier, this timeline was one year.
- ⁷ This can be inferred from the recent quarterly newsletters published by IBBI.
- ⁸ The Report of the Bankruptcy Law Reforms Committee, Volume I: Rationale and Design, 2015, p. 14.
- ⁹ Report by the Insolvency Law Committee, February, 2020, p. 21.
- ¹⁰ Covitz D. et.al. (2006), "Are Longer Bankruptcies Really More Costly?", Federal Deposit Insurance Corporation.
- ¹¹ McGowan M. and Andrews D. (2016), "Insolvency Regimes and Productivity Growth: A Framework for Analysis", OECD Economics Department, Working Papers No. 1309, OECD Publishing.
- ¹² Supra Note 3, p. 31.
- ¹³ Supra Note 8, p. 30.
- ¹⁴ Supra Note 1, p. 23.
- ¹⁵ Supra Note 9, p. 23.
- ¹⁶ Section 215, IBC
- ¹⁷ Under the Code, '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.
- ¹⁸ Supra Note 1, p. 26.
- ¹⁹ National E-Governance Services Limited.
- ²⁰ *Univalu Projects Private Limited & others v. Union of India*, W.P. No. 5595 (W) of 2020 and W.P. No. 5861 (W) of 2020 (Calcutta High Court) [*'All factors being taken in consonance and on a harmonious reading of section 215 of the IBC, 2016 with section 7 of the IBC, 2016 along with the Rules and Regulation discussed above, I come to the conclusion that the legislature did not intend to make it mandatory for financial creditors to submit financial information to the IU. This view of mine is fortified by the fact that the Supreme Court had also considered the pertinence of the IU based on the IU Regulations, 2017 and specifically stated that other sources of evidence are present apart from the record maintained by the IU. It may therefore be inferred that Section 215 of the IBC, 2016 is not mandatory in nature.'*].
- ²¹ Supra Note 1, p. 26.
- ²² *Ibid.*
- ²³ Supra Note 3, p. 4.
- ²⁴ Shah N. et.al. (2019), "Indian Stressed Asset Market: The Next Investment Wave in India", Alvarez and Marsal, 25 November. [*'While there exists tremendous investment opportunity under the IBC regime, participation of stressed asset investors under IBC has been tepid so far. Though USD 7+ bn of capital has been raised between seven major stressed asset investors, most resolutions have been driven by strategic investors, and funds have still not deployed large amounts of capital in stressed assets.'*].
- ²⁵ That being said, other than information asymmetry, other factors like litigation delays and legal uncertainty also contributes to the current reluctance of a larger investor class in participating in the IBC process. *Ibid.*, at

page 12. See Supra Note 3, p. 12.

²⁶ This framework is under the Telecom Commercial Communications Customer Preference Regulations, 2018 issued by the Telecom Regulatory Authority of India.

²⁷ World Bank Group (2017), “Distributed Ledger Technology and Blockchain, Fintech Note-1” [“*DLT allows for transactions and data to be recorded, shared, and synchronized across a distributed network of different network participants... A ‘blockchain’ is a particular type of data structure used in some distributed ledgers which stores and transmits data in packages called “blocks” that are connected to each other in a digital ‘chain’.*”].

²⁸ PTI (2021), “TRAI Suspends Norms For Commercial SMS For One Week”, *Bloomberg Quint*, 9 March.

²⁹ Hughes H. (2020), “Blockchain and the Future of Secured Transactions Law”, *Stanford Journal of Blockchain Law and Policy*, 3(1), p. 31.

³⁰ Supra Note 27, p. 15

³¹ Niti Aayog (2020), “Blockchain – the Indian Strategy: Towards Enabling Ease of Business, Ease of Living and Ease of Governance”, January.

³² *Ibid*, pp. 26 - 29.

³³ *Ibid*, p. 26.

³⁴ *Ibid*, p. 20.

³⁵ Dyatko N. (2019), “No, you don’t store data on the blockchain – here’s why”, Jaxenter, 16 December.

³⁶ That being said, other methods like storing the ‘hash’ of such underlying documents on the blockchain could be explored to undertake document authentication in this context.

³⁷ Chapter V, IBC.

³⁸ IBBI (Information Utilities) Regulations, 2017 (as amended).

³⁹ Guidelines for Technical Standards for the Performance of Core Services and Other Services under the IBBI (Information Utilities) Regulations, 2017.

⁴⁰ Under the Code, ‘core services’ means ‘*services rendered by an IU 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 IU to specified persons.*’

⁴¹ Supra Note 38, section 1.1

⁴² *Ibid*.

⁴³ Supra Note 37, regulation 19. [*Illustration: A debt transaction has creditor A and debtor B. A may submit information about the debt to information utility X, while B may submit information about the same debt to information utility Y.*’]

⁴⁴ Altexsoft (2019), “What is API: Definitions, Types, Specifications”, 18 June.

⁴⁵ Report of the Working Group on Information Utilities, January, 2017, p.30.

⁴⁶ Supra Note 31, p. 17.

⁴⁷ Supra Note 43, p. 31.

⁴⁸ McGowan K. (2020), “BDO Asset Management Insights, Blockchain: Forging the Future of Asset Management”, BDO.

⁴⁹ Blockchain technology can also potentially herald an entirely new type of resolution framework in which physical assets of a CD could be tokenised (i.e., securitised or converted into tokens or digital representations on blockchains) which could then be acquired (including fractionally) by investors and traded. However, this aspect would require a detailed study.

UNDERSTANDING A BORROWER’S ABILITY AND INTENT TO REPAY DEBT

M. V. Nair¹

ROLE OF CREDIT INFORMATION COMPANIES

The assessment of credit risk is crucial to the granting of loans and advances by lenders to prospective borrowers. In order to efficiently assess credit risk of a proposed funding, the nature of credit information available to a particular lender *vis-à-vis* a particular borrower becomes critical. In this past decade, credit bureaus have enabled better information sharing which allows lenders to review how much and at what rate they would lend to borrowers. This has in turn resulted in Credit Information Companies (CICs) playing a significant role in improving the credit offtake and management of credit risk by credit institutions in this economy.

CICs have played a pivotal role in providing numerous insights in credit operations and driving effective policy changes in India. They have also provided important inputs for the banking supervisors in monitoring systemic risks. Not only so, CICs have time and again assisted regulators in analysing appropriate capital and provisioning strategies for banks and, in particular, to assess whether current capital and provisioning regulations match up to actual risks.

CICs have not only acted as collectors and distributors of data but have instead fulfilled the mandate of being a perpetuator of information literacy by processing the data collected from various sources into credible and usable credit information and by helping the users of information, both lenders and borrowers, to integrate this information into their decision-making processes.²

India’s credit industry has gone through a rapid evolution over the last decade and has experienced a transformation of the consumer mindset from a savings-focused and debt-averse country to a more consumption-focused, leveraged economy. The rate of change has been and still is, significant. This

has been aided by multiple factors such as changing demographics, urbanisation, rising digitisation and the subsequent rise of e-commerce, improved access to retail lending, and increased exports. One of the driving factors towards this evolution is that credit institutions have effectively leveraged credit information solutions to drive faster turnaround times, expand customer base and enhance customer loyalty, improve asset quality and grow profitably across retail and micro, small and medium enterprise (MSME) lending. The benefits are evident in the form of reduced credit approval and access time, improved access to finance and thereby ease of doing business.

REGULATORY AND LEGAL FRAMEWORK

The Credit Information Companies Regulation Act, 2005 (CICRA) read with the Credit Information Companies Rules, 2006 (CIC Rules) and the Credit Information Companies Regulations, 2006 (CIC Regulations) is the governing framework for CICs in India. The CICRA, the CIC Rules and the CIC Regulations came into effect from December 14, 2006. The CICRA provides a regulatory mechanism for mitigating credit risk by enhancing the quality of credit decisions and helps in curbing the growth of fresh non-performing assets (NPAs) through the creation of CICs. A CIC in India is required to be licensed by the Reserve Bank of India (RBI) and comes under the purview of the CICRA, the CIC Rules and the CIC Regulations and various notifications issued by the RBI, from time to time. At present, under the extant CIC laws, there are four registered CICs in India who have been duly authorised by the RBI to undertake the functions of a CIC. In terms of CICRA, credit institution³ and specified users⁴ (as defined under the Act) are required to submit/ take data and information from the CIC.

Role of TransUnion CIBIL in lending ecosystem

TransUnion CIBIL manages the complete spectrum of ₹ 121 lakh crore of India's lending industry across all credit institutions. The country's lending market has NPAs of over ₹ 12 lakh crore as of March, 2021. Figure 1 provides a snapshot of lending credit outstanding, NPA rates and loan accounts and borrowers as of March 31, 2021.

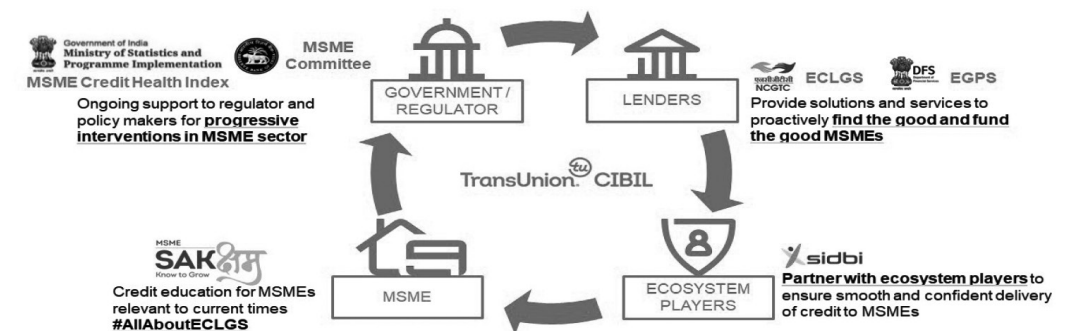
Figure 1: Lending industry credit outstanding, NPA rates and loan accounts and borrowers as of March 31, 2021

	Retail	Agriculture	SME	Large Corporates
	- Lending to Individuals - Sample loan types: • Credit Cards • Personal Loans • Housing Loans • Car Loans	- Tractor Loans - Kisan Credit Cards - Agriculture Loans	Lending to Business Entities - ticket size of between INR 1 Cr. to INR 50 Cr.	Lending to Business Entities - ticket size of greater than INR 50 Cr.
NPA Rate	2.8%	11.7%	12.1%	17.2%
Credit Outstanding	₹ 47.1 lac crores	₹ 7.5 lac crores	₹ 18.3 lac crores	₹ 48.3 lac crores
Loan accounts & borrowers	109 crores loan accounts 42 crores individual borrowers		5.8 crores loan accounts 2.8 crores entities as borrowers	

Source: TransUnion CIBIL credit database

Over a period of time, the role of CICs has evolved into supporting the entire lending ecosystem. In the changing MSME lending landscape, TransUnion CIBIL has supported all the ecosystem players so that the lending industry can progress profitably. Figure 2 shows the role played by TransUnion CIBIL to support each player for their role in MSME lending ecosystem.

Figure 2: Role played by TransUnion CIBIL in MSME lending industry



CIC's DATABASE AND NPAs– AN ICEBERG CONCEPT

TransUnion CIBIL continuously monitors banking system's risk and credit trends. Its latest analysis suggests that from an economic perspective, India's bad debt problem is larger than what is revealed. TransUnion CIBIL focusses on three components of the bad debt to not only evaluate the current situation, but also identify potential future Gross NPA rate in the lending portfolio which, as of March, 2021 stands at ₹ 121 lakh crore. The three components of bad debt being:

- (a) Gross NPA (recognised) which are stamped NPA by a lender. This component stood at ₹ 12.7 lakh crore as of March, 2021;
- (b) 'Partially recognised NPAs' which occurs because banks in which an account was 'Standard' were *prima facie* not expected to tag it as NPA, even though the borrowing entity may have been tagged as NPA by other lender(s). This component amounted to ₹ 6.1 lakh crore;
- (c) Further, future NPA's are also driven by the stock of 'Analytics Layer accounts' which from a technicality perspective are not NPA but are identified as high risk or sub-prime i.e. Credit Vision Score of individuals <=680 for retail and agriculture segments, CIBIL MSME Rank (CMR) 7-10 for MSMEs and accounts in overdue / SMA for last six months for large corporate borrowers. The exposure of this component was ₹ 14.9 lakh crore.

Figure 3 : Illustrates the Iceberg Concept

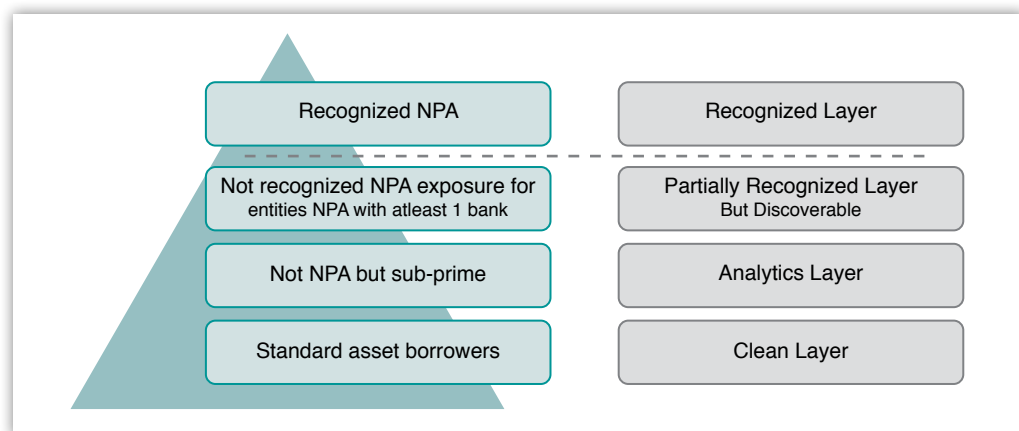


Figure 4: Iceberg Concept based credit outstanding as of March 31, 2021

Segment (in ₹ lac crores)	Retail	AGRI	MSME	Large Corporate	Overall	Overall %
Recognized Layer	1.3	0.9	2.2	8.3	12.7	11%
Partially Recognized	2.1	0.3	0.4	3.3	6.1	5%
Analytics Layer	3.4	1.1	2.6	7.7	14.9	12%
Clean Layer	40.3	5.1	13.1	28.9	87.4	72%
Total	47.1	7.5	18.3	48.3	121.1	100%

Source: TransUnion CIBIL credit database

Curing of NPA borrowers

NPA borrowers have a very different curing from each other depending upon many factors. These factors can be sharply understood using Credit Information Report (CIR) and CMR of TransUnion

CIBIL. Take an example of an MSME NPA book as of March 31, 2020. Of all the NPAs as of March 31, 2020, 21% of them cured back to Standard Assets. Remaining 79% either had delayed curing or eventually no recovery. The advantage lenders, Information Utility (IU) and Resolution Professionals (RPs) can, by using CMR understand the difference in probability to cure in the next one year. Figure 5 shows how the cure rate differs based on CMR of the MSME.

Figure 5: CMR MSME Rank based cure rate for NPA MSMEs within one year

CIBIL MSME Rank as of March 31, 2020	Cure Rate in Next 1 Year (%)
CMR-8	55
CMR-9	26
CMR-10	2
Overall	21

Source: TransUnion CIBIL credit database. Cure rate is defined as borrower transforming from NPA Asset Classification to Standard Asset Classification in one year.

CMR-8 cure rate of 55% can provide IU and RPs with more confidence about borrowers as compared to borrowers with CMR-10, which have cure rate of only 2%. Hence, the CIR and CMR can be an important tool for the IUs and RPs to design their resolution plans of borrowers.

In addition to above, the underlying collateral behind the security also determines the curing probability. Borrowers with stronger collateral attached to loan, like a residential property are typically more likely to cure than a borrower with no collateral attached to the loan. But the challenge is that this information is not available with CICs, and making this information available to CICs will strengthen the prediction of cure possibility, and in turn support IUs and RPs

CONCLUSION

TransUnion CIBIL's credit database maintains information and data of about ₹ 121 lakh crore of India's lending industry across all borrower types, from individual loans to large corporate loans. The analytical capabilities built on this database like cure rate based on CMR and Iceberg Concept, provide the much-needed lens for IU and RP for a deeper understanding of the intent and ability to repay debt by the underlying borrower. Lenders currently leverage these services to sharpen their credit analysis of the borrower. Given the fact that IU and RP are specified user to CICs, these services that can also be consumed by them to sharpen their analysis. Some of these services are mentioned below:

Company's CIR: A month-on-month record of a company's debt related exposure and payments, the report captures cash credit, overdraft facilities, loans of all maturities, bank guarantees, letters of credit, packing credit, deferred payment obligations, forward contracts and any other banking

debt exposure that a company has incurred. This information is captured for non-individuals like sole proprietors, partnership firms, association of persons, private and public limited companies. These are widely used by lenders like banks and non-banking financial institutions to evaluate the company's past payment behaviour and ability to bear additional debt.

CIBIL MSME Rank: Today, CIBIL Score – the three-digit numeric indicator of the probability of default by the borrower – has become one of the most important criteria for assessment of retail credit applications by banks and credit institutions. On MSME lending, the CIBIL rank is a credit default predictor model for MSMEs. It provides insights in the credit behavior of the borrowing entity (MSMEs) and predicts the probability of default over a one-year horizon, thereby, helping the lenders to make well informed credit decisions. It is applicable to MSMEs with aggregate commercial borrowings up to ₹ 50 crore. It measures and predicts the risk of the MSME on a scale of one to ten, one being the best rank and ten being the worst.

The availability of CIBIL Score and CMR has played a significant role in the development of the credit sector, the economy and more so the society in our country. Credit information solutions have enabled banks and credit institutions to drive quick, easy and affordable access to credit for millions of borrowers in our country. Additionally, CIBIL Score and CMR based lending and credit information support has fostered financial inclusion by enabling lenders to find and fund the good borrowers, thereby helping drive access to finance for consumers and MSMEs, while also controlling asset quality for lenders.

In the evolving ecosystem, as more forms/ sources of data become available, the ability of lenders and RPs to create a consolidated and/or comprehensive view of the assets and liabilities of the borrower will indeed become a game-changer. As per the author's view, collection of non-traditional data and alternate payment information by CICs is the need of the hour to enable such game-changing solutions for IUs, RPs and lenders. Credit reporting system in India (in line with practices across the world) should allow the reporting of all non-lender data useful for determining creditworthiness of a borrower. As a CIC, TransUnion CIBIL is actively working with the relevant stakeholders to help foster these possibilities.

TransUnion CIBIL is committed to supporting the credit industry and regulators with insights and solutions to catalyse and further strengthen India's data ecosystem, foster trust among market participants and help accelerate economic development and financial inclusion for driving economic resurgence.

NOTES

¹ Author recognises the contributions of Ms. Padmini Vora, General Counsel, Head Legal & Compliance and Mr. Vipul Mahajan, Business Lead, MSME and Corporate Lending, TransUnion CIBIL Ltd., in writing this article.

² Credit Information Companies: Seeking New Frontiers (Inaugural address by Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India at the Experian India Conclave 2013 organised in Mumbai on July 5, 2013).

³ 'Credit institution' means a banking company and includes: (a) corresponding new bank, the State bank of India, a subsidiary bank, a co-operative bank, the national bank and regional rural bank; (b) NBFC; (c) a factor; (d) a public financial institution; (e) the financial corporation established by a state; (f) housing finance institutions; (g) companies engaged in the business of credit cards & other similar cards; (h) companies dealing with distribution of credit; (i) Any other institution as RBI may specify from time to time.

⁴ Regulation 3 of the CIC Regulations has expanded the scope of 'specified user' (as such term is defined in CICRA) and includes: (a) an insurance company and registered with IRDA; (b) a company providing cellular or phone services and registered with the TRAI; (c) a credit rating agency; (d) stock broker; (e) a trading member, registered with a recognised commodity exchange; (f) SEBI; (g) IRDA; (h) Information Utility; (i) Resolution Professional.

CONTRACTUAL FREEDOM VS. CORPORATE RESCUE: TAKING ANTI-DEPRIVATION RULE BEYOND GUJARAT URJA RULING

Vinod Kothari and Sikha Bansal

Insolvency is a state of insufficiency – as such, the need to protect ‘whatever is there’ is quite obvious. The rule of ‘anti-deprivation’ offers that protection.

Under normal circumstances, the autonomy of parties entering into contracts is well-established. However, in insolvency, there is an inherent tension between contractual freedom and the objective of corporate rescue and the need to ensure *pari passu* treatment to all claimants clamouring to share what is insufficient, and therefore, contractual provisions are quite often subjected to either statutory challenge or are read down or invalidated by courts. The anti-deprivation rule, also sometimes called rule against *ipso facto* clauses in contracts, seeks to invalidate any contractual provision which has the effect of depriving the insolvent’s estate of any right, property, or benefit, by the very fact (hence, *ipso facto*) of the entity becoming insolvent. The rule of anti-deprivation thus seeks to protect the insolvent’s estate (and consequentially, its creditors) from getting ‘deprived’ as such.

Though apparently simple, the contours of the anti-deprivation rule have been debated, inconclusively, across jurisdictions, given the need of balancing between two foundational pillars of insolvency regime – preservation of contractual rights, and protection of the value of the insolvent’s estate. It is right that the insolvent’s estate should not suffer due to termination of a property or contractual right as a result of initiation of insolvency proceedings. It is also right that if parties to a contract want certain rights to be terminated on certain ‘events of default’ or ‘adverse material change’, and insolvency is certainly one such event, the freedom to have the contract as parties would want it,

should be preserved. After all, enforcement of a contractual clause is more important in insolvency of a counterparty than ever otherwise. Hence, the dilemma of a conflict between ‘what is right’ and ‘what is right’ was aptly captured by the Supreme Court (SC) in *Gujarat Urja Vikas Nigam Limited v. Amit Gupta & Ors.*¹

In the said ruling, SC clearly highlighted the significance of the anti-deprivation rule when it observed that continuation of the contract assumes enormous significance for the successful resolution process, however, SC did say what is quite obvious for the judiciary – that courts are not lawmakers, and therefore, while SC gave enough indication as to the need for legislative provisions in the matter, it had to resort to what it would call the ‘dialogical remedies’.

In this article, the authors want to take the next steps. Clearly, the SC’s ruling is rich with not just the jurisprudential history of the anti-deprivation rule, but it also makes a global comparison of legislative steps, and characteristically, remarks: ‘As India develops into a responsive member of the international community, our laws cannot afford to be inward-looking’. The SC tracks through United Nations Commission on International Trade Law (UNCITRAL) guide, and legislative provisions across the globe and provides a complete background to take the next steps. In this article, the authors also build a case as to why the legislative steps in this regard are required, how other countries have tackled the issue, and what could be a potential pathway for India in terms of legislative action. Before reaching there, we will also want to give a quick understanding of the anti-deprivation rule, and a brief view on how courts have often been baffled by choosing between what is right and what is right, and then they end up choosing what is right.

ANTI-DEPRIVATION RULE IN INSOLVENCY JURISPRUDENCE

The anti-deprivation rule originally is, like several other principles of insolvency law, a judge-made law rather than a statutory provision. The ruling of the Court of Appeal in *Perpetual Trustees Company Ltd v. BNY Corporate Trustee Services*² tracks the early history of the rule in rulings from 1860 to 1930. However, the many shades of the rule have been related to *pari passu* rule, rule pertaining to set-off, rule against contracting out of insolvency, flip rules (so known in cases where the contract provides for the priority order or rights of an insolvent to be modified or flipped against the insolvent, on the occurrence of insolvency), or rule for termination of executory contracts.³

Since the rule has been developed with over 200 years of wisdom of powerful common law judges, it is obvious that it would have many facets. The significance of the rule has also moved over time, but it is certain that the relevance of the rule has only increased over time, since the extent of value and corporate wealth enshrined in intangible assets, contractual rights, etc. has only increased over time.⁴

The early cases of anti-deprivation⁵ have been concerned with contracting out of bankruptcy laws, or the intuitive principle against contracting out of public policy. These early cases were concerned with invalidating and blocking an attempt by someone to avoid a property from coming to the

bankruptcy waterfall, and therefore, was seen as interfering with the *pari passu* rule by diverting a property or benefit away from the bankruptcy claimants. Thus, in the classic case of *Whitmore v. Mason*⁶, the Court said, ‘. . . no person possessed of property can reserve that property to himself until he shall become bankrupt, and then provide that, in the event of his becoming bankrupt, it shall pass to another and not to his creditors.’

Given that the fundamental principle is equity of distribution, such a contractual provision amounted to contracting out of public policy. *Whitmore* concerned with exclusion of a mining lease from the scope of partnership assets on the partner becoming insolvent, which was held to be void as being in ‘fraud of bankruptcy laws’, as because as per the rule in bankruptcy, ‘all of bankrupt’s property shall vest with his assignees’. Hence, the rule seems to have been a subset of the *pari passu* rule, and the courts were not looking at the deprivation of the estate of the insolvent itself; rather, the courts were looking at some specific person getting an advantage over the rest of the creditors. A non-exhaustive list of such cases, all of them of individual insolvency, is: *Ex p Mackay*; *Ex p Brown*; *In re Jeavons* (1873) LR 8 Ch App 643 (CA); *Ex p Jay*; *In re Harrison* (1880) 14 Ch D 19 (CA); *Ex p Newitt*; *In re Garrud* (1881) 16 Ch D 522 (CA); *Ex p Barter*; *Ex p Black*; *In re Walker* (1884) 26 Ch D 510 (CA); *In re Detmold*; *Detmold v Detmold* (1889) 40 Ch D 585 ; *Borland’s Trustee v Steel Bros & Co Ltd* [1901] 1 Ch 279 ; *In re Johns, Worrell v Johns* [1928] Ch 737 ; *Bombay Official Assignee v Shroff* (1932) 48 TLR 443 (PC)⁷; and *In re Apex Supply Co Ltd* [1942] Ch 108. In such contracts, as it appeared, the provisions were ‘in violation of the policy of bankruptcy law’, ‘contractually controlling the user of the property’, or meant to give an ‘unlawful’ advantage to the third party.

The House of Lords decision in *British Eagle International Airlines Limited v. Compagnie Nationale Air France*⁸ seems to be the first case of applying the principle developed over time to corporate insolvency and seems to be initiating an application of the principle to set-off rights. The case involved a ‘clearing house arrangement’ which facilitated clearing of debit and credit accounts among multiple airlines. One of the airlines, British Eagle slipped into liquidation. Air France took the view that any net debit balances owed by airlines in respect of business transacted by British Eagle for them should be applied in reduction of the net credit balances owed by British Eagle in respect of business done by other airlines for it, and claimed that they ought not to be treated in the liquidation as ordinary unsecured creditors but that they have achieved by the medium of the ‘clearing house’ agreement a position analogous to that of secured creditors. However, the court ruled that the clearing arrangement was to set up by simple contract a method of settling each other’s mutual indebtedness at monthly intervals. The clearing house arrangements, by agreeing that simple contract debts are to be satisfied in a particular way, would amount to ‘mini liquidation’, which being contrary to public policy, should yield to general liquidation.

In 2007-08, the world suffered the Global Financial Crisis, and several securitisation transactions fell like house of cards. These included several synthetic securitizations, which sought to package a bunch of corporate exposures into securities. Lehman Brothers is a well-known casualty of the crisis, as the litigation in Lehman synthetic securitisation was fought on both sides of the Atlantic⁹.

The proceedings in UK started from Chancery Court, to Court of Appeal and finally in the Supreme Court (UKSC) led to elaborate discussion on the anti-deprivation rule in *Belmont Park Investments PTY Limited v. BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc.*¹⁰. The proceedings at the Court of Appeal and UKSC seem to one of the most elaborate discussions on the history of the anti-deprivation rule.

The Belmont Park ruling is an important landmark in the development of caselaw on anti-deprivation, in many senses. To the extent this ruling underscores the predicament of the judiciary over time in upholding the rule in some cases, and rejecting some, the case is typical; however, it is unique to the extent it, presumably for the first time, gave several limitations of the anti-deprivation rule. Also, like in several other rulings, the UKSC reiterated the need to preserve the law, despite specific statute having developed since the common law rulings. The UKSC also reiterated the difficulty in codifying principles where the doctrine should apply but went on draw several exceptions to the rule. One of the important exceptions was the ‘intent’ test, rather than the ‘effect’ test, to preserve what may judicially be regarded as a *bonafide* part of a commercial bargain. This carve-out, as may be easy to understand, is to both compel and allow the courts to get into the facts and circumstances, rather than base the applicability of the doctrine on principles. The UKSC also makes important distinctions between the *pari passu* principle and the anti-deprivation principle (see, the discussion below). It distinguishes between the determinable rights and defeasible rights, etc. Finally, the UKSC certainly highlights that the exceptions to the freedom of contract must come from the statute.

Another important aspect which has often been discussed by courts is whether anti-deprivation rule is the same as *pari passu* principle, and the courts have noted that, while there are differences, it is quite clear that the two are complementary.

As discussed in *Belmont Park*, the anti-deprivation rule applies only if the deprivation is triggered by bankruptcy and has the effect of depriving the debtor of property which would otherwise be available to creditors. The *pari passu* rule applies irrespective of whether bankruptcy or liquidation is the trigger. Further, as noted in as noted in *Lomas v. JFB Firth Rixson Inc*¹¹, the relationship between anti-deprivation rule and *pari passu* rule is both dependent and autonomous. While the anti-deprivation principle facilitates the application of *pari passu* rule, but their areas of operation are distinct and *pari passu* rule applies only to such assets as at the commencement of bankruptcy or liquidation.

Hence, while there can be overlaps; however, these are aimed at different mischiefs - Goode ‘Perpetual Trustee and Flip Clauses in Swap Transactions’ (2011), 127 LQR 1, 3-4¹². The anti-deprivation rule focuses on attempts to withdraw assets on insolvency, thereby reducing the value of the insolvent estate to the detriment of creditors. It is not concerned with the *pro rata* distribution of assets among equally ranked creditors. Hence it has been rightly observed that while the anti-deprivation rule ensures that the size of the pie available for division is not improperly reduced, the *pari passu* rule focuses on the appropriate division or distribution of the pie¹³. The primary objective of the rule is asset preservation and the maximisation of realisations for the general body of creditors.

The jurisprudence has thus, over years, has shaped the contours of anti-deprivation rule. The rich jurisprudence as well as recently enacted legislative amendments across globe can provide a basic guide for legislating the anti-deprivation rule – as discussed in subsequent paragraphs.

LEGISLATIVE MEASURES TO CODIFY ANTI-DEPRIVATION RULE

USA

In the USA, the anti-deprivation rule, mostly known as *anti-ipso-facto* rule, is statutory, and is cast in the provisions of the US Bankruptcy Code under section 365. Section 365(e) of the US Bankruptcy Code makes provisions for unenforceability of *ipso facto* clauses present in an executory contract or an unexpired lease. The provision prohibits termination/modification of an executory contract and unexpired lease (or any right or obligation under such contract) solely because of a provision in the contract or lease that is conditioned on the insolvency or financial condition of the debtor at any time before the closing of the case, or the commencement of a case, or appointment of a trustee/custodian. Contracts to make loan or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor are excluded from the operation of the section.

The intent of the *anti-ipso-facto* rule is set out in the legislative policy objectives in the statute, as ‘being to enable trustees to assume or assign useful executory contracts or leases that will aid the company’s rehabilitation or liquidation.’¹⁴

Besides section 365, there is section 541 of the US Bankruptcy Code. It states that an interest of the debtor in property becomes the property of the estate notwithstanding any provision in an agreement, transfer instrument, or applicable non-bankruptcy law that is

conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor’s interest in property.

United Kingdom

On the other side of the Atlantic, in the UK, there had been no explicit references to invalidation of *ipso facto* clauses in the Insolvency Act, 1986. Courts were relying on the age-old precedents, which became considerably weakened with the ruling in *Belmont Park* validating what may subjectively be seen as *bonafide*. However, the COVID-19 crisis underscored the need for corporate rescue, and in order to ensure that companies undergoing insolvency procedures continue to trade, certain protections were deemed necessary to ensure that suppliers do not terminate supply contracts during such rescue. While the intent to introduce these amendments dates to 2016¹⁵, it was after the COVID-19 disruption that the amendments were carried out in 2020. This led to insertion of section 233A to the Insolvency Act, 1986 to prohibit enforcement of ‘termination’ clauses in supply contracts

where the company, under specified insolvency procedures, is a recipient of such supplies under those contracts. The supplier may be allowed to terminate a contract only where either the office-holder or the company consents to such termination or the court is satisfied that the *'the continuation of the contract would cause the supplier hardship and grants permission for the termination of the contract.'* It may be further noted that schedule 4ZZA provides for exclusions from section 233B, which covers persons involved in financial services or contracts involving financial services. Further, section 233C empowers the Secretary of State to frame regulations specifying exclusions from section 233B with reference to kinds of company, supplier, contract, goods or services or in any other way.

Notably, amendments similar to those in UK have been made in the Indian law as well (see below). Despite the scope to include several deprivation actions in the vague expression 'any other thing' (as under section 233B (3)¹⁶), in view of the authors, these provisions are more concerned only with keeping the corporate debtor (CD) functional during reorganisation, rather than protecting the assets of the insolvent's estate.

Singapore

Singapore has legislated Insolvency, Restructuring and Dissolution Act, 2018¹⁷ - provisions have mostly commenced from mid-2020, including section 440 which limits the contractual rights of a person to terminate 'rights or obligations' under any agreement with the company by reason 'only that the proceedings are commenced or that the company is insolvent'. Such a provision in an agreement "that has the effect of providing for, or permitting, anything that, in substance, is contrary" has been rendered unenforceable. An important feature of this section is that a party to an agreement can approach the court and the court can exempt the agreement from the operation of the section if the party satisfies the court that *'the operation of this section would likely cause the applicant significant financial hardship.'* Notably, the section keeps certain contracts out of the purview of such invalidity – prescribed 'financial contracts'; government licenses, permits, approvals; a contract which is likely to affect national interest, etc. In the context of Singapore, it is important to note that the Singapore Insolvency Law Committee¹⁸ did not recommend introducing restrictions on the enforcement of *ipso facto* clauses, citing potent reasons like risk of domino insolvencies, flexibility and party autonomy leading market forces to work rationally, etc.

Australia

In Australia, provisions have been existing in the context of 'arrangements and reconstructions'. Section 415D of the Corporations Act, 2001 puts stay on enforcing rights merely because of a proceeding under section 411; while certain kinds of rights are not subject to stay – including as prescribed by way of regulations. However, further amendments were made in the Corporations Act, *vide* Corporations Amendment (Corporate Insolvency Reforms) Act, 2020¹⁹ to provide for restructuring processes in Schedule 1 (with effect from January 15, 2021). Section 454N provides for stay on enforcing rights and section 454P provides for court's interference if the same is

'appropriate in the interests of justice'. The Productivity Commission Inquiry Report on Business Set-up, Transfer and Closure, 2015²⁰ notes that *ipso facto* clauses can severely constrain the ability of a business to continue trading during restructure. The operation of these clauses can reduce the scope for a successful restructure or prevent the sale of the business as a 'going concern'. Hence, the committee recommended that Corporations Act be amended such that *ipso facto* clauses are void (unless otherwise directed by a court) when a business is controlled by an administrator (as already applies if a person is in bankruptcy). This would not excuse the business from complying with all other terms of the contract or remove whatever termination rights the counterparty has in the event of any other breach. Further, in circumstances where this moratorium could lead to undue hardship, suppliers should be able to apply to the court for an order to terminate the contract.

European Union

European Union (EU) too, has formulated Directive (EU) 2019/1023²¹ for invalidating *ipso facto* clauses. Article 7 requires formulation of rules to ensure that the parties are prevented from *'withholding performance or terminating, accelerating or, in any other way, modifying essential executory contracts to the detriment of the debtor'*, by virtue of a contractual clause providing for such measures, solely by reason of a request for the opening of or preventive restructuring proceedings; or opening of such proceedings; or a request for a stay of individual enforcement actions; or granting of such stay. Exceptions have been made for netting arrangements, including close-out netting arrangements, on financial markets, energy markets and commodity markets. Germany, *vide* Restructuring Update Act, has inculcated the said EU Directives in its insolvency regime. In France, French Code de Commerce, art. L. 622-13 provides that, notwithstanding any legal rule or contractual term to the contrary, the indivisibility, termination or rescission of the contract shall not result from the commencement of safeguard proceedings alone.

India

In India, section 14 of the IBC touches upon fringes of the anti-deprivation rule, but it is only for protection against termination during the moratorium period. Section 14 (1) curbs transfers/alienations of assets by CD, besides prohibiting debt-recovery actions by creditors, which can be partly viewed as embracing the features of anti-deprivation. However, section 14 (2) prohibits termination of specified 'essential goods/services' during the moratorium period. This, as in our opinion, is more concerned about general functioning/operational continuity of the CD than addressing the issue of 'asset-stripping' from the insolvent's estate.

Later, as concerns arose regarding termination of grants/licenses by government authorities/third parties on account on *ipso facto* clauses in contracts, based on recommendations of the Insolvency Law Committee (ILC)²², a *proviso* was inserted under section 14 (1), which prohibits suspension or termination of *'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'* *'on the grounds*

of insolvency' on condition that payments against these grants/licenses, are continued during the moratorium period. Besides, section 14 (2A) was inserted which covered supply of critical goods and services to the CD.

Two points deserve to be noticed as regards *proviso* to section 14 (1) – One, the prohibition is on termination on grounds of insolvency. This, exactly, is the proposition of anti-deprivation rule. The discussions of ILC were also clear that the termination on other grounds shall not be covered by the proviso. However, the second but more important point, which considerably weakens the amendment in the broader context of anti-deprivation, it is that the provision only mentions governmental (or statutory) authorities, and not private parties. So, what is covered is grants/licenses given by government authorities, but not rights granted under contracts by private parties. Therefore, it does not dabble into private contracts.

In addition to the specific provisions of the insolvency regulations, there has been an age-old principle of property law, called rule against forfeiture on insolvency, which is coded in section 12 of the Transfer of Property Act, 1882. Section 12 provides, 'Where property is transferred subject to a condition or limitation making any interest therein, reserved or given to or for the benefit of any person, to cease on his becoming insolvent or endeavouring to transfer or dispose of the same, such condition or limitation is void.' The section, however, does not apply to a condition in a lease for the benefit of the lessor or those claiming under him.

The section incorporates the anti-defeasance provisions discussed earlier, and has been deployed in several rulings, including the ruling in *Official Assignee of Bombay v. Shroff* referred earlier.

Further, the J. J. Irani Committee, in Report of the Expert Committee on Company Law (2005), did talk about statutory provisions to override contractual provisions, 'The law should provide for treatment of unperformed contracts. Where the contracts provide for automatic termination on filing of insolvency, its enforcement should be stayed on commencement of insolvency.'

However, this recommendation was never seen in the Companies Act, 2013. The Bankruptcy Law Reforms Committee (BLRC), in its Interim Report²³, has discussed 'Safe Harbours' in insolvency and noted that several international laws provide exemption to financial contracts (including contracts in securities, derivatives in various asset classes, repo transactions, contracts entered into on recognized securities exchanges etc.) from the normal operation of insolvency laws, including exemption from the prohibition on the exercise of termination provisions exercisable upon the entry of the contractual counterparty into formal insolvency proceedings. Referring to a Securities and Exchange Board of India (SEBI) proposal for ensuring priority of the rights of clearing corporations and other financial market infrastructure providers. BLRC, in its recommendations, agreed to the SEBI proposal, taking note of international regulatory regime. However, such safe harbour does not seem to have been imbibed in IBC yet.

Hence, as it appears, the Indian insolvency law has not inculcated the anti-deprivation stance to the fullest – that, there is a perceived gap in law relating to *ipso facto* clauses (as also, anti-deprivation rule) is clearly recognised.

NEED FOR LEGISLATIVE PROVISIONS

The need for legislative provisions on anti-deprivation is explained by several factors:

- The courts have, time and again, expressed that the judiciary cannot tread into contractual rights, except where there is a lack of *bonafides*, or an attempt to defeat insolvency objectives. The very determination of the *bonafides* itself becomes highly subjective, and therefore, the 200 years of history of anti-deprivation case law will show abundant examples of incoherence, which, Neuberger²⁴ and several others have admitted – see also, discussion below.
- Contracting parties need a safe harbour. When the parties write a contract, they are entitled to know if any part of their contract is invalid. Certainty of performance is the essential promise that law has to give to the contracting parties, and the lack of a safe harbour in judicial determination will be fatal to contracts.
- The relevance of contractual assets and intangibles as a part of the bankruptcy estate has tremendously increased over time. These rights are not only the subject matter for a lender to give loan or creditor to extend credit, but increasingly, contractual rights are subject matter of assignments too. There are concession rights, power purchase agreements, licensing rights, prospecting rights, participating rights, joint venture rights, rights of use, etc. And invariably, in every contract, there will be a clause to the effect that initiation of insolvency proceedings against the counterparty will lead to determination of the contract. If the insolvency event causes these assets to disappear, the very objective of corporate rescue, and maintenance of going concern status will be frustrated. Let alone in liquidation, even during CIRP, the assets will disappear into extinction.

Hence, the question is too significant to be left to incertitude. The SC, in *Gujarat Urja*, had clearly drawn attention to the need for legislative reforms by saying –

This is a matter which raises complex issues of legal policy and a balancing between distinct and conflicting values. Reform will have to take place through the legislative process. The stages through which legislative reform must take place -absolute or incremental – is a matter for legislative change.

GUIDE TO LEGISLATIVE ACTION

While the need for legislative measures to codify anti-deprivation rule can be substantiated with the factors as stated above, the legislative action has to take into consideration certain factors (including the rich jurisprudence) around the rule, as discussed below –

Weighing of burden and benefits

Contractual freedom is an essential feature of commercial bargains. All agreements are 'contracts' and therefore, mutually enforceable, unless they are void or voidable, in accordance with the broad principles contained in sections 10-32 of the Contract Act, 1872.

Opposed to the objective with which parties enter into contract, is the state of 'insolvency', which has its own set of uncertainties for each party or each stakeholder – but for the insolvent, it might

be a matter of ‘existence’. Hence, insolvency causes ‘interference’ in the autonomy of parties, and as such, there is an obvious conflict between contractual freedom and corporate rescue – so much so, that very urgency associated with the rescue of the insolvent might displace the certainty of contracts. What can be a better indicator of intrusion of insolvency law into contractual freedom to say that the haircuts imposed in a resolution plan shall be binding on all parties. Of course, these haircuts were not contractual. Thus, insolvency law by its very nature intrudes into contractual freedom: every creditor has the right to enforce his debt against the debtor, but not so during a moratorium, and potentially, may be only a fraction of his claim, upon resolution. If contractual freedom was allowed its play, rescue would never happen.

Courts have held that general principles governing contractual benefits and burdens do not always apply in the bankruptcy context, and the ‘normal operations’ of rights and obligations between the debtor and his creditors may be suspended. (*Whitcomb & Keller Mortgage Co.*²⁵, *Fontainebleau Hotel Corp. v. Simon*²⁶). However, with increasing complexities in commercial world, courts have also recognised the need to give effect to the contracts – see, *Perpetual Trustees Company Ltd v. BNY Corporate Trustee Services*²⁷, and *Butters and Ors. v. BBC Worldwide Ltd. & Ors.*²⁸, where the court observed,

It is also desirable that, if possible, the Courts give effect to contractual terms which parties have agreed. Indeed, there is a particularly strong case for party autonomy in cases of complex financial instruments . . . ; in such cases, the parties are likely to have been commercially sophisticated and expertly advised.

The UNCITRAL Legislative Guide on Insolvency Law too, recognises such tension between insolvency law and the contract law, and says, ‘Although the approach of overriding such clauses can be regarded as interfering with general principles of contract law, such interference may be crucial to the success of the proceedings.’ It further states,

While this issue is clearly one that may require a careful weighing of the advantages and disadvantages, there are, nevertheless, circumstances where the ability of the insolvency representative to ensure that a contract continues to be performed will be crucial to the success of reorganization and also, but perhaps to a lesser extent, liquidation where the business is to be sold as a going concern. For these reasons, it is desirable that an insolvency law permit such clauses to be overridden. Any negative impact of a policy of overriding these types of clauses can be balanced by providing compensation to creditors who can demonstrate that they have suffered damage or loss as a result of the contract continuing to be performed after commencement of insolvency proceedings or including exceptions to a general override of these clauses for certain types of contracts, such as contracts to lend money and, in particular, financial contracts.

However,

Where the insolvency law does seek to achieve a result that differs or fundamentally departs from that other law (e.g. with respect to treatment of contracts, avoidance of antecedent acts and transactions or treatment of the rights of secured creditors), it is highly desirable that that result be the product of careful consideration and conscious policy in that direction.

Hence, although it might be desirable to interfere with contracts during insolvency, however, weighing ‘burden’ and ‘benefits’ would be crucial to have a fair play of the law.

Every time the world goes into a systemic crisis, insolvency law evolves into new dimensions. *Belmont Park* ruling was the product of the Global Financial Crisis. The recent spate of amendments in insolvency law, where rescue has been seen as the pressing objective, have highlighted the need for anti-deprivation provisions. As also discussed earlier, recent legislative amendments across countries have coded anti-deprivation as a statutory provision, while taking note of the possible ‘burdens’ or ‘hardship’ (specifically, financial burdens) which the solvent counterparty may be subjected to. The laws or amendments thereto have, therefore, made provisions enabling the counterparty to approach the court and prove (and satisfy the court) that the counterparty has been burdened to the extent that it would be just to terminate the contract.

‘Intent’ Vs. ‘Effect’

In *Belmont Park*, the concerned ‘flip clause’ was upheld on the basis that it was ‘a complex commercial transaction entered into good faith’. The majority judges in UKSC noted an

impressive body of opinion from some of the distinguished judges that, in the case of the anti-deprivation rule, a deliberate intention to evade the insolvency laws is required’, and that, ‘it does suggest that in borderline cases a commercially sensible transaction entered into in good faith should not be held to infringe the anti-deprivation rule.

It may be noted that, *mala fide* intent can be sufficient ground to strike down the contract even if the provision is otherwise valid. As noted in *Money Markets International Stockbrokers Ltd v. London Stock Exchange Ltd.*²⁹

...a deprivation provision, which might otherwise to be held valid, can be shown to have been entered into by the parties with the intention of depriving creditors their rights on an insolvency, then that might be sufficient to justify holding invalid the provision when it would not otherwise have been held invalid.

Hence, courts have gone on the ‘intent’ of the parties to determine applicability of the anti-deprivation rule.

However, courts have also indicated difficulties in applying the intent test and ascertaining the existence of these ingredients, e.g. applying the test would require courts to determine the intention of the contracting parties long after the fact and detract from the efficient administration of corporate bankruptcies and encourage parties who can plausibly pretend to have a *bona fide* intention to create a preference over other creditors by inserting such clauses. (*Chandos Construction Ltd v. Deloitte Restructuring Inc.*)³⁰

In *Chandos*, the Canadian Supreme Court chose to apply the ‘effects’ test and not the intent test, as the headnote reads:

What should be considered is whether the effect of the contractual provision was to deprive the estate of assets upon bankruptcy, not whether the intention of the contracting parties was commercially reasonable. Adopting a purpose-based test would create new and greater difficulties. It would require courts to determine the intention of contracting parties long after the fact, detract from the efficient administration of corporate bankruptcies, and encourage parties who can plausibly pretend to have bona fide intentions to create a preference over other creditors by inserting such clauses. It would also be inconsistent with the general principles of contractual freedom — parties do not negotiate with a view to protecting the interests of their creditors in the event of their bankruptcy. Finally, under a purpose-based rule, unsecured creditors would receive even less than they do now. An effects-based approach provides parties with the confidence that contractual agreements, absent a provision providing for the withdrawal of assets upon bankruptcy or insolvency, will generally be upheld.

The ‘intent test’, coming of the *Belmont Park* ruling, is not only subjective, but defies the intuitive understanding, as noted by Canadian Supreme Court, that no contracting party while signing on a contract is envisaging its own bankruptcy. It is only the bankruptcy of the counterparty that is before the draftsman. Hence, on the day of the contract, neither of them are ‘intending’ to defeat insolvency principles; at heart, every contract is for most innate self-protection. Hence, the effect-based test, in the authors’ view, would assist in comparative determination of ‘burdens’ and ‘benefits’ (as discussed above) as well as gauging the ‘purpose’ for which the agreement was entered.

For instance, in *Chandos*, on onset of insolvency of the debtor, the principal contractor relied on the forfeiture clause to reduce the amount it owed to the debtor under the contract. The Court noted that the debtor’s bankruptcy occurred before it had even completed its own work under the sub-contract — therefore, the contract was executory at that time. The debtor’s bankruptcy exposed the principal contractor to significant risks. Given plenty of administrative and management costs which the principal contractor might be compelled to incur as a result of the debtor’s fall-out, the forfeiture clause was held to be legitimate and to further *bona fide* commercial purpose.

Also, in *Hsin Chong Construction Company Limited*³¹, there was an exclusion clause which prevented the defaulting party from participation and management of the JV. The court considered it unrealistic to think that the provisional Liquidators would be able to discharge such obligations and responsibilities. As the company was in no position to perform its contractual obligations due to its insolvency, it was artificial to view a share of future profits as the company’s existing asset. Further, any default by the defaulting party would completely change the innocent party’s risk profile in the JV. In the circumstances, the other party’s exercise of exclusion rights could not be regarded as destroying or dealing with any asset of the debtor. It was considered sensible and in the interest of the parties to provide for contingency in the event that one of them goes into insolvency. It was thus a commercial bargain entered into freely by the parties.

Determinable and defeasible interests

In applying the anti-deprivation rules, a distinction is also sometimes made between ‘determinable’

and ‘defeasible’ interests, to say that determination of a right due to insolvency will not be hit by anti-deprivation rule; it is only defeasance which is hit.

A determinable interest is an interest which gets limited by the occurrence of a stipulated event, marking the end of such interest. The interest gets determined, that is, terminated, when the specific event occurs. For example, if the grant of tenancy to someone is only as long as the entity remains solvent, the interest as a tenant exists only during solvency, and gets determined when the entity becomes insolvent. On the other hand, if there is a forfeiture of interest based on occurrence of bankruptcy, that may be hit by the anti-deprivation rule.³² As the court affirmed in *Belmont Park*, ‘Professor Sir Roy Goode rightly accepts (*ibid*) that the principle that a determination clause is not an attempt to remove an asset from the company but simply a delineation of the quantum of the asset or the duration of the transferee’s entitlement is too well established to be dislodged otherwise than by legislation.’

Even after making the distinction between determinable and defeasible interests, the court still expresses the predicament of survival of the anti-deprivation rule, as also the survival of contractual freedom — ‘But it does not follow that any proprietary right which is expressed to determine or change on bankruptcy is outside the anti-deprivation rule, still less that a deprivation which has been provided for in the transaction from the outset is valid. If it were so, then the anti-deprivation rule would have virtually no content.’

We are of the view that the distinction between determination and defeasance is arcane, and what matters is, what effect does either of them have. If, in either case, the effect is to dig a shovel in the estate of a beleaguered company, does the distinction really matter?

Bankruptcy as sole reason for deprivation

The rule applies only in cases of deprivation triggered by bankruptcy and has the effect of depriving the debtor of the property which would otherwise be available to the creditors of the debtor. As a corollary, where deprivation is for reasons other than bankruptcy, say, breach of a covenant under the contract, such deprivation would remain untouched by the rule.

In *Hsin Chong Construction*, the court approved a termination clause in a joint venture contract terminating the rights of a joint venturer on insolvency of the other party. One of the grounds for following *Belmont Park* was that there were other termination events, and therefore, the insolvency was not the only event for termination, thereby indicating that the intent of the provision was not to avoid insolvency law.

Evidently, SC’s decision in *Gujarat Urja*, was premised on the fact that the sole reason for termination of power-purchase agreement was ‘insolvency’ of the CD, and the CD would have been rendered dead on termination of such agreement.

The laws across (as discussed earlier) also emphasise that the invalidation of termination clauses

shall take effect where such termination is conditioned solely on the grounds of insolvency/commencement of a reorganisation proceeding, etc.

Nature of bankrupt's property

As the jurisprudence speaks, *valueless assets* may not attract application of anti-deprivation rule. If the asset has no value, or if it is incapable of transfer, then it would scarcely be said to be to the detriment of the creditors of the owner if he was deprived of the asset. Similarly, if the ownership of the asset depends on the personal characteristics of the owner, it would be 'inherently unsuitable' to be retained for the benefit of the creditors (e.g. membership of a club). Therefore, anti-deprivation rule did not apply where the share was incapable of uncontrolled transfer and was closely connected with a right in respect of which a deprivation provision was effective. (*Money Markets International Stockbrokers Ltd.*)

BROAD RULES FOR LEGISLATING ANTI-DEPRIVATION RULE

The Insolvency Law Review Committee in Singapore discussed the US model but was inclined not to go for a full-fledged anti-*ipso facto* approach. However, statutory provisions have been enacted in the insolvency law. Other countries that have recently enacted anti-*ipso facto* provisions include Australia and EU, both noted above. As the need for corporate rescue became all the more pressing pursuant to global COVID-19 disruption, the setting was just right to legislate against *ipso facto* clauses.

In India, the stance of the law is admittedly rescue, and liquidation is the terminal and last option. India has opted for an approach where every distressed entity is first given the chance to resolve itself. Even in liquidation, the regulations now require considering the going concern option which is essentially resolution even out of liquidation. With this stance, if contractual provisions were to affect the estate of the insolvent and deprive the same of property rights or benefit, the chances of rescue get compromised. The ruling *Gujarat Urja* will come to help only where the contractual rights are the key to survival, and not key to revival. In that sense, the *Gujarat Urja* ruling becomes a beckon call to legislate.

Drawing inference from the discussions as above, the consolidated views are presented in the following paragraphs:

Firstly, in general, the contractual rights of the parties, whether solvent or insolvent, shall be respected and upheld. Interference in contractual rights for insolvency of a party should broadly be legislated and certain aspects may be left for adjudication.

Second, an insolvent should not be deprived of an asset (whether or not in the form of a contractual right, interest, or benefit), solely because of commencement of insolvency proceedings or merely because it is an insolvent. This is an unequivocal stipulation in all laws and all judicial precedents. Also, while in certain rulings, existence of multiple 'events' of default was seen as an indication of

bona fide intent of the parties not to circumvent the bankruptcy law; in view of the authors, the same does not change the scenario. Reason being, absent other events or circumstances, if the termination has happened due to insolvency, then the statutory protection should follow.

Third, there must be weighing of comparative burdens and benefits falling upon or accruing to each party – especially, the insolvent and the counterparty. Where the burden on the solvent party, in case the contractual provision that seeks to deprive the insolvent, is more than the burden on the insolvent's estate, the question of 'balance of convenience' and 'balance of inconvenience' will arise, which will lead us to the next point. However, an important factor to be decided is - whether the deprivation provision should be void in law, or should be voidable at the instance of the office-holder, and if it is voidable, should it be based on the adjudication of the adjudicating authorities? In the interest of speed of corporate rescue, we suggest that the provision should be voidable at the option of office holder, and in that case, the aggrieved party should have a right of remedy as noted below.

Fourth, the counterparty should not be left without remedy. Such party shall be allowed to approach the adjudicating authority and prove that the burden falling upon the party would outweigh the benefit accruing to the insolvent. If the court is so satisfied, the remedies (not mutually exclusive) can be – (i) the party may be allowed to terminate the agreement in entirety, (ii) the parties may be directed to perform parts of the agreement as would be sufficient to reach a balance, (iii) the suffering party may be compensated appropriately for any financial loss suffered as a direct consequence of application of the rule. Whether such compensation would be in the form of 'claim' on the insolvent's estate or shall be given super-priority is another question. Needless to say, in such types of scenarios, courts would again have to read the law with the jurisprudence to arrive at conclusions.

Fifth, certain contracts (for example those as mentioned in the BLRC Interim Report) may need to be kept outside the purview of operation of the rule, for example certain financial contracts, which may broadly be defined in the law and specifications may be left to the subordinate law.

The above are broad guidelines extracted from the precedents and global antecedents. This goes without saying, that the law has to take care of the desired balance between protection and over-protection and thus it might be impossible to have an 'entirely coherent set of rules'³³. Hence, even the legislature has to leave space for enough flexibility for operation (or in-operation) of the rule, which has to be left to be adjudicated based on developed jurisprudence and established principles.

NOTES

¹ Civil Appeal No. 9241 of 2019; decision dated March 8, 2021.

² EWCA (2009), Civ 1160, para 32 to 42.

³ The last expression is commonly used in US jurisprudence, and there is a statutory provision in section 365 of the US Bankruptcy Code. The rule against termination of executory contracts is that a provision in a contract permitting a solvent party to terminate or modify any right or obligation in such contract on the condition of insolvency/commencement of a case is invalid.

⁴ Ross J. (2020), “Intangible Assets: A hidden but crucial driver of company value”, The value of intangible assets, consisting of intellectual property, B2B rights, brand, data, non-revenue rights, relationships, etc. has continued to increase over time. In large publicly traded entities such as Microsoft and Amazon, intangibles constituted more than 90% of the enterprise value. In case of Apple, it was around 77% and Facebook, about 79%.

⁵ The term ‘deprivation’ itself is widely accredited to the ruling of Neuberger in *Money Markets International Stockbrokers Ltd. v. London Stock Exchange Ltd.*, [2001] EWHC 1052 (Ch).

⁶ (1861) 2 J & H 204, 212.

⁷ This Privy Council ruling arose as an appeal against a ruling of the Bombay High Court and pertained to forfeiture of a share of member of the Bombay Stock Exchange by virtue of insolvency of a member.

⁸ [1975] 1 WLR 758, [1975] 2 All ER 390.

⁹ The US proceedings are *Lehman Bros. Special Financing Inc. v. BNY Corporate Trustee Services Ltd. (In re. Lehman Bros. Holdings Inc.)* in United States Bankruptcy Court for the Southern District of New York in 422 BR 407, 2010.

¹⁰ [2011] UKSC 38.

¹¹ [2012] 1 CLC 713.

¹² As quoted in *Belmont Park*.

¹³ Goode R. (2011), *Principles of Corporate Insolvency Law*, Fourth Edition, p. 61.

¹⁴ Senate Report (1978), No. 989, 95th Congress 2nd Session 59.

¹⁵ UK Government (2016), “A Review of the Corporate Insolvency Framework”, The Insolvency Service, 25 May.

¹⁶ Sub-section (3) of section 233B of the UK Insolvency Act, 1986 reads as:

‘(3)A provision of a contract for the supply of goods or services to the company ceases to have effect when the company becomes subject to the relevant insolvency procedure if and to the extent that, under the provision—
(a)the contract or the supply would terminate, or any other thing would take place, because the company becomes subject to the relevant insolvency procedure, or
(b)the supplier would be entitled to terminate the contract or the supply, or to do any other thing, because the company becomes subject to the relevant insolvency procedure.’

¹⁷ Singapore Statutes Online (2018), *Insolvency, Restructuring and Dissolution Act*, 2018.

¹⁸ Ministry of Law, Singapore, Final Report of the Insolvency Law Review Committee, 2013, pp. 84-90.

¹⁹ Federal Registrar of Legislation (2020), *Corporations Amendment (Corporate Insolvency Reforms) Act*, 2020.

²⁰ Productivity Commission, Australia, Productivity Commission Inquiry Report, 2015, Recommendation 14.5, pp. 394-398.

²¹ Directive (EU) 2019/1023 of the European Parliament, EUR-Lex. 3.

²² Report by the Insolvency Law Committee, February, 2020. Report noted that such grants, etc. may constitute ‘property’ of the CD going by the definition under section 3(27) and may form the substratum of the business of the CD – hence termination of such grants may tantamount to ‘alienation’ of property under section 14.

²³ Interim Report of the Bankruptcy Law Reforms Committee, Heading 7, February, 2015.

²⁴ Neuberger, J had commented upon the inconclusivity of the principles in *Money Markets*. In *Belmont Parks Park*, he mentioned: ‘It is not entirely easy to identify the rule’s precise limits, or even its precise nature from these cases, as the reasoning in the various judgements in which the rule has been considered is often a little

opaque, and some of the judgements are hard to reconcile.’

²⁵ 715 F.2d 375 (7th Cir. 1983).

²⁶ 508 F.2d 1056, 1059 (5 Cir. 1975).

²⁷ [2010] 3 WLR 87.

²⁸ *Ibid*

²⁹ [2002] 1 WLR 1150.

³⁰ 2020 SCC 25 (Canada).

³¹ [2019] HKCFI 1531 (Hong Kong).

³² Goode R. (2011), “Perpetual Trustee and Flip Causes in Swap Transactions”, 127 LQR 1, pp. 3-4.

³³ In *Money Markets International Stockbrokers*, the court, in the context of various rulings pertaining to the rule, observed, ‘Fourthly, it is not possible to discern a coherent rule, or even an entirely coherent set of rules, to enable one to assess in any particular case whether such a provision (a “deprivation provision”) falls foul of the principle. Fifthly, and perhaps not surprisingly, it is not entirely easy to reconcile the conclusions, and indeed the reasoning in some of the cases.’

TREATMENT OF MSME INSOLVENCY UNDER IBC

Prachi Apte and Sushanta Kumar Das

Micro, small and medium enterprises (MSMEs) form the foundation of the economy and are the key drivers of employment, production, economic growth, entrepreneurship, and financial inclusion. MSME sector is the critical source of livelihood for nearly 110 million people in the country and a total of 30% of India's GDP.¹ It has envisioned that the MSME sector would account for 50% of GDP and add 50 million fresh jobs over the next five years.² It is perhaps no surprise that MSMEs are particularly vulnerable to financial shocks. The most important reason for this being first, difficulty in accessing finance in the right quantity, at the right time; second, attracting and retaining qualified workforce, and third, penetrating regional, national and international markets. The emergence of the second wave of COVID-19 was unexpected, for which the sector was ill-prepared, having hardly recovered from the blow of the first wave of pandemic.³ It is trite to mention here that these enterprises are increasingly recognised as being the backbone of many economies but face specific hurdles in using the insolvency system. Moreover, MSMEs in India have relatively suffered the most during the current pandemic times and the problem of delayed payment remains one of the biggest challenges to these MSMEs.

IMPORTANCE OF MSME SECTOR

Changing definition

While India will now be using investment and annual turnover as the criteria to classify MSMEs⁴, global trends in classifying the MSMEs show that it has widely used, the number of employees as a variable to define MSMEs. The earlier definition of MSMEs is defined in the MSME Development

Act, 2006 (MSMED Act) based on investment in plant, machinery or equipment to classify MSMEs. The limit on investment was different for the manufacturing and services sectors. These limits were exceptionally low in terms of financial limits.⁵

Since then, the economy has undergone significant changes. To facilitate ease of doing business, the Government has proposed a turnover-based definition by replacing the current investment-based definition of MSMEs.⁶ Union Ministry of Micro, Small and Medium Enterprises (Ministry of MSMEs) has notified the new definition and criterion which came into effect from July 1, 2020.⁷ The new definition also removed the difference between the manufacturing and service sectors.⁸

Revised classification applicable w.e.f. July 1, 2020			
Composite Criteria: Investment in Plant & Machinery/equipment and Annual Turnover			
Classification	Micro	Small	Medium
Manufacturing Enterprises & Enterprises rendering Services	Investment: Not more than ₹ 1 crore & Turnover; not more than ₹ 5 crore.	Investment: Not more than ₹ 10 crore & Turnover; not more than ₹ 50 crore.	Investment: Not more than ₹ 50 crore & Turnover; not more than ₹ 250 crore.

Growth

This section focuses on the role played by MSMEs in maintaining a healthy economy. It analyses the data on the employment rate generated by MSMEs, MSMEs by socially backwards groups, percentage of different categories of MSMEs etc. The purpose of the analysis is to understand the consequences of the failure of MSME sector on the economy as a whole. India is currently one of the fastest growing economies in the world. MSME sector is likely to continue to play a significant role in the growth of the Indian economy. In the last ten years, the MSME sector has shown impressive growth in terms of parameters like number of units, production, employment, and exports. Given the right set of support systems and enabling framework, this sector can contribute much more, enabling it to actualise its immense potential.⁹

The MSMEs in India are playing a crucial role by providing large employment opportunities at comparatively lower capital costs than large industries as well as through industrialisation of rural and backward areas, *inter alia*, reducing regional imbalances, assuring more equitable distribution of national income and wealth. According to the National Sample Survey (NSS) 73rd round, conducted by National Sample Survey Office, Ministry of Statistics & Program Implementation during the period 2015-16, there were 633.88 lakh unincorporated non-agriculture MSMEs in the country engaged in different economic activities.¹⁰ Table 1 shows the distribution of MSME activity-wise.

Table 1: Estimated Number of MSMEs (Activity Wise)

Activity Category	Estimated Number of Enterprises (in lakh)			% Share
	Rural	Urban	Total	
Manufacturing	114.14	82.50	196.65	31
Electricity*	0.03	0.01	0.03	-
Trade	108.71	121.64	230.35	36
Other Services	102.00	104.85	206.85	33
All	324.88	309.00	633.88	100

*Non-captive electricity generation and transmission

Table 2: Distribution of Enterprises Category Wise (in lakh)

Sector	Micro	Small	Medium	Total	% Share
Rural	324.09	0.78	0.01	324.88	51
Urban	306.43	2.53	0.04	309.00	49
All	630.53	3.31	0.05	633.88	100

As Table 2 shows, 99.5% of all MSMEs fall in the micro category. While micro enterprises are equally distributed over rural and urban India, small and medium ones are predominantly in urban India. In other words, micro enterprises essentially refer to a single man or a woman working on their own from their home. The medium and small enterprises, that is, the remaining 0.5% of all MSMEs, employ the remaining five crore-odd employees.¹¹

Table 3: Percentage Distribution of Enterprises in rural and urban areas (Male/ Female ownership)

Sector	Male	Female
Rural	77.76	22.24
Urban	81.58	18.42
All	79.63	20.37

Table 2 and 3 shows that out of 633.88 lakh MSMEs, 608.41 lakh (95.98%) MSMEs were proprietary concerns. There was dominance of male in ownership of proprietary MSMEs. Thus, for proprietary MSMEs, male owned 79.63% of enterprises as compared to 20.37% owned by female.

Employment in MSME Sector

As per the NSS 73rd round conducted during the period 2015-16, the MSME sector has been creating 1109.89 lakh jobs across the country. Table 4 shows the distribution of MSME activity wise.

Table 4: Estimated Employment in the MSME Sector (Activity Wise)

Broad Activity Category	Employment (in Lakh)			Share (%)
	Rural	Urban	Total	
Manufacturing	186.56	173.86	360.41	32
Electricity	0.06	0.02	0.07	0
Trade	160.64	226.54	387.18	35
Other Services	150.43	211.69	362.22	33
All	497.78	612.10	1109.89	100

Out of 1109.89 lakh people employed in MSME sector, 844.68 (76%) are male employees and remaining 264.92 lakh (24%) are females. Table 5 shows the sectoral distribution of workers in male and female category.

Table 5: Distribution of workers by gender in rural & urban areas (Numbers in lakh)

Sector	Female	Male	Total	% Share
Rural	137.50	360.15	497.78	45
Urban	127.42	484.54	612.10	55
Total	264.29	844.68	1109.89	100
% Share	24	76	100	

These numbers suggest that, on average, less than two people are employed per MSME. At one level this gives a picture of how small these really are. But a breakup of all MSMEs into micro, small and medium categories is even more revealing.

However, in spite high growth rate and good prospects, the Indian MSMEs have been subject to certain constraints. The most notable barriers are lack of timely credit, procurement of raw materials at a competitive cost, inadequate infrastructure facilities including power, water and road, and lack of skilled manpower for manufacturing, services, marketing, etc. The most important constraints faced till date are technological backwardness.¹²

GOVERNMENT'S STEPS FOR MSME SECTOR

The Government and regulators through various legislations and directives have attempted to create a conducive environment for the development of the MSME sector. One of the major steps in this direction has been the enactment of the Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act).¹³ The Insolvency and Bankruptcy Code, 2016 (Code/ IBC) brought in a robust insolvency regime in India. An effective insolvency regime, if properly implemented, may mitigate many of the challenges facing MSMEs.¹⁴ IBC is the one-stop solution for resolving insolvencies, which previously was a long process that did not offer an economically viable arrangement. The Code aims to protect the interest of the small investor and provides for ease of exit for business in India.¹⁵

MSMED Act, 2006

This law has measures for the promotion, development, and enhancement of competitiveness of MSMEs. The Act also specifies how payment delays and related disputes are to be settled. In case of a default, the MSME could approach the Facilitation Council which can help with payment or impose a penalty or pass a decree. But in practice, this mechanism has met with limited success.¹⁶ Although the Act addresses the issue of delayed payment, the said process has been highly questionable owing to the enforceability of the awards passed by the council.¹⁷

Resolution under IBC

The IBC becomes relevant to MSMEs mostly when they are operational creditors to large debtors. There are cases where MSME can also be a financial creditor.¹⁸ The IBC provides a comprehensive framework for the resolution of insolvency and bankruptcy of corporate persons, LLP, individuals, partnership firms, and sole proprietorship firms in a time-bound manner for maximisation of value of assets. The pre-packaged insolvency resolution process (PPIRP/Pre-Pack) at present applies only to corporate MSMEs. Most MSMEs by virtue of being a partnership or proprietorship firms have to resort to the standard corporate insolvency resolution process (CIRP).¹⁹ The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 (Second Amendment) has brought relief to the MSME by relaxing the applicability of the provisions of section 29A of the Code.²⁰

Section 29A of IBC

Section 29A of the Code provides for the persons ineligibility to be a resolution applicant(s) and thus, forms an important criterion of eligibility to submit a resolution plan. The Second Amendment introduced section 240A, which provides certain relaxations to MSMEs with respect to the applicability of restrictive provision of section 29A. The intention behind the enactment of this provision was to grant exemptions to corporate debtors (CDs) which are MSME(s), by permitting a promoter who is not a willful defaulter or covered under any other specific disqualification as provided under section 29A, to bid for the resolution plan of an MSME.²¹ The second amendment also empowers the Central Government to allow further exemptions or modifications with respect to the MSME sector, if required, in the public interest. With the introduction of these mindful exemptions, it is expected that the MSMEs may find bidders, and may not have to undergo liquidation.²²

In recognition of the importance of MSMEs to the Indian economy and the unique challenges faced by them, the Insolvency Law Committee (ILC) recommended the exemption of the application of certain provisions of the Code on MSMEs. Illustratively, since usually only promoters of an MSME are likely to be interested in acquiring it, the applicability of section 29A has been restricted only to disqualify willful defaulters from bidding for MSMEs.²³ The Supreme Court in *Swiss Ribbon's* case²⁴ reiterated that the rationale for excluding such industries from the eligibility criteria laid down in section 29A (c) and (h) is because *qua* such industries, other resolution applicants may not be forthcoming, which then will inevitably not lead to resolution, but liquidation.

INSOLVENCY IN THE MSME SECTOR

In pursuit to create a vibrant MSME sector, the Ministry of MSME, Government of India has taken a multi-pronged strategy. The focus is not merely on the issues related to the commencement and growth of MSMEs but also on ensuring that they sustain their business. However, due to various reasons, MSMEs are prone to sickness.²⁵ There have been a few attempts to address this issue. However, the need to devise a more robust mechanism for dealing with sick MSMEs became necessary so as to make suitable arrangements for detecting symptoms of industrial sickness at an early stage and take corrective actions to prevent sickness.²⁶

In the aftermath of the COVID-19 pandemic, the Hon'ble Prime Minister was quick to recognise the role of MSMEs in building the Nation. Consequently, MSMEs formed a very prominent part of the announcements made under the *Atmanirbhar Bharat Abhiyaan*. Under this scheme, the MSME sector has not only been given substantial allocation but has also been accorded priority in the implementation of the measures to revive the economy. To provide immediate relief to the MSME sector, various announcements have been made under the scheme. The Government's top focus is on energising the MSMEs in the country.²⁷ It is also trite to mention here that under this scheme all businesses (including MSMEs) were provided with collateral-free automatic loans of up to three lakh crore rupees. MSMEs were allowed to borrow up to 20% of their entire outstanding credit as of February 29, 2020, from banks and non-banking financial companies (NBFCs). Borrowers with up to ₹ 25 crore outstanding and ₹ 100 crore turnover were made eligible for such loans to avail the scheme till October 31, 2020. Interest on the loan was capped and a 100% credit guarantee on principal and interest were given to banks and NBFCs.²⁸

It is also noteworthy that the scheme has provided ₹ 20,000 crores subordinate debt for stressed MSMEs. This scheme aims to support stressed MSMEs which have non-performing assets (NPAs). Under the scheme, promoters of MSMEs will be given debt from banks, which will be infused into the MSMEs as equity. The Government will facilitate ₹ 20,000 crore of subordinated debt to MSMEs. For this purpose, it will provide ₹ 4,000 crore to the Credit Guarantee Fund Trust for micro and small enterprises, which will, in turn, provide partial credit guarantee support to banks providing credit under the scheme.²⁹

A Special Liquidity Scheme was announced under which ₹ 30,000 crore of investment will be made by the Government in both primary and secondary market transactions in investment grade debt paper of NBFCs/Housing Finance Companies (HFCs)/Micro Finance Institutions (MFIs). The Central Government will provide a 100% guarantee for these securities. The existing Partial Credit Guarantee Scheme (PCGS) will be extended to partially safeguard NBFCs against borrowings of such entities (such as primary issuance of bonds or commercial papers (liability side of balance sheets)). The initial loss of 20% will be borne by the Central Government. The PCGS scheme will facilitate liquidity worth ₹ 45,000 crores for NBFCs.³⁰ Although these announcements are expected to assist MSMEs in tackling economic stress, they may not prove to be much effective owing to low

demand and longer period to derive economic normalcy. Thus, several steps have also been taken to revive the stressed MSMEs under the aegis of the MSME Act and IBC.³¹

Reasons for MSME insolvency

It is observed in the World Bank Report³² that, part of the explanation of why MSMEs fail in such large numbers is simply because they constitute the largest proportion of private sector businesses. These challenges arise from factors such as size, lack of available collateral, undiversified nature, and lack of suitable external governance mechanisms, all of which contribute to a high MSME failure rate. As such, it is crucial for insolvency regimes to be responsive to MSMEs particular requirements. In India MSMEs are facing great challenges some of the notable challenges are listed below:

Complex insolvency systems

MSME insolvency faces unique challenges and issues. Complex insolvency systems deter MSMEs from resorting to formal procedures to tackle financial distress. Unsophisticated MSMEs struggle to understand this complexity; thus, discouraging timely use of insolvency by MSMEs.³³

Creditor behaviour

In the absence of any mechanism to deal with insolvent MSMEs, creditors have few incentives to deal with MSME debtors through legal processes. Creditor passivity often arises when creditors weigh the amount they estimate they will receive from participating in the insolvency process against the amount of time and money this effort requires. If the cost outweighs the return, then creditors make the rational decision of not getting involved. Secured creditors typically focus on enforcement of security as the first sign of financial distress, and thus, efficiencies may be lost.³⁴

Lack of information about MSME debtors

Another major weakness that inhibits the growth of this sector is the lack of good records management by the MSMEs.

Post-insolvency financing

Post insolvency financing is hardly available. MSMEs rely on family and friends for help. MSMEs often lack the resources to cover the costs and fees for a formal insolvency procedure.

Insufficient assets to fund a formal insolvency procedure

The insolvency process itself can be challenging for MSMEs. Smaller MSMEs may lack funds to cover the expenses of an insolvency process or fail to generate an expectation for unsecured creditors to receive any returns.³⁵

Personal debts

MSMEs are often financed with a mixture of corporate debt and personal debt taken by the

entrepreneur (including granting of potentially personal guarantees). The failure of the MSME may thus have severe consequences for the entrepreneur and their family including, social stigma.³⁶

In order to understand the structural bottlenecks and factors affecting the performance of the MSMEs, RBI had set up an Expert Committee on MSMEs under the Chairmanship of Shri U.K. Sinha in January 2019. The Committee undertook a comprehensive review of the sector and gave several recommendations for the economic and financial sustainability of the MSME sector. These recommendations are wide-ranging and broadly relate to, legislative changes, infrastructure development, capacity building, technological up-gradation, improving backward and forward linkages, improving financial support from formal sources, newer technological interventions for robust underwriting practices, and credit delivery.³⁷ Due to the above-stated reasons, there needs to be a certain reconsideration of the insolvency process, in order to ensure the timely resolution and protection of the MSMEs. The report suggested that, based on the vulnerability and size, the insolvency code should provide for out-of-court assistance to MSMEs, who are predominantly proprietorships, such as mediation, debt counseling, financial education, etc.³⁸

Action taken by the Government

To reduce corporate stress, the Government suspended the initiation of fresh insolvency proceedings under sections 7, 9 and 10 of IBC for defaults arising on or after March 25, 2020, till March 25, 2021. RBI, too, announced a loan moratorium from March 1, 2020, to August 31, 2020, along with an asset classification dispensation and special resolution framework for COVID-19 related stressed assets. Under the resolution plans that could be invoked under the above window, lenders were permitted to grant an additional moratorium of up to two years. Also, MSME accounts classified as Standard, where the aggregate exposure of banks and NBFCs was ₹ 25 crore or below as of March 1, 2020, were permitted to be restructured without a downgrade in the asset classification, subject to certain conditions.³⁹

Pre-packaged insolvency resolution for MSMEs

The Central Government promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 on April 4, 2021, which aimed at providing an efficient, alternative insolvency resolution framework for corporate persons classified as the MSMEs under the Code, for ensuring quicker, cost-effective and value-maximising outcomes for all the stakeholders in a manner which is least disruptive to the continuity of MSME businesses and preserves jobs.

The Ordinance, in essence, has amended the Code allowing the Central Government to notify the pre-packaged process for defaults of not more than one crore rupees to be initiated by the corporate debtor.⁴⁰ The ordinance introduces PPIRP exclusively for MSMEs as defined under section 7(1) of the MSME Act. The PPIRP is regulated under chapter III-A of part II of IBC; from sections 54A-58 read with Insolvency and Bankruptcy Board of India (Pre-packaged Insolvency Resolution Process) Regulations, 2021 and Insolvency and Bankruptcy (Pre-packaged Insolvency Resolution Process) Rules, 2021.

INSOLVENCY RESOLUTION PROCESS FOR NON-CORPORATE MSMEs

The PPIRP applies only to corporate MSMEs. Although Part III of the Code provides for a resolution and bankruptcy process to address the insolvency of proprietorships and partnership firms, its provisions are yet to be notified. It is found that a vast number of MSMEs in the country fall outside the purview of PPIRP for their turnaround under IBC as these are not registered companies.⁴¹ As noted above, in 2015-16, there were 633.88 lakh unincorporated non-agriculture MSMEs in the country engaged in different economic activities.⁴² These far outnumber the MSMEs which are registered as companies around 780,000 or 60% of all active companies in the country which will benefit from the PPIRP.⁴³ These companies represent just above 1% of all the unincorporated MSMEs, implying that the informal sector businesses far outnumber the organised sector and will not be covered by the PPIRP. Extending an insolvency resolution scheme under IBC to unincorporated entities and proprietorships, however, is hugely challenging given the large number of such enterprises.⁴⁴

The United Nations Commission on International Trade Law (UNCITRAL) referred to pre-packs as 'expedited reorganisation proceedings'. In attempting to understand the pre-pack and framing the provisions of pre-pack for the Indian scenario, the ILC, in its report⁴⁵ has studied several global jurisdictions, including the United Kingdom (UK), the United States (US), in order to frame relevant law for our country. There is no doubt that the UK and US continue to be the lead flag bearers of pre-pack arrangements, but pre-packs for unincorporated MSMEs is yet to be formally brought under Part III of the Code. Therefore, it is imperative to examine the treatment of non-corporate MSMEs under other jurisdictions so that the pre-pack resolution process for non-corporate MSMEs in India, can be brought into existence that will benefit the un-incorporated MSMEs in India.

International Practices

United Kingdom

The primary legislation governing insolvency is the Insolvency Act, 1986 which was modified by the Enterprises Act, 2002 and has made radical changes to corporate and personal insolvency.⁴⁶ The UK legislation does not specifically use the term MSME. However, a company voluntary arrangement (CVA) is a vehicle for SME to restructure, rather than to liquidate through bankruptcy.⁴⁷ The UK law has made provisions for Individual and Partnership firms.

Individual Voluntary Arrangement (IVA) is a private negotiation between debtors and creditors wherein the debtors avoid the stigma of bankruptcy. While negotiations are outside of the court, they are supported by legal provisions embedded in the law.⁴⁸ If the debtors and creditors can come up with an agreement on the composition of debts, then the court only plays a role in sanctioning the agreement. There is no bankruptcy in the case of an IVA since a plan of repayment is agreed upon before a debtor can be called 'bankrupt'.⁴⁹ An IVA is available to all individuals, sole traders or those in a business partnership who are experiencing financial difficulty.⁵⁰

A Partnership Voluntary Arrangement (PVA) is a formal agreement between a partnership firm and its creditors to repay all or part of its debts over time. Much like the very similar Company Voluntary Arrangement (CVA), a PVA is a legally binding agreement to repay debts owing to creditors through monthly contributions over a typical period of between three and five years. Depending on the circumstances of the business and the amount it can afford to repay each month, this could mean that only a proportion of the total debt is paid. The PVA also provides the partnership with protection from creditor action. Once the PVA has been proposed, no creditor action can be taken. This extends for the length of the agreement if it is approved. That can make a PVA an especially useful restructuring tool.⁵¹

Where an unincorporated/non-LLP partnership is insolvent and where a rescue of that partnership or business is possible, an administration may be appropriate. An Administrator is a licensed insolvency practitioner appointed by the partners of the business out of court, a floating charge holder (for example the holder of an agricultural charge) or by the court on application. An administration protects the partnership and its business from its creditors whilst proposals regarding its future are prepared. It does not protect the individual partners' estates and other assets and the individual will need to deal with any residual claims of creditors following the administration. The Administrators deal with all classes of the creditor. The procedure is similar to that of Company administrations.⁵²

United States

In the US, businesses and individuals seeking relief under the US Bankruptcy Code are allowed to file a petition under the Bankruptcy Code Chapters 7, 9, 11, 12, 13, and 15.⁵³ The US Bankruptcy Code specifies 'small business debtors', it does not refer to MSME or SME.⁵⁴

A Chapter 11 bankruptcy is a legal process that involves the reorganisation of a debtor's debts and assets. It is available to individuals, sole proprietorships, partnerships, and corporations. The main reason to file for Chapter 11 bankruptcy is to be able to prevent a business from permanently closing. Of course, the company needs to be in such a position that the restructuring of its debt makes financial sense.⁵⁵

Chapter 13 provides a reorganisation plan to individuals who do not want to go through a Chapter 7 bankruptcy. Individuals get an opportunity to reorganise their financial affairs while being under the protection of the Bankruptcy Court. Although an individual, who is operating a business as a sole proprietor or conducting a professional practice, can file a Chapter 13 petition as most Chapter 13 debtors are 'consumer debtors'.⁵⁶

The COVID-19 pandemic has made few changes in the bankruptcy laws of the US. The Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed into law by the president on March 27, 2020, made several changes to bankruptcy laws designed to make the process more available to businesses and individuals, economically disadvantaged by the pandemic.⁵⁷

Canada

In Canada, Division II 'consumer' proposal is used as a highly streamlined mechanism for micro business which is provided under the Bankruptcy and Insolvency Act, 1985 (BIA). These provisions are accessible to non-incorporated self-employed individuals and sole proprietors whose debts are less than 250,000 CAD, excluding a mortgage or hypothec on the individual's principal residence.⁵⁸

The consumer proposal provisions of Division II of Part III of the BIA allow a much more streamlined summary process. The provisions were enacted as a mechanism to deal with smaller estates on a more cost-effective and expedited basis. A Division II proposal must be made to creditors generally but is not binding on secured creditors that have not filed a proof of claim. Division II proposals were designed as consumer proposals; however, they are available to self-employed individuals and sole proprietors that fall within the criteria mentioned above.

For individuals, bankruptcy offers an opportunity for a fresh start financially. Individuals, including business sole proprietors, who are first-time bankrupts have the option of automatic discharge after they make an assignment or are ordered into bankruptcy, which is either in nine months or 21 months, depending on whether the bankrupt has surplus income, unless it is opposed by a creditor, the trustee, or the Superintendent of Bankruptcy.⁵⁹

Australia

Debt agreements were introduced as an alternative to bankruptcy. They were intended to provide debtors with a cost-effective means of making arrangements with their creditors while avoiding bankruptcy and some of its more serious consequences. Debt agreements are binding agreements made between debtors and their creditors in accordance with Part IX of the Bankruptcy Act, 1966. Under these agreements, insolvent debtors propose legally binding repayment arrangements to their creditors. If such a proposal is accepted by the creditors, the debtor is released from the debts owed to these creditors upon completion of the agreed payments.

Debt agreements are subject to the oversight of the Official Receiver, AFSA.⁶⁰ Debtors proposing a debt agreement cannot have been bankrupt, nor have had a debt agreement or a Part X arrangement⁶¹, within the preceding 10 years.⁶²

Republic of Korea

The Debtor Rehabilitation and Bankruptcy Act (DRBA) consolidated the Corporate Reorganisation Act, 1962, the Composition Act, 1962 and the Bankruptcy Act, 1962 to make the procedure for bankruptcy and rehabilitation of insolvent companies more efficient and streamlined.⁶³ The Composition Act and the Bankruptcy Act apply to all types of legal entities including individuals, corporations, and unincorporated foundations or associations, etc.⁶⁴

The DRBA includes (i) a rehabilitation procedure for corporates and individuals; (ii) a streamlined summary rehabilitation procedure (SRP) for SMEs; (iii) a rehabilitation procedure for individuals

with small debts; (iv) a liquidation procedure for individuals and corporates which includes a summary liquidation procedure for SMEs.⁶⁵

The process, timing, and product of the Korean Individual Rehabilitation Proceeding (IRP) is generally similar to the U.S. Chapter 13 process. Owners of unincorporated businesses are eligible to use the procedure for individual rehabilitation, provided they meet the debt thresholds for the procedure.⁶⁶ This simplified procedure enables individuals to restructure all debts (business and personal) in a single proceeding.

The Summary Rehabilitation Proceedings (SRP) under the DRBA is a streamlined procedure that aims to reduce costs, increase efficiency, and boost the chances of successful plan adoption. SMEs with debts of no more than KRW 3 billion may access the process. The SRP modifies the corporate rehabilitation procedure described above by eliminating the need for a custodian and an inspector in most cases. An inspection commissioner, who is an accountant or a court official may be appointed, with simplified duties under Supreme Court Regulations. In addition, a creditors' council is not required in all cases and the voting thresholds for adoption of a plan are relaxed.⁶⁷

CONCLUSION AND SUGGESTIONS

The ongoing pandemic has led the Government of India to restructure, reset and revamp the present insolvency law to boost the Indian economic growth prospect. The COVID-19 crisis has caused distress and failure in the MSME sector. The insolvency law since its enactment in 2016 has been amended several times in order to protect the interest of MSMEs. The authors are of the view that the Code has introduced prepacks for MSMEs in order to safeguard their interest. However, provisions for resolution process for non-corporate MSMEs also need to be deliberated upon.

The Working Group on Individual Insolvency⁶⁸ noted that, in 2009-10, the Indian MSME sector was estimated to include 29.8 million enterprises out of which 28 million are unregistered and only 1.8 million registered. MSMEs vary in size and nature. Most fall into the 'micro' category, which usually includes sole proprietorships and single-employee businesses. Small enterprises may have more than one owner and multiple employees but may have an informal business structure. Firms at the other end labeled as 'medium' enterprises may be starkly different from their micro and small counterparts and have hundreds of employees, yet they may not be corporatised. MSMEs, for a variety of reasons, forgo the formal registration of their enterprise and operate without limited liability. These MSMEs are, therefore, likely to be the biggest consumers, and expected to be the biggest beneficiaries of the law relating to insolvency and bankruptcy of individuals and partnership firms, as and when notified. MSME insolvencies cannot be treated at par with corporate resolution as MSME insolvency faces unique challenges and issues.⁶⁹

The Union Budget 2021-22 has made structural reforms in the MSME sector. It further aims to ensure faster resolution of cases by strengthening the NCLT framework and introducing an alternate method of debt resolution and a unique framework for the MSME sector. As noted above,

in 2015-16, there were about 633.88 lakhs unincorporated MSMEs⁷⁰ in India. Many MSMEs are not incorporated and even if they are, the shareholders/managers usually guarantee the company's debts. Therefore, any effort to enhance the attractiveness of the corporate insolvency regime should be accompanied by a simultaneous reform of the regime of personal insolvency in order to allow an effective discharge of debts for honest but unfortunate debtors.⁷¹ This makes it imperative to address issues faced by unincorporated MSMEs. Going forward, lawmakers will play a crucial role in addressing the challenges associated with insolvency of unincorporated MSMEs. They can examine how pre-packs will evolve and operate for the unincorporated MSMEs in India.

The concept of 'Pre-packaged Insolvency' has not suddenly come into vogue. This concept by different names has found its place in the Insolvency Laws in the UK, US, Singapore, France and Canada. The outbreak of the COVID-19 pandemic and the lockdown imposed thereto forced companies, industries and enterprises all over the world to remain shut for a long period of time thus pushing innumerable business units, specifically, the MSMEs, into financial distress and causing a threat to the very existence of such enterprises.⁷²

It is trite to mention here that IBC is evolving to offer innovative ways of servicing emerging needs of the economy. Taking note of the current practices prevailing in other jurisdictions with respect to non-corporate MSMEs, some suitable tailor-made changes can be adopted in Indian context. The UK's IVA model offers negotiation between the parties, even though the negotiations are outside of the court but are backed by the legal provisions and in the end this process will avoid the stigma of bankruptcy. The PVA model offers debt repayment plan wherein the debtor - creditor enter into formal agreement. The US Code offers 'reorganisation proceedings' under chapter 11, which are out-of-court restructurings wherein it provides reorganisation of debtor's debts and assets and this prevents a business from permanently closing. The chapter 11 proceedings will be beneficial to non-corporate MSMEs in India, as large number of MSMEs fall in the non-corporate category and are often financed with a mixture of corporate and personal debt. The Canadian 'consumer' proposal of BIA provides for a streamlined summary process and DRBA also includes the streamlined summary rehabilitation procedures for SMEs, which can be adopted in case of individuals and partnerships firms with minimum debts. At this juncture, the authors opine that combination of 'consumer' proposal and chapter 11 of US Bankruptcy can be adopted in Indian scenario, which in the end will be able to rescue the MSMEs with minimum debt and prevent permanent closure of business.

Currently, the application of PPIRP framework under the Code is restricted to corporate MSMEs. Considering the need of the hour, the Government has played a highly visible role in the insolvency regime. However, we hope to see some rescue mechanism under IBC for the treatment of insolvency of non-corporate MSMEs. The practices in other jurisdiction with respect to non-corporate MSMEs, over all depicts that, the insolvency and bankruptcy laws of US, UK, Canada, Australia and Republic of Korea's focus is more towards, rehabilitation, negotiation, summary proceedings, debt restructuring and ultimately rescue the MSMEs from permanent closing and revive it to the normal mode of functioning. We are aware of the fact that in India, the second wave of COVID-19 is putting

a majority of small businesses in a precarious financial situation, pre-pack has emerged as a ray of hope for the MSMEs. Unfortunately, since large number of MSMEs which fall under the category of non-corporate entities are not benefited of pre-pack. Therefore, the authors are of the opinion that there is need for policy discourse on providing for a framework if possible, within the IBC, or otherwise to rescue non-corporate MSMEs.

NOTES

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A CODE OF CONDUCT FOR COMMITTEE OF CREDITORS

B. Sriram

Appropriateness and fairness of decisions taken in a corporate insolvency resolution process (CIRP) have been an intensely debated question since the implementation of the Insolvency and Bankruptcy Code, 2016 (Code/IBC). Increasingly, dependence is being laid on the commercial wisdom of the committee of creditors (CoC) as the key decision-making body especially in the context of rescuing the corporate debtor (CD) through a sustainable resolution plan. Given their key responsibilities under the Code, the objectivity of the CoC in its decision making and its ability to best address the interests of the CD as well as all other concerned stakeholders is as important as the rescue of the CD itself. Against the backdrop of its current role and responsibilities, is it an appropriate time to adopt a code of conduct for the CoC to further strengthen the institution and ensure its smoother functioning leading to overall value maximisation for all stakeholders? How does the Indian experience compare with international jurisdictions, and can some inspiration be drawn from best practices across the globe?

ROLE OF CoC

The Code envisaged the CoC to be the supreme decision-making body during CIRP. The CoC is a transient heterogenous body consisting of financial creditors (FCs)¹ with diverse interests, which is dissolved on the conclusion of the CIRP. The Code and the regulations made thereunder bestow various powers on the CoC which includes appointing the Interim Resolution Professional (IRP) as the Resolution Professional (RP), supervising their functioning and conduct, and in the event, the conduct of the RP is not to its satisfaction, even replace the RP.² Even though it is the RP who is responsible for the management of the day-to-day affairs of the CD, it is the CoC which has

been bestowed with the power and responsibility to decide on all matters which are critical to the functioning of the CD. The Code³ specifically lists down acts which can be undertaken by the RP only with the prior approval of the CoC such as creation of security interest over the CD's assets, change in ownership, capital structure or management of the corporate person, unearthing related party transactions, raising interim finance, delegation of powers of the RP to any other person and the like to ensure that commercially prudent actions are taken to preserve the value of the entity. The most important function of the CoC is, however, to determine the viability of the CD's business, examine the feasibility of future operations, the cost and expenses involved and accordingly, resolve to either proceed with the resolution process including the decision to extend the timeline⁴ or opt to immediately liquidate the CD, where it is convinced that the resolution process is bound to fail.⁵ Further, an application for withdrawal of the insolvency application after it has been admitted can be made by the applicant, only with the approval of 90% of creditors of the CoC.⁶

Once the CoC approves a resolution plan with the requisite majority, the RP is bound to place the same before the Adjudicating Authority (AA) for its approval.⁷ In the matter of *K Shashidhar v. Indian Overseas Bank and Ors.*⁸, the Hon'ble Supreme Court (SC) discussed the aspect of approval or rejection of resolution plan by the CoC in detail and very clearly stated that-

There is an intrinsic assumption that financial creditors are fully informed about the viability of the corporate debtor and feasibility of the proposed resolution plan... The opinion on the subject matter expressed by them after due deliberations in the CoC meetings through voting, as per voting shares, is a collective business decision. The legislature, consciously, has not provided any ground to challenge the "commercial wisdom" of the individual financial creditors or their collective decision before the adjudicating authority. That is made non justiciable.⁹ It is clear that the limited judicial review available, which can in no circumstance trespass upon a business decision of the majority of the Committee of Creditors, has to be within the four corners of section 30(2) of the Code, insofar as the Adjudicating Authority is concerned, and section 32 read with section 61(3) of the Code, insofar as the Appellate Tribunal is concerned.¹⁰ Thus, while the Adjudicating Authority cannot interfere on merits with the commercial decision taken by the CoC, the limited judicial review available is to see that the CoC has taken into account the fact that the corporate debtor needs to keep going as a going concern during the insolvency resolution process; that it needs to maximise the value of its assets; and that the interests of all stakeholders including operational creditors has been taken care of.¹¹ [Emphasis supplied]

In the matter of *The Committee of Creditors of Essar Steel Limited v. Satish Kumar Gupta*¹², the larger bench of the SC described the National Company Law Tribunal (NCLT) as having a 'hands-off' approach. The decision deliberated on the role of the CoC, the NCLT and the National Company Law Appellate Tribunal (NCLAT). In this judgment, the SC reiterated that the limited judicial review available with the AA can be exercised only where the CoC has abdicated its responsibility of considering important parameters such as maximisation of asset value, that the CD needs to keep going as a going concern, balancing the interest of all stakeholders, etc.¹³

Relying heavily on the *Shashidhar* judgment, the Hon'ble SC, in the matter of *The Karad Urban Cooperative Bank Ltd. v. Swapnil Bhingardevay and Ors.*¹⁴ held that-

if all the factors that need to be taken into account for determining whether or not the corporate debtor can be kept running as a going concern have been placed before the Committee of Creditors and the CoC has taken a conscious decision to approve the resolution plan, then the adjudicating authority will have to switch over to the hands-off mode.¹⁵

The decisions of the SC in *Arcelor Mittal India Pvt. Ltd. v. Satish Kumar Gupta and Ors.*¹⁶ and *Swiss Ribbons Pvt. Ltd. and Anr. v. Union of India*¹⁷ lay emphasis on the role and responsibility of the CoC including but not limited to assess the feasibility and viability of a resolution plan, the eligibility of the resolution applicant (RA), all attempts to keep the CD as a going concern with liquidation as the last resort, safeguard the interest of all stakeholders and that the resolution plan to provide for fair and equitable treatment of operational creditors (OCs). While the commercial wisdom of the CoC is protected from judicial scrutiny, the decisions taken by the CoC while performing such other responsibilities in the course of the CIRP remain subject to challenge.

The SC in the matter of *Arun Kumar Jagatramka v. Jindal Steel and Power Ltd. and Anr.*¹⁸ made an observation on the role of the NCLT and NCLAT functioning as the AA and Appellate Authority under the Code-

...the IBC was introduced in order to overhaul the insolvency and bankruptcy regime in India. As such, it is a carefully considered and well thought out piece of legislation which sought to shed away the practices of the past. The legislature has also been working hard to ensure that the efficacy of this legislation remains robust by constantly amending it based on its experience. Consequently, the need for judicial intervention or innovation from the NCLT and NCLAT should be kept at its bare minimum and should not disturb the foundational principles of the IBC. This conscious shift in their role has been noted in the report of the Bankruptcy Law Reforms Committee (2015)...

INTERNATIONAL PRACTICES

While deliberating on the powers and functions of the CoC, it will be worthwhile to refer to the practices in some of the other evolved jurisdictions which have a robust insolvency resolution regime. The resolution processes of three jurisdictions which are similar to the CIRP under the Code in India are analysed hereunder with an intent to study the best practices that have led to the success of the resolution process in such jurisdictions and those which probably could be adopted to strengthen the objectives of the Code.

Singapore

The formal insolvency process of Singapore is known as the judicial management process¹⁹, which is supervised by the court. The judicial management process is akin to the CIRP where the ultimate objective is rehabilitation of a financially distressed company. The judicial management process is driven by a licensed Insolvency Practitioner called the Judicial Manager. The role and functions of a Judicial Manager are very wide and includes, *inter alia*, to do such things as necessary for the

management of the affairs, business and property of the company, take over directors' functions, perform all functions in the interest of the company's creditors, etc. In the matter of *Lim Siew Soo v. Sembawang Engineers*²⁰, the High Court held that-

The roles and duties of a judicial manager are multi-faceted. One of the purposes of appointing a judicial manager is to rehabilitate a distressed company as a going concern, for the benefit of all stakeholders...A judicial manager is therefore empowered to continue the company's business. That includes causing the company to perform its existing contracts.'

In a nutshell, the Judicial Manager performs the functions of the RP as well as exercises the commercial wisdom of the CoC, all within the overall supervision and active involvement of the court.

United Kingdom

In the UK, the insolvency process under the formal insolvency regime²¹ is called administration. The objective of the administration process, depending on the suitability and feasibility of the options, can either be to rescue the company as a going concern, attempt to achieve a better result for the company's creditors as a whole *vis-à-vis* winding up or realise the property of the company in order to make a distribution to one or more secured creditors.²² The scope of administration is to rescue the company as a going concern while ensuring value maximisation and balancing the interest of all stakeholders.

The role of the Administrator as stipulated in the statute, requires him to act in the best interest of the creditors as a whole. He must act in good faith, fairly and honorably, and shall also be seen to be independent and impartial in his management of the company and its property. An Administrator is subject to a duty to perform his functions as quickly and efficiently as is reasonably practicable. The Administrator has a wide range of powers, he can do anything necessary or expedient for the management of the affairs, business and property of the company.²³ Thus, the broad scope of the Administrator's duties allows him to exercise good business judgement. The creditors of a company can establish a creditors' committee; however, their role is limited to assisting the Administrator in discharging his functions.

Given such wide powers of the Administrator, in order to avoid misuse, rights have been provided to a creditor to challenge the Administrator's conduct by applying to the court on the ground that his conduct has harmed the interest of a creditor unfairly or there has been misfeasance by the Administrator.²⁴

Moreover, to streamline the conduct of Insolvency Practitioners (like Administrators, Liquidators, etc.) under the various insolvency processes, there is a statement of practice called the Statement of Insolvency Practice 15 (SIP) which sets out basic principles and essential procedures with which Insolvency Practitioners are required to comply. Departure from the standards set out in the SIP is a matter that may be considered by a Practitioner's regulatory authority for the purposes of possible disciplinary or regulatory action. The key compliance standards include, *inter alia*:

(a) Insolvency Practitioners should advise creditors, in writing, how they may access suitable information on the rights, duties and the functions of the committee prior to inviting nomination of committee members to enable creditors to make an informed decision on whether they wish to be nominated to serve on a committee.

(b) At the creditors' committee meetings, Insolvency Practitioners should discuss with committee members how frequently they wish to receive reports and obtain their directions.

(c) Where an Insolvency Practitioner considers their professional judgement should override the views of creditors' committee, the office holder should clearly document why it is inappropriate to follow the views of the creditors' committee and provide an explanation for the same.

Similar to the code of conduct stipulated for regulating the functioning of RPs under the Code in India, there is a code of conduct for the various Insolvency Practitioners, including Administrators, in the UK which stipulates best practices to enhance their functioning, ensure uniformity and develop accountability.

United States of America

Under the formal insolvency regime, the primary reorganisation tool for corporates is either Chapter 11- reorganisations or Chapter 7 -liquidations. Chapter 11 governs the reorganisation of corporate entities, similar to CIRP in India. The purpose of Chapter 11 is two pronged. On one hand, the automatic stay²⁵ provides a debtor with 'breathing space' so that the distressed entity can preserve its business as a going concern by preventing creditors from taking precipitative action against its assets and allowing the debtor to propose a plan of reorganisation. On the other hand, Chapter 7 is meant to maximise recovery for various creditors of the debtor *vis-à-vis* liquidation.

Under Chapter 11 the debtor remains in control of its business operations and repays creditors concurrently through a court-approved reorganisation plan. An officer of the US Department of Justice, called the US Trustee, is responsible for monitoring the progress of a Chapter 11 case and supervising the debtor-in-possession's operation of the business. In rare cases such as fraud, dishonesty, incompetence, or gross mismanagement by the debtor, the bankruptcy court may order the appointment of an Examiner to investigate the affairs of the debtor or a Trustee to take over management of the debtor's business. Upon the appointment of a Trustee, the debtor loses its right to be 'in possession' and is required to hand over the operation of its business to the Trustee. The Trustee substitutes the debtor's board of directors and assumes responsibility for the executive leadership and management of the debtor's business in a very similar fashion as the RP under CIRP in India.

The US law provides for the creation of a committee of unsecured creditors in order to represent the interests of all general unsecured creditors for the purpose of maximising returns to those creditors. The creditors' committee usually plays an active role in the interest of the creditors.

Once a plan of reorganisation is proposed by the debtor and if the requisite number of stakeholders vote in favour of the plan, a hearing to confirm the plan will take place (with notice to parties in interest). The US Bankruptcy Code provides that a court can confirm a Chapter 11 plan only if certain requirements are met, including that: (a) the plan and the plan proponent have complied with the applicable provisions of the US Bankruptcy Code and the plan has been proposed in good faith; (b) if there are classes that are impaired under the plan, then at least one impaired class has voted to accept the plan ('cram down'); (c) subject to the cram down requirements, each class has accepted the plan or is unimpaired; (d) the plan is in the best interests of the holders of claims or interests of any impaired class; and (e) the plan is feasible.

The insolvency process in the US is debtor friendly, unlike other jurisdictions, and the unsecured creditors' committee exercises some influence and plays an active role in the insolvency process.

The most important aspect in all the above examples is the unbiased, independent and objective conduct of the entity that is steering the insolvency resolution process. In the three jurisdictions that we have analysed above, while different players such as the Judicial Manager, the Administrator, are tasked with the proper conduct of the roles and responsibilities connected with the insolvency process, the conduct narrative is largely similar. It broadly encompasses:

- Suitability to drive the resolution process without any conflict of interest and in an objective and unbiased manner;
- Act in the best interest of the stakeholders' group as a whole;
- Act in good faith, fairly and honorably, and also be seen as independent and impartial;
- Must exercise good business judgement;
- Resolution is commercially feasible and viable, compliant with laws, and fair and equitable.

PROPOSED CODE OF CONDUCT FOR CoC

While there is no doubt that all stakeholders are vital, during the CIRP where the prime objective is revival/rehabilitation of a financially distressed company, the FCs play a very significant role as they have larger stakes involved, are equipped with the ability to decide on matters relating to commercial viability of the CD and display their willingness to take the risk of restructuring their debts in order to keep the CD a going concern. It may also be argued successfully that the FCs with 'skin in the game', like banks and financial institutions, are better placed to assess the feasibility and viability of a resolution plan for the successful continuance of a CD as a going concern. And if a CD revives successfully, it can as well be reasonably assumed that other stakeholders like OCs would also equally benefit from the revival.

The law in India has recognised the above and relies on the CoC to run CIRP and looks to them to set highest levels of standards in conduct and performance. The NCLTs in some cases have also recognised the diligence and roles played by the CoC. For example, in the matter of *Ashika Commercial Private Ltd.*²⁶, NCLT, Kolkata Bench observed;

This is a case in which the COC has judiciously distributed the financial bids to the stakeholders according to their full entitlements. There is nothing in the plan, so as to disapprove it. The COC has very well deliberated with the two plans and decided the viability, feasibility and financial matrix of each plan and approved one.....

Similarly, in the matter of *Pawan Impex Pvt. Ltd.*²⁷, NCLT, Principal Bench at New Delhi observed that '*...the decision of the COC is a reasoned and self speaking one as required under provisions of regulation 39(3) of CIRP Regulations, 2016.*'

Having emerged as the most appropriate body to attempt to revive and rehabilitate distressed CDs in a commercially prudent manner, it may be worthwhile to consider steps that could be taken to further strengthen the framework of CoC under the Code. A possible way to achieve this objective could be to consider adopting a code of conduct along the similar lines of the SIP in the UK, which would set out the guiding principles for the conduct of the CoC and ensure that its commercial wisdom is largely confined to within the four walls of these guiding principles, with any deviations requiring proper justification or attracting incidental consequences.

Some of the guiding principles could include intent statements on the following areas:

- (a) demonstrable transparency in the conduct of the CoC especially with regard to conflict-of-interest issues;
- (b) all decisions of the CoC to be backed by fair reasoning and to be recorded;
- (c) maintain arm's length with RPs in respect of jurisdiction and responsibilities, especially in respect of engagement of professionals and in the area of treatment of avoidance transactions;
- (d) requirement for better due diligence of the RA as well as the CD;
- (e) mechanism for resolution of deadlocks on matters where the CoC is unable to take decisions due to lack of requisite majority;
- (f) mandatory disclosure of all information to the RP for assisting the RP in conducting the business of the CD such as technical reports, forecasts, etc.;
- (g) appropriate penalties or disciplinary action for a CoC member on account of misconduct or malfeasance while being on the CoC of another CD, subject to carve out of decisions taken in good faith applying business judgement rule;
- (h) strict adherence to timelines stipulated in the Code and the regulations made thereunder;
- (i) commercial wisdom of CoC to be supported by suitable and reasoned back up information and data;
- (j) minimum stipulated professional and empowered competency of the members representing the creditors in the CoC meetings;
- (k) in respect of large resolutions, the CoC to be encouraged to have a heterogeneous composition such as involving experts from different areas of specialisation such as compliance, credit, risk, investment banking, legal and also suggest minimum thresholds of representation for such experts to encourage more diverse and multi-faceted discussions;

- (l) encouraging entrepreneurial and business initiative by the CoC while exercising its commercial wisdom along with requisite immunities to protect them against unfavorable outcomes as an outcome of exercising such commercial wisdom.

CONCLUSION

There appears to be no global consensus on the optimum approach to achieve an objective and transparent CIRP. The Code, in India, imposes this duty largely on the CoC, which is best placed to maintain the CD as a going concern. An appropriate code of conduct for CoC members has the potential to support procedural certainty and fairness to the CIRP. The introduction of principles and processes such as transparency, prior due diligence and disqualification for misconduct, strengthen the ability of the CoC to exercise its commercial wisdom for the benefit of the CD, while also ensuring that the interests of all stakeholders are best served. Overall, the adoption of a code of conduct, along the lines suggested above, could greatly strengthen the CIRP, maximise value for all stakeholders with high levels of process conduct and bring the Indian insolvency law at par with established international jurisdictions.

NOTES

¹ There are certain specific scenarios stipulated in regulation 16 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) when the CoC constitutes of OCs instead of FCs.

² Section 27, IBC.

³ Section 28, IBC.

⁴ Section 12(2), IBC.

⁵ Section 33, IBC.

⁶ Section 12A of IBC read with regulation 30A of CIRP Regulations.

⁷ Section 30(6), IBC.

⁸ Civil Appeal No. 10673/2018, February 05, 2019.

⁹ *Ibid*, para 52.

¹⁰ *Ibid*, para 48.

¹¹ *Ibid*, para 54.

¹² Civil Appeal No. 8766-67/2019, November 15, 2019.

¹³ *Ibid*, para 46.

¹⁴ Civil Appeal Nos. 2955/2020 and 2902/2020, September 04, 2020.

¹⁵ *Ibid*, para 13.

¹⁶ Civil Appeal Nos. 9402-9405 of 2018, October 04, 2018.

¹⁷ (2019) 4 SCC 17, January 25, 2019.

¹⁸ Civil Appeal No. 9664/2019, March 15, 2021.

¹⁹ Insolvency, Restructuring and Dissolution Act, 2018.

²⁰ [2021] SGHC 32, para 118.

²¹ Insolvency Act, 1986.

²² Insolvency Act, 1986, Schedule B1, para 3.

²³ Insolvency Act, 1986, Schedule B1, para 99(4).

²⁴ In *Re Charnley Davies Ltd. (No 2)*, the administrator sold the insolvent company's business at an allegedly undervalued price, which creditors alleged breached his duty to not unfairly harm them. Millett J held that 'the standard of care was not breached, and was the same standard of care as in professional negligence cases of an 'ordinary, skilled practitioner'. He emphasised that courts should not judge decisions which may turn out sub-optimal with the benefit of hindsight. Here the price was the best possible in the circumstances.

²⁵ Section 362(a), US Bankruptcy Code.

²⁶ CP No. (IB) 600/KB/2020.

²⁷ CP No. (IB)-1396 (PB)/2019.

LITIGATION FUNDING: A BREAKTHROUGH FOR AVOIDANCE PROCEEDINGS UNDER IBC

Debajyoti Ray Chaudhuri and Radhika Agarwal

Litigation funding, sometimes also known as ‘third party funding’ is a mechanism to facilitate the recovery of claims by individuals and companies, especially those under financial stress, by funding the costs of legal proceedings. A litigation funder finances the cost of the litigation in exchange for a share of any recovery made through the proceedings, rather than the claimant paying the costs of the same.

This type of funding is often on non-recourse basis, meaning thereby that if the claim cannot be recovered, the claimant is not responsible for repaying the legal costs incurred by the litigation funder. As a result, the litigation funding agreement usually provides that the litigation funder bears most of the risk, whether it is the risk of losing a claim or even any damages imposed because of the litigation relating to the claim.

According to World Bank’s Ease of Doing Report¹, commercial contracts are resolved in around 1445 days in India, while in OECD (Organisation for Economic Co-operation and Development) countries it takes around 589.6 days. The report shows that the cost of litigation in India is approximately 31% of the claim value which is around 10% higher than in OECD countries. This often acts as a deterrent for claimants to initiate legal proceedings to recover a claim, which might have potential for being successful, but due to the prohibitive costs of pursuing the claim, they are discouraged from doing so.

LITIGATION FUNDING AND INTERIM FINANCE

The Insolvency and Bankruptcy Code, 2016 (Code/IBC) provides that the Insolvency Professional (IP) can raise funds for the corporate debtor (CD) through interim finance.² Interim finance can be crucial in resolving and restructuring a CD under corporate insolvency resolution process (CIRP), as it can provide much needed funds for the company's business operations to continue and meet other costs including litigation costs, subject to necessary approvals, as provided under the IBC. However, in general, it has proved to be a challenge for companies undergoing CIRP to access interim finance. One of the earliest instances where the IP was able to access interim finance was the CIRP of Alok Industries Ltd.³ Similarly, the IP was able to avail interim finance in the CIRP of Bharti Defence and Infrastructure Ltd.⁴

Interim finance is required to preserve value of a CD in a CIRP and facilitate the resolution process. Accordingly, the law provides that interim finance is paid in priority in a resolution plan in CIRP and under the waterfall mechanism in liquidation. As a facilitation measure, Reserve Bank of India (RBI) has, vide its circular⁵ on Prudential Framework for Resolution of Stressed Assets provided that interim finance may be treated as 'standard asset'.

Although, interim financing provides an opportunity for the CD to raise funds, but it is included in the CIRP or liquidation cost and since it is paid in priority, it does have an impact on the value of CD in a resolution plan or recovery in liquidation proceedings. Under litigation funding, the costs are borne by the litigation funder and the creditors have no direct impact under the scheme. Moreover, the IP can focus on his responsibilities without fretting about the outcome of the legal proceedings.

Advantages of Litigation Funding

Litigation funding gives an opportunity to the litigation funder to invest in a specific claim according to its potential with the possibility for investing in multiple claims at the same time. Litigation funding is usually on non-recourse basis, i.e., the cost is borne entirely by the funder. In the event of non-recovery from the claim, the parties disputing the claim are under no obligation to make any payments to the funder. The funder while pursuing a claim takes on a financial risk which could lead to irrecoverable loss suffered due to unsuccessful recovery of a claim, besides the costs of damages, if claimed by the counter party.⁶ However, for the claimant, this could be a viable option as he does not have to go through the financial risk of non-recovery of a claim. The litigation funder usually has its own risk assessment team which does risk assessment of each claim before deciding to take it up.

Litigation funding is best suited for the financiers with appropriate risk appetite as the yields from these types of investments are higher, with commensurate risks. The funders would invest in a claim only after getting fully satisfied on the probability of winning the litigation battle. It can be said to yield higher returns for the funders with relatively low investments, although the cost and time frame for recovery may be uncertain.

Litigation funding can have significant strategic benefits in addition to providing vital resources to

the claimants. In United Kingdom, some of the litigation funders have built such a reputation that their presence signals to a tribunal and the defendant, that an objective third party with significant expertise and experience in disputes is willing to put its own money on the line, because of the merits of the underlying claim. The likelihood of obtaining recovery brings about a negotiated settlement between parties. Moreover, a financially supported claimant is also less likely to feel compelled to accept a low settlement offer.

There is scope for litigation funding in avoidance proceedings under the IBC, as the IP can freely focus on keeping the CD as a going concern and running the processes of CIRP like invitation of claims, conduct of meetings of committee of creditors (CoC), invitation of expression of interest etc. The costs are being taken care of by the funders and the claims are processed by professionals who ensure that they are taken to a logical conclusion.

Litigation funding for avoidance transactions under IBC

In general, litigation funding is used in arbitration proceedings where the possibility of return on investment is huge. In CIRP, the claims that have potential for litigation funding are avoidance transactions⁷ including preferential transactions, under-valued transactions, extortionate credit and fraudulent transactions. The Code provides for the manner of treatment of avoidance transactions. There is a 'relevant period' for avoiding these transactions under the Code. However, for transactions which are fraudulent in nature, no such period is provided. The provisions for avoidance transactions under the Code ensure that transactions which have no commercial purpose and were performed just to benefit some creditors or to obstruct the insolvency or liquidation procedure, are set aside. The law aids in rectifying the situations where a property/asset is transferred merely to keep it out of the pool of assets available to a resolution applicant in CIRP or to be distributed among creditors in a CD under liquidation. However, the principles of avoidance, should be applied with caution so that lawful transactions which are consummated in the normal course of business are not reversed.

In the matter of *Anuj Jain Interim Resolution Professional for Jaypee Infratech Limited v. Axis Bank Limited and others*⁸ (Jaypee Infratech) the Hon'ble Supreme Court of India (SC) has clarified many aspects in respect of avoidance transactions under the IBC. The approach of the court has been to keep the value maximisation of assets of the CD in account while examining relevant provisions of the Code. The questions that arose before the SC were whether the transactions under reference were to be avoided for being preferential, fraudulent, or undervalued and whether the respondents could be recognised as financial creditors (FCs) based on mortgage created by the CD as a collateral security for the debt of its holding company. The SC, in its judgement, concluded that the impugned transactions had been for the benefit of the holding company, a related party of the CD and the transactions had the effect of putting such a related party in a beneficial position than it would have been in the event of distribution of assets being made in accordance with section 53 of the Code. Thus, the CD had given a preference to a related party in the manner laid down in section 43(2) of the Code. On the second issue, the SC opined that lenders of the related party, on the strength of the mortgages in question, may fall in the category of secured creditors, but such mortgages, are not a

facility or an advance to the CD nor towards protecting any facility or security of the CD. Therefore, it cannot be said that the CD owes them any ‘financial debt’ within the meaning of section 5(8) of the Code; hence, such lenders of the holding company do not fall in the category of the FCs of the CD.

The SC upheld the order of the Adjudicating Authority (AA) that cancelled the mortgage of immovable property without any consideration created by Jaiprakash Infratech Limited (JIL) to secure the financial debts of its parent company and CD, Jaiprakash Associates Limited (JAL), thereby ordering JAL to return the 858 acres parcel to JIL. The judgment has paved the way for the litigation funders to pursue the avoidance transaction claims, as a conclusive decision was taken on an avoidance transaction to restore the assets of the CD during the period of CIRP.

The law makes it mandatory for the IP to determine such transactions and take remedial measures, however, sometimes the real potential of a claim may not be considered by an IP due to paucity of funds and the uncertainty of getting a decision from the appropriate authority. Further, since there is no settled principle as to who will get the benefits of such claims if the avoidance application continues after the conclusion of the CIRP, the creditors are often disinterested in pursuing the claim. Litigation funding covers the cost of litigation and may also provide an arrangement where the creditors also benefit from the recoveries made from such proceedings.

In the recent past there have been some discussion about the recovery for FCs in CIRP.⁹ The total recovery of the Scheduled Commercial Banks is 45.5% under the IBC¹⁰, which is much better than the earlier mechanisms for resolution of stressed debt. However, there is a potential for better value maximisation of the CD under CIRP, if recoveries can be effected under the avoidance transactions.

LITIGATION FUNDING AND TIMELINES UNDER IBC

The Code endeavours to complete the insolvency resolution of the corporate and other debtors in a time bound manner. As provided in section 12 of the Code, the CIRP shall mandatorily be completed within a period of 330 days from the insolvency commencement date. The 348 CIRPs, which have yielded resolution plans by the end of March, 2021 took on average of 406 days for conclusion of process. The average period for resolution in 242 CIRPs completed by March, 2020 was 414 days, whereas 106 resolutions since then took an average of 563 days.¹¹

According to the report of the Insolvency Law Committee¹² (ILC), there would be no prescriptive timelines for the completion of avoidance transaction processes, and they may extend beyond the CIRP period. These cases may require evaluating many disputed transactions over a longer clawback period than CIRP, so they should have been allowed to continue beyond CIRP. It was suggested that IP shall continue with existing practice and remain as appropriate authority for carrying out preferential transaction investigations.

It appears from the experience till date that the applications for avoidance transactions are given lower priority, as in very few cases, AA has been able to arrive at a decision.¹³ Section 26 under the Code states that if any avoidance application is filed under section 25 of the Code, then it shall not affect the proceedings of CIRP. The application for avoidance proceedings is against the directors/

promoters/related parties of the CD and the resolution is for the CD. Therefore, the law and practice seem to indicate that the avoidance application proceedings and CIRP are two different and separate processes. However, some questions arise as to who will be the ultimate beneficiary of the amount that is recovered and who will handle the whole proceedings for avoidance applications filed, after the resolution plan of CD is approved by the AA. Also, the issues like, under which capacity IP will be dealing with these transactions after approval of resolution plan and who will bear the cost of such litigation is still to be addressed in a conclusive manner.

In the case of *M/s. Venus Recruiters Pvt Ltd*¹⁴, the question arose that whether an application filed under section 43 for avoidance transaction can survive beyond the conclusion of CIRP. Hon’ble Justice Pratibha Singh of Delhi High Court (HC) adjudged that the avoidance transaction applications which are pending on the date of approval of resolution plan cannot be allowed to continue after the resolution plan gets approved under section 31 of the Code. It was also held that the avoidance application is intended to benefit creditors of the CD in its pre- insolvency state, not the CD in ‘new avatar’ after the resolution plan is approved.

The experience till date is that CIRP has been susceptible to the delays at the stage of admission as well as due to litigation during CIRP.¹⁵ The Hon’ble HC, in the *Venus Recruiters Pvt. Ltd.* case was of the opinion that, with the completion of CIRP, the application of avoidance transaction will also cease. This implies that the applications of avoidance transaction must be completed in a time bound manner. Litigation funding for avoidance transactions could be an efficient way to proceed with such claims, as it would bring in professionals with domain expertise to process and pursue such claims, leaving the IP free to pursue the core processes of CIRP.

The promulgation of Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 introduced pre-packaged insolvency resolution process (PIRP) for corporate persons classified as micro, small and medium enterprises (MSMEs), and the process is to be completed within 90 days. The shorter window would require quick decisions to be taken regarding determination and necessary action in respect of avoidance proceedings where there could be benefits of litigation funding from professionals. Secondly the MSME sector in general has large dues from the larger corporates, many MSMEs have also got poor recoveries from CIRPs of large corporates. This has led to litigation and public outcry leading to delay in implementation of resolution plan, even where a resolution plan has received the approval of the AA. Litigation funding could enable MSMEs recover their dues even outside insolvency proceedings.

LITIGATION FUNDING- INTERNATIONAL SCENARIO

Litigation funding was generally limited to common law jurisdictions like United Kingdom (UK), United States and Australia until recently, but it has seen a significant expansion in recent years. Countries such as Germany, Hong Kong and Singapore have also taken measures to remove legal impediments to Third Party Funding. These jurisdictions have clearly recognised the benefits of the concept, which includes a more effective recovery mechanism, and easier access to justice.¹⁶

However, regulation in litigation funding is also a necessity. In UK, for example, a code of conduct for litigation funders is in place, requiring them to act properly, refrain from withdrawing such funds except under particular conditions, keep confidentiality, and not seize control of the litigation or settlement negotiations. The practice in the UK is keeping the responsibilities of funders, claimants, and their lawyers separate. The Association of Litigation Funders (ALF), an independent group mandated by the Ministry of Justice with delivering self-regulation of disputes resolved primarily through litigation proceedings in England, was established in November, 2011.

In UK, litigation funders can either acquire the claims completely from the Insolvency Practitioner or provide services for a fee plus a percentage of the proceeds. The purchase of claims can benefit both the funder and the IPs, as it gives the funder control over the claims and allows the IPs to utilise the cash to examine other prospective claims.¹⁷

Many firms in UK are investing in insolvency cases. Manolete Partners Plc¹⁸ is one such leading UK firm that finances the litigation in claims related to insolvency proceedings to maximise recoveries for creditor estates while also taking on all the risk. The firm has invested in over 600 claims and approximately 388 cases have been completed. About 459 claims out of total claims were purchased via assignment and 159 were funded which shows that assignment model has been popular in UK. As per an advertisement put out by the firm, it claims a very high success rate in all the cases it has funded.

BUSINESS MODEL OF THE LITIGATION FUNDER

Dedicated financiers perceive litigation funding as part of new business opportunities, and these Litigation Funds, in the anticipation of high-stakes legal procedures, provide funding to litigation expenses, and reap the benefits of the proceedings.¹⁹ The avoidance transaction claims in CIRP may provide an opportunity to these financiers since the claims can be separated from the CIRP and can progress independently.

In the litigation funding model in insolvency proceedings, the funder makes a three-way partnership with the IP and the lawyers so that the claim is pursued and resolved quickly. Whether the funder funds the IP or has taken the assignment of the claims, the IP stays closely related to the claim. The agreement between the funder and the IP can be simple purchase or funding agreement. The defendant is intimated about the claim so that they may be made aware of the fact that the claim is funded by the third party. In UK, where litigation funding is common in insolvency proceedings, many cases are settled on commercial terms, and few also go to trial stage.²⁰

While evaluating a claimant's litigation funding request, the funder usually looks at six key factors which includes the merits of the claim, credentials of the claimant, litigation budget, claimant's legal representative/law firm, expected damages and the mode of recovery.²¹ Funders like to invest in situations that can be resolved quickly. They are unwilling to participate in instances that may result in a lengthy court battle because of the uncertainty factor and therefore the risks to a favourable outcome.

The scope of the funder's scrutiny will be determined primarily by the type of case, the importance of the action, the complexity of the issues involved, the preparation of the diligence papers, and litigation counsel's ability to present its position succinctly.²²

The funder will examine whether the parties are likely to act reasonably when negotiating a settlement offer based on how interested the claimant is in the dispute. To comprehend the economics of the plan and determine whether the claimant's and its law firm's interests are sufficiently aligned, the funder needs to assess the experience of the legal team working on the case and the terms of the agreement with the claimant.

Litigation funding is a pre-determined amount of money that will be used to pay for legal fees and expenses. If the estimated budget is exceeded, the funder may rely on the claimant or counsel depending on the agreement between the parties.²³ Also, the size of a prospective award must be sufficient to give the funder with a return that equals the investment risk while also covering the actual costs of litigation.

CHALLENGES FOR FINANCIERS UNDER IBC

The IBC provides that the IP must form an opinion whether any avoidance of transaction have taken place, after which he makes an application to the AA under section 26 of the Code. It needs to be examined whether the IP can assign the claim to the litigation funder, as the responsibility to file the application lies with the IP. Therefore, this is a challenge for the financiers as there is no certainty of assignment of the claim under the existing provisions of the IBC. However, the IP could have an arrangement, where, after examining its legal validity, the litigation funder can process and fund the litigation related to such claims, in lieu of share of proceeds from such transaction which can be paid in advance for the benefit of the creditors.

The beneficiaries of litigation funding may have an apprehension that once the funds are provided to the CD, the funder firm may wish to appoint its own lawyers to handle the claim. To rule out such an apprehension, the litigation funder usually provides in the agreement itself that, it only must be updated on the case progress and be consulted on big disbursement expenditures²⁴, with the case being handled by a professional legal team. Further, if the funder firm were to have its own legal counsel in each case, it would need a staff almost the size of a major law firm, and the business wouldn't be economically viable. The experience in UK is that in most cases, the existing legal team continues the proceedings under the supervision, where required of the litigation funding team.

The reputation of a professional funder is just as crucial as the assets he manages.²⁵ Another apprehension is that a funder may rely on its financial strength to finance even unmeritorious claims. If the funder finances unmeritorious claims, the funder will lose money and the funder's promoters will lose faith in the funder's ability to select claims and run a viable, lucrative, and long-term business.

The biggest challenge that litigation funder might face is when it makes upfront payment against the claims, besides the risks of non-recovery of claim, it could also be subject to scrutiny where there are windfall gains against such claims. A way to resolving such issues could be to provide in the agreement with the IP, a clause that some benefit be passed on to the creditors or the CD, in cases where the recovery is substantially more than the initial pay out to creditors.

Potential of Litigation Funding in India

Shortage of resources triggered by the COVID-19 pandemic has already made business operations for industries in certain sectors extremely arduous, which are combating shrinking balance sheets and a reduction in the available credit. These factors could increase opportunities for litigation funding and for funders to help businesses pursue their litigation claims through the ‘third-party funding’ route.

In India, third-party litigation funding is permitted under the Civil Code of Procedure (CPC), 1908 in some states (for example, Madhya Pradesh, Maharashtra, Gujarat, and Uttar Pradesh), by the respective state amendments to Order XXV Rules 1 and 3 of the CPC. Therefore, we can see that the authorisation for third-party funding is there from CPC in India. Further, there is no express prohibition under any legislation for the same.

In the recent past, two significant examples of third-party fundraising prompted corporate finance experts to consider litigation funding as an alternative source of funding: arbitration award monetisation in Hindustan Construction Company and Patel Engineering. The major infrastructure companies in India are dealing with stretched receivables and large pending claims²⁶, litigation finance will surely assist them in resolving these issues.

As per the report of ILC²⁷, there are issues regarding the funding for expenditure incurred for litigation related to avoidance transactions under the IBC in India and analysed some ways for funding that are prevalent globally like debtor’s estate, state funding, appointment of contingency counsel, funding by creditors and third parties. The committee examined all aspects and stated in its report that the extant legal provisions do not prohibit third-party litigation funding in India and accordingly funding for such litigations may be left to the market. It therefore concluded that no legal change is required in this regard.

The Indian Association for Litigation Financing (IALF) incorporated on February 11, 2021 by practitioners, law firms, and third-party funders, provides a glimmer of hope to this source of funding. The association aims to self-regulate litigation funding in India and disseminate information about it for the people to learn the business of litigation finance. This is the first step towards setting up the regulatory framework for litigation funding in India. The working group of IALF comprises Phoenix Advisors, Omni Bridgeway, Singularity Legal, FTI Consulting and Grant Thornton. According to the working group, the biggest beneficiary of the third-party financing would be MSMEs. The first meeting of the working group of IALF was held in April, 2021 where the future course of the organisation and first 100-day plan for IALF was discussed.

CONCLUSION

India needs a robust regulatory structure that focuses on litigation funders’ disclosure, credentials, and conduct. Such legislative and regulatory safeguards are necessary to ensure that there is an equitable and fair settlement procedure for parties receiving litigation funding and is also able to withstand judicial scrutiny.

India still has a long way to go in terms of realising the potential of litigation funding. However, many stakeholders are looking at this very seriously to meet the costs of litigation involved in recovery of a claim. A good business model can help financiers become interested in the project. With the implementation of the IBC, jurisprudence on a variety of issues has developed within a very short span of time. It is certain that we are not far behind in getting better avenues for funding of litigation costs, especially for avoidance proceedings under the IBC. This could lead to better outcomes under avoidance proceedings which in turn could lead to maximisation of the value of the CD, one of the objectives of the IBC.

NOTES

¹ World Bank’s Ease of Doing Business Report, 2020.

² Section 5(15) under Chapter 1 Part II, IBC.

³ CP(IB) 48 of 2017.

⁴ MA 170/2018 CP292/I&B/NCLT/MAH/2017.

⁵ Prudential Framework for Resolution of Stressed Assets, June 7, 2019.

⁶ Singh A. (2021), “Funding lawsuits- For a piece of Justice”, *Indian Legal*, 02 January.

⁷ Section 26, IBC.

⁸ Civil Appeals 8512-8527 of 2019.

⁹ IA 196 of 2021.

¹⁰ IBBI Quarterly Newsletter, January- March, 2021.

¹¹ *Ibid.*

¹² Report of Insolvency Law Committee, February, 2020, p. 20.

¹³ IBBI (2019), Discussion paper on “Corporate Liquidation Process for Corporate Persons along with Draft Regulation, 2016”, 27 April.

¹⁴ W.P.(C) 8705/2019 & CM APPL. 36026/2019.

¹⁵ *Supra* Note 12, p. 21.

¹⁶ Limpiner A. and Simons W. (2019), “A Practical guide to litigation funding”, Woodsford Litigation Funding Insight.

¹⁷ Wilkins S. and Ganguly R. (2020), “Litigation funding in Insolvency”, Digest South Square, 16 March.

¹⁸ Manolete Partners PLC.

¹⁹ Fuqua R. (2021), “How Litigation Funders Have Improved the Quality of Settlements in America”, Harvard Negotiation Law Review, June, 2021.

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²⁴ Nasta M (2016), “Third party litigation funding in insolvency”, Financier Worldwide, 10 September.

²⁵ Eccles R. et. al. (2007), “Reputation and its Risks”, Harvard Law Review.

²⁶ PIB Press Release on reforms passed by Cabinet Committee on Economic Affairs, August 31, 2016.

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THIRD PARTY LITIGATION FUNDING: OPPORTUNITIES UNDER THE IBC

Ashwin Bishnoi*

Undertaking an assessment of the assets and liabilities of a corporate debtor (CD) is the first and foremost responsibility of any newly appointed Resolution Professional (RP) or Liquidator. Realisable assets translate into the availability of funds for eventual distribution among creditors, and therefore this assessment becomes key at the onset of any insolvency resolution or liquidation process under the Insolvency and Bankruptcy Code, 2016 (Code/IBC). A CD’s estate comprises of crystallised assets (recorded in its balance sheet with an assigned book value) as well as contingent assets, such as litigated claims against counterparties – often requiring funds and conscientious efforts on part of an officeholder to pursue and realise prior to culminating into distributable funds. In this article, we explore third party litigation funding (TPF) as a viable avenue available to a CD in insolvency or liquidation for the realisation of its contingent claims.

Officeholders are responsible for the management of a CD’s estate (and in the case of liquidation, its eventual realisation). Often, such estates comprise of little to no liquidity but may consist of substantial claims against errant business counterparties or other third parties responsible for the CD’s financial distress. The fructification of such claims generates significant value, but such realisations require costs, management of administrative hurdles such as access to poorly maintained books and records and a requirement on part of the office holder to carry out detailed investigations, sometimes looking back to a number of years.

Conventionally, officeholders have looked to the creditors of a company to provide for such funds and assistance. However, this remains unviable as a long-term solution, as creditors are usually reluctant to throw good money after bad, have competing interests *inter-se* and are generally averse to the risk of courts imposing third party cost orders, particularly if they are seen to be running the

litigation. It is in this context that the relevance and importance of TPF as a viable alternative to step in and fill this gap in the market is discussed in this article.

LEGALITY OF TPF ARRANGEMENTS IN INDIA

In contrast to other common law jurisdictions, TPF arrangements have never been explicitly barred under Indian law. Common law torts of champerty and maintenance are seldom imposed strictly by Indian courts and their application under Indian law is restricted to where it could affect public policy or where the TPF financier seeks to make extortionate, inequitable or unconscionable gains at the expense of a claimant. An equitable funding arrangement to carry on an ongoing litigation for a share in its proceeds has usually been validated by Indian courts, including the Hon'ble Supreme Court of India. In fact, Maharashtra, Gujarat, Madhya Pradesh and Uttar Pradesh have given statutory recognition to TPF arrangements by enacting amendments to Order XXV of the Code of Civil Procedure, 1908 and vesting courts with powers to implead TPF financiers to secure costs for litigation.

Historically, Indian courts have given credence to the principle that a financier who risks losing his money must be allowed an advantage on the successful outcome of a litigation. Courts have also validated incremental returns to a TPF financier, where the financier's participation continued throughout the length of the litigation, for instance where the TPF financier has also contributed to the costs of an appeal. Moreover, unlike several other common law jurisdictions such as the United Kingdom, Indian law also recognises the ability of a TPF financier to significantly control and manage the litigation, including by way of engaging counsel, formulating a litigation strategy, conducting the litigation under a power of attorney, receiving the proceeds of litigation and distributing to the litigant his share in such proceeds. More recently, TPF arrangements have seen application in the EPC (engineering, procurement and construction) space, with distressed companies such as Hindustan Constructions Company Limited and Patel Engineering Limited attempting tying up with global TPF financiers to resolve their ongoing litigation, under the looming threat of insolvency resolution.

Various structures have been adopted to give effect to TPF arrangements in India. These include loan like structures, with negotiable terms of repayment and funding arrangements in return for an assignment in the share of the proceeds of a claim (or an assignment of the claim itself). The assignment structure seems to be more widely accepted given the protracted nature of litigations in India, where a continuing interest-clock is detrimental to the financial health of the claimant company.

TPF AND THE FRAMEWORK UNDER THE IBC

Globally, the most common application for TPF in the context of insolvent companies is for avoidance actions as well as other claims of a company that are too costly to pursue, for example –

claims relating to commercial and intellectual property, breach of fiduciary duties, theft of corporate opportunities, tax refunds, etc. Successful recoveries hold the potential to increase the value of the CD's estate and provide a greater return to its creditors. Typically, TPF arrangements are considered when the realisable assets of a CD are generally insufficient to fund legal and other costs involved in pursuing a litigation and have application both in the context of administration and recovery, or liquidation of a company. The IBC provides for distinct and separate mechanisms for liquidation, focussed on value maximisation to the creditors of a CD and insolvency resolution, undertaken with the objective of reviving a CD as a going concern. The juxtaposition of TPF arrangements within the regulatory framework for each of these processes is discussed below.

Liquidation

The IBC stresses on a time-bound closure of the liquidation process, recognising that a CD's estate is likely to depreciate in value with time. The dissolution of a CD, while there still remain assets unrealised in its estate is detrimental to the creditors as a whole, and equally – a protracted dissolution accounting for the successful fructification of litigation claims is also financially unviable on account of continuing costs of running an enterprise.

It is in this context that the Insolvency and Bankruptcy Board of India (IBBI) in its discussion paper on 'Corporate Liquidation Process', dated August 26, 2020, highlighted the need for statutory recognition of assignment of non-readily realisable assets (NRRAs) under the IBC. Consequent amendments to the IBBI (Liquidation Process) Regulations, 2016 under the IBC have potentially opened the doors to TPF arrangements in liquidation. Under this regime, a Liquidator is permitted to assign or transfer an NRRAs through a transparent process in consultation with the stakeholders' consultation committee (SCC) to any person who is not rendered ineligible to submit a resolution plan under section 29A of the IBC. NRRAs have been broadly defined to include '*any asset in the liquidation estate which could not be sold through available options and include contingent or disputed assets underlying proceedings for preferential, undervalued, extortionate credit and fraudulent transactions referred to in Sections 43 to 51 and 66 of the IBC*'.

Liquidators may therefore enter into TPF arrangements with financiers and assign NRRAs either by way of an absolute assignment, or with a recompense facility under which any subsequent net discovery of value over and above an initial price may be shared between the Liquidator and the TPF financier. Liquidators considering such arrangements must also be guided by the principles reiterated by the IBBI in its discussion paper, which include acting in the best interest of the liquidation estate, seeking maximum consideration for such assignment, consulting the SCC, undertaking the assignment on an arm's length basis and dealing in a reasonable and fair manner in good faith. These resonate with global best practices and reduce the risks of such arrangements being subsequently challenged before courts.

Insolvency Resolution

Critically, the application of TPF in insolvency resolution, for the moment, is not expressly acknowledged by statute and the right to assign NRRAs is only available in the liquidation of a CD. However, it is inconceivable that such a remedy should not be made available to RPs as well. In the United Kingdom, for example, the right to assign litigation claims is statutorily available to both Liquidators as well as Administrators. Indeed, the Insolvency Law Committee (ILC) in its report dated February 20, 2020, has acknowledged that there is no legal bar to third party litigation funding in India and that it may be undertaken in the commercial wisdom of the stakeholders involved. The ILC expressly noted that there is no change required to be made in the IBC in this regard. Therefore, until a formal amendment to the IBC follows or any jurisprudence is established in this regard, it may be worthwhile for RPs to adopt global best practices before entering into TPF arrangements in insolvency. In the context of the IBC, these include:

- (a) Obtaining prior approval of the committee of creditors (CoC) for the terms of the TPF arrangements, including the recovery of any associated costs incurred by the RP as ‘insolvency resolution process costs’ (though here regulatory clarity as to TPF costs being insolvency resolution cost will be much helpful);
- (b) Obtaining a legal opinion in connection with the legal tenability and viability of the suit in question and a valuation report indicating the potential recovery in case the suit is successful;
- (c) Obtaining appropriate and available insurance cover against the imposition of any costs on the RP or the CD;
- (d) Selection of a TPF financier through an independent process, on an arms-length basis and in each case on terms acceptable to the CoC. The RP should be careful to ensure that the TPF financier so engaged is not ineligible to submit a resolution plan under section 29A of the IBC;
- (e) Disclosing to potential resolution applicants (RAs) any TPF arrangements entered into by the RP as well as requiring such RAs to hold in trust and provide to the CoC any amounts received in the event that a claim fructifies after the approval of a resolution plan;

Such means will also reduce reliance on the debtor, post-implementation of the resolution plan. This allows the debtor to focus on its fresh start rather than pursue old and difficult contingent claims against third parties or erstwhile promoters.

CONCLUSION

TPF plays a vital role in permitting Administrators and Liquidators to pursue wrongdoers or actions that would otherwise be impossible due to the lack of funding opportunities. It serves to insure potential losses associated with such litigations and provides low risk and equal recovery for the creditors of a CD. TPF also reinforces the principles of the IBC by allowing more avoidance and

misfeasance claims and attempts to deter corporate defendants who would normally not have suits instituted against them on account of lack of funding avenues. TPF encourages the resolution of insolvency or the efficacious liquidation of the CD by dealing with litigation claims in an orderly and expeditious fashion.

The TPF market in India is still very much a work in progress, conspicuous by the lack of domestic TPF players and the unavailability of financial products such as adverse costs insurance. Further, the nascency of this market brings with it certain challenges around the valuation of contingent assets, resultant price discovery, mechanisms for distribution of proceeds after the dissolution of the CD, risk mitigation for counterclaims etc. Perhaps to further jump-start this industry, TPF should be given further and clear statutory impetus.

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SCOPE AND LIMITATIONS OF SUBORDINATE LEGISLATION UNDER IBC

Unnikrishnan A.

The Insolvency and Bankruptcy Code, 2016 (Code/IBC) is a comparatively large piece of legislation. It deals with the subject of resolution and liquidation of different types of entities in an elaborate manner. There are more than 250 sections in the Code. At many places, the Code demands making of subordinate legislation for the purpose of carrying out its purposes. The subordinate legislation can be in the form of ‘rules’ or ‘regulations’. This paper analyses the scope and limitations of subordinate legislation under the Code.

The Code uses two different terms *viz.*, ‘prescribe’ and ‘specify’ to denote the making of subordinate legislation under it. Clause (26) of section 3 of the Code defines the term prescribed as ‘*prescribed by rules made by the Central Government*’. The term specified is defined in clause (32) of the very same section as meaning ‘*specified by regulations made by the Board*’. In the Code, the rule making powers of the Central Government are conferred by section 239. Section 240 of the Code provides for the regulation making powers of the Insolvency and Bankruptcy Board of India (IBBI/Board). By exercising such powers, a good number of rules and regulations have been made by the Government and the Board.

What is the scope of subordinate legislation? In one case¹, the Hon’ble Supreme Court observed that the essential legislative function consists in the determination or choosing of the legislative policy and of formally enacting that policy into a binding rule of conduct. The legislature must retain in its own hands the essential legislative functions.² It can formulate the policy as broadly and with such details as it thinks proper, and it may delegate the rest of the legislative work to a subordinate authority who will work out the details within the framework of that policy.

DISTINCTION BETWEEN RULES AND REGULATIONS

While thinking about the rules and regulations, the first question that comes to the mind of a lay reader is the need for such a distinction. Under the Indian legislative practice, rules are what the Central Government or the State Governments make, and the regulations are made by any institution or organisation established by a statute. While rules apply to all matters covered by the statute, the scope of the regulations is narrower - being usually confined to internal matters of the statutory body. When regulations standardise the conditions of service of the employees or purport to formulate them, their character is further diluted by the nature of the subject matter.³ In this article, for ease of description, the terms rules and regulations are used interchangeably, unless otherwise specifically indicated.

Source of power need not be mentioned always

It is beyond doubt that rules and regulations can be framed only if there is an enabling power in the body of the statute. Such powers may be express or implied but should be clearly traceable to the provisions enacted by the Legislature. The fact that the source of power is not mentioned in the subordinate legislation is not going to affect its validity.⁴ As long as the power is present, non-quoting of the relevant source of power also does not vitiate the regulation. Even a misquoting of the section is not fatal.

Rules and regulations cannot travel beyond the Code

The rules are essentially meant for carrying out the purpose of the Act. It is one of the established principles of subordinate legislation that the rules and regulations cannot travel beyond the scope of the parent Act.⁵ If so done, it will be declared as *ultra vires* by courts. Further, the conferment of rulemaking power by an Act does not enable the rule making authority to make rule which are inconsistent with the provisions therein or repugnant thereto.⁶

*'It is fundamental that a rule-making body cannot frame rules in conflict with or derogating from the substantive provisions of the law or statute under which the rules are framed.'*⁷

Rules made under the rule making provision of an Act cannot take away what is given by the Act.⁸ A conferment of general power to make rules is strictly ancillary and does not enable the authority to extend the scope of general operation of the enactment. Of course, the power will also cover what is incidental to the execution of its specific provisions. At the same time, such a power will not support attempts to widen the purposes of the Act, to add new and different means of carrying them out or to depart from or vary the plan which the legislature has adopted to attain its ends.⁹

Ordinarily, recourse to rules is not advisable to interpret the provisions of the primary enactment. However, where the statute is ambiguous or doubtful and a particular construction has been put upon the Act by the rules for a particularly long time, it might be justified.¹⁰

Can rules or regulations be made retrospectively?

It is a settled law that the rule-making authority does not possess plenary power to give the subordinate delegated legislation retrospective operation unless and until that power is expressly conferred by the parent enactment.¹¹ However, there is no general legal bar in law against giving a retrospective effect to a subordinate legislation. Normally, rules and regulations operate prospectively, and retrospectivity is an exception. It would be possible only if the parent Act permits such retrospective rule making.¹² Even where the statutes permit framing with retrospective effect, the exercise of the power must not operate discriminately or in violation of any constitutional right so as to affect a vested right.¹³ The Supreme Court has held that the rule making authority should not be permitted normally to act in the past.¹⁴ A look at sections 239 and 240 of the IBC will make it clear that neither the Government nor the Board has powers to make retrospective subordinate legislation.

Is levy of fees permissible under a subordinate legislation?

As indicated earlier, an authority can make rules or regulations only if the parent statute contains an enabling provision to do so. The delegated authority must act strictly within the parameters of the authority delegated to it and it will not be proper to bring the theory of implied intent or the concept of incidental and ancillary power in the matter of exercise of fiscal power and impose any tax or fee by a delegated authority.¹⁵ Sometimes, the general powers to levy fees for carrying out the purposes of the Act is treated as an enabler for levying of fees.¹⁶

PROCEDURE FOR LAYING BEFORE PARLIAMENT AND ITS EFFECT

Normally, the rule making powers specifically provide the manner in which the rules are to be placed before Parliament. It would also prescribe the number of days the concerned rules are to remain before Parliament.

In the case of the IBC, every rule and every regulation made has to be laid before each house of Parliament, while it is in session, for a total period of 30 days. During that period, if both houses agree in making any modification in the rule or regulation or both houses agree that the rule or regulation should not be made, they have effect only in such modified form or be of no effect, as the case may be. At the same time, the statute declares that any such modification or annulment shall not prejudice to the validity of anything previously done under that rule or regulation.

What is the consequence of failure to lay the regulation? A laying requirement has been held as directory¹⁷ when not coupled with affirmative mandate of laying rules in draft form requiring approval of the houses.

It is true that the Legislature has prescribed that the rules shall be placed before the Houses of Legislature, but failure to place the rules before the Houses of Legislature does not affect the validity of the rules merely because they have not been placed before the Houses of the Legislature.¹⁸

In other words, if a laying clause defers the coming into force of the rules until they are laid, the rules do not become effective before laying. In case of a laying clause which requires a negative procedure, the coming into force of the rules is not deferred and the rules come into force as soon as they are made. The legal effect of a laying clause of this type is that the rules continue to be in force, subject to any modification that Parliament may choose to make when they are laid; but the rules remain operative until they are so modified.¹⁹

Laying before the houses of Parliament will not give the rules the status of the statutes made by Parliament. The rules become effective as soon as they are made and published. Parliament is, no doubt, entitled to modify the said rules in such manner as it thinks appropriate or even annul them. Once these rules and notifications are published in the official gazette these must be deemed as being incorporated in the Act itself.²⁰

Draft Rules

Rules even in their draft stage can be acted upon provided there is a clear intention on the part of the rule making authority to enforce those rules in the near future.²¹

Is public consultation mandatory for publication of rules and regulations?

Public consultation before making of a subordinate legislation is not a mandatory requirement unless the relevant statute specifically so mandates. In case of the IBC, the Governing Board (GB) has framed the Insolvency and Bankruptcy Board of India (Mechanism for Issuing Regulations) Regulations, 2018. According to the said regulations, the Board has to upload on its website, the following documents seeking comments from the public:

- (i) draft of proposed regulations;
- (ii) the specific provision of the Code under which the Board proposes regulations;
- (iii) a statement of the problem that the proposed regulation seeks to address;
- (iv) an economic analysis of the proposed regulations;
- (v) a statement carrying norms advocated by international standard setting agencies and the international best practices, if any, relevant to the proposed regulation;
- (vi) the manner of implementation of the proposed regulations; and
- (vii) the manner, process and timelines for receiving comments from the public.

The regulations contemplate completion of a period of 21 days before acting upon the draft regulations put up for public consultation. However, in urgent matters, this procedure can be dispensed with.

When does a rule or regulation become effective?

The rules and regulations become effective when they are published in the manner prescribed. If there is no prescription about the nature of publication, it would be necessary to publish in such a

way as to make it available to those who are supposed to act as per the regulations.²² A reasonable procedure may have to be adopted for this purpose.²³ Where the parent statute does not specify, but the subordinate legislation itself prescribes the manner of publication, such a mode of publication may be sufficient.²⁴ In case of the IBC, both the rule and regulation making powers indicate that they are to be notified. An unannounced law cannot bind. In the context of the IBC, notification would mean publication in the official gazette.²⁵ The Supreme Court has ruled that publication in the Gazette amounts to sufficient notice.²⁶ In one case²⁷, it was observed by the court:

It would be a proper publication if it is published in such a manner that persons can, if they are so interested, acquaint themselves with its contents. If publication is through a Gazette, then mere printing of it in the Gazette would not be enough. Unless the Gazette containing the notification is made available to the public, the notification cannot be said to have been duly published.

In *Avdhesh Singh v. Bikaram Ahir*²⁸, the Allahabad High Court considered a similar issue and held that unless it is determined on facts that the persons interested had an occasion to know the notification, it could not be made effective. Similarly, an office memorandum or executive instruction must be made public or made known to everybody concerned in order to be efficacious and applicable.²⁹

Power to make includes power to amend

The power to make the rules or regulations carries with it the power to amend them.³⁰

Penal provisions should not be brought through subordinate legislation

The subordinate legislation power should not be utilised for making penal provisions. Such provisions are to be brought through primary statute itself.

Frequent amendments not desirable

Though the rule making authority has all powers to make amend the rules it has made, frequent amendments to the rules is not a healthy sign.³¹ One possible reason for such frequent amendments could be the lack of a holistic consideration of issues at the time of initial making. This leads to a number of operational difficulties for the persons who are governed by the rules. If the law has to be effective, it has to have a certain amount of stability and continuity.

Cost-benefit analysis of regulations

A cost-benefit analysis of regulations would be mandatory in India only if the primary statute makes such an exercise compulsory. In the context of the IBC, regulation 5 of the Insolvency and Bankruptcy Board of India (Mechanism for Issuing Regulations) Regulations, 2018 provides that the Board shall cause an economic analysis of the proposed regulations to be made. The issues to be covered by the economic analysis are: (i) expected costs to be incurred by, and the benefits that will accrue to, the society, economy, stakeholders and the Board, both directly and indirectly on account

of the proposed regulation; and (ii) how the proposed regulations further strengthen the objectives of the Code.

Increased illustrative enumerations

A recent phenomenon that is seen in the legislation making is a tendency to enumerate a large number of issues in the section, conferring power for making regulations. This is unnecessary. In most of the legislations, there will be a sub-section preceding the enumerations, which would specifically empower the regulation making authority to make regulations for carrying out the purposes of the Act. What follows subsequently is by way of illustration. Where a statute confers particular powers without prejudice to the generality of a general power already conferred, the particular powers are only illustrative of the general power and do not in any way restrict the general power.³² If there are too many enumerations, it may lead a court to conclude that the intention of the Parliament was to make the list exhaustive, and therefore, there cannot be a regulation making beyond the enumerated items there.

Court's powers to direct framing or amendment of rules

The Supreme Court has ruled that no court can direct a legislature to enact a particular law. So is the case when an executive authority exercises a legislative power by way of subordinate legislation pursuant to the delegated powers.³³ A direction of that nature would result in usurpation of legislative power of the executive by the judiciary.³⁴

CONCLUSION

Subordinate legislation making is an extremely important activity delegated to the Government and the Board by Parliament. While exercising the delegated powers, the Government and the Board have to ensure that they do not travel beyond the scope of the Code. The language of subordinate legislation should be clear, and the regulated entities should be able to understand them without much effort. This is especially true when there is a penalty prescribed for the violations.

NOTES

¹ *In Re The Delhi Laws Act*, 1912 [1951] S.C.R. 747.

² *Municipal Corporation of Delhi v. Birla Cotton, Spinning and Weaving Mills, Delhi and Anr.*, AIR 1968, SC, 1232.

³ *Sukhdev Singh v. Bhagatram Sardar Singh Raghuvanshi* (1975), (1) SCC 421; AIR 1975 SC 1331.

⁴ *V.T. Khanzode v. Reserve Bank of India*, AIR 1982 SC 917; (1982) 2 SCC 7.

⁵ *Huzrat Syed Shah Mustarshid Ali Al Quadari v. Commr. of Wakfs*, AIR 1954 Cal 436.

⁶ *Addl. District Magistrate (Rev.) Delhi Admn. v. Siri Ram*, AIR 2000 SC 2143.

⁷ *Abdul Gani v. Settlement Officer, Nowgong*, AIR 1955 Gau 45.

⁸ *Radha Krishan v. Compensation Officer, Meja, Allahabad*, AIR 1954 All 202.

⁹ *Shanahan v. Scott* (1957), 96 CLR 245 at 250 (Aus).

¹⁰ *All India Lakshmi Commercial Bank Officers' Association v. Union of India*, [1985] 20 TAXMAN 412 (Delhi).

¹¹ *Bagga B. Murhar Rao*, AIR 1956 Hyd 35.

¹² The power to frame rules to regulate the conditions of service under the proviso to Article 309 of the Constitution carries with it the power to amend or alter the rules with a retrospective effect: *B. S. Vadhera v. Union of India*, (1968) 3 SCR 575; *Raj Kumar v. Union of India*, (1975) 3 SCR 963; *K. Nagaraj v. State of A.P.*, (1985) 1 SCC 523.

¹³ An amendment which retrospectively takes away the benefit already given under the existing unamended rule is violative of Articles 14 and 16 of the Constitution. *Food Corporation of India v. Om Prakash Sharma* (1998), 7 SCC 676.

¹⁴ *K. Narayanan and Ors. v. State of Karnataka and Ors.*, AIR 1994 SC 55; 1994 Supp (1) SCC 44. For instance, it has been held that the power to frame rules to regulate the conditions of service under the proviso to Article 309 of the Constitution carries with it the power to amend or alter the rules with a retrospective effect. *B. S. Vadera v. Union of India*, AIR 1969 SC 118.

¹⁵ *Ahmedabad Urban Development Authority v. Sharad Kumar Pasawalla* (1992), 3 SCC 285.

¹⁶ In *BSE Brokers Forum, Bombay & Ors. etc. v. SEBI & Ors.* [(2001)3 SCC482] the power of SEBI to levy registration fee from stock brokers for the purpose of registration was challenged. SEBI had contended that the fee collected was a combination of a regulatory fee as well as a registration fee. The Supreme Court upheld SEBI's action relying upon the express powers available to it under section 11(2)(k) of SEBI Act to 'levy fees or other charges for carrying out the purposes of this section' and under section 12 to levy fees for registration.

¹⁷ *State of Kerala and Ors. v. Annam and Ors.*, AIR 1969 Ker 38.

¹⁸ *Jan Mohammad Noor Mohammad v. State of Gujarat*, AIR 1966 SC 385.

¹⁹ *Prasad Yadava v. Inspector General, Railway Protection Force*, 1974 MPLJ 373 (M.P.).

²⁰ *Brojendra Kumar Saha v. Union of India*, AIR 1961 Cal 217.

²¹ *Vimal Kumari v. State of Haryana and Ors.* (1998), 4 SCC 114.

²² *State of Maharashtra v. Mayer Hans George*, AIR 1965 SC 722; *Joti Parshad v. State of Haryana*, AIR 1993 SC 1167.

²³ *Harla v. State of Rajasthan*, AIR 1951 SC 467.

²⁴ *B. K. Srinivasan & Ors. v. State of Karnataka & Ors.*, AIR 1987 SC 1059.

²⁵ Clause (22) of section 3 of IBC.

²⁶ *Pankaj Jain Agencies v. Union of India and Ors.* (1994), 5 SCC 198; *Jai Singh v. Punjab National Bank and Ors.*, AIR 2005 SC 3134.

²⁷ *Collector of Central Excise v. New Tobacco Co.*, AIR 1998 SC 668.

²⁸ AIR 1975 All. 324.

²⁹ *Sub-Inspector Rooplal v. Lt. Governor, Delhi* (2000), 1 SCC 644.

³⁰ *Rajkumar v. Union of India*, AIR 1975 SC 1116.

³¹ *Sonal Sihimappa v. State of Karnataka*, AIR 1987 SC 2359.

³² *D.K. Trivedi v. State of Gujarat*, AIR 1986 SC 1323; 1986 (Supp) SCC 20.

³³ *Supreme Court Employees' Welfare Association v. Union of India*, AIR 1990 SC 334.

³⁴ *Mallikarjuna Rao v. State of A.P.* (1990), 2 SCC 707; *State of J&K v. A.R. Zakki*, AIR 1992 SC 1546; *M. Basheer v. Kerala Assistant Motor Vehicle Inspectors Association*, 1995 Lab IC 620 (Ker) (DB) (A direction to frame rules will be illegal and without jurisdiction).

PART IV
QUELLING QUALM

COVID-19 PANDEMIC: NON-TRADITIONAL RESOLUTION MECHANISMS FOR RESOLVING BUSINESSES

Shashank Saksena

Nonfinancial firms and households across many economies entered the era of COVID-19 induced crisis with historically high levels of leverage on the support of relatively easy financial conditions.¹ While the massive policy support response (both fiscal and monetary) has helped in mitigating the negative impact of COVID-19 crisis, continuation of easy financial conditions has led to further increase in leverage in the nonfinancial sector in both advanced and emerging market economies. There is robust empirical evidence that a rapid accumulation or high level of nonfinancial sector leverage has often preceded financial and economic downturns. The blend of easy financial conditions and quick increase in aggregate credit tends to reduce downside risk to economic activity in the short term but increases it in the medium term.² The firms in the developing countries appear to be in a state of financial stress which indicate that firm insolvencies would rise with decline in revenues continuing. COVID-19 pandemic-induced negative shocks to earnings have worsened the financial resilience of firms, with small businesses being severely affected. A recent study giving the survey data of more than 1,00,000 businesses in developing countries shows that 39% of micro and small businesses are in arrears or expect to fall into arrears in the next six months.³ While the immediate policy response to flatten the curve of insolvency cases was designed to avoid the insolvency ecosystem from being overburdened with cases, it is important to keep in mind to monitor the response of longer-term functioning of insolvency ecosystems as both the cases of liquidations and restructurings, including those arising from the economic disruption of COVID-19, increase.

APPROACHES TO INSOLVENCY SYSTEMS

While there are demands to provide a calibrated financial support (both direct and indirect) to facilitate recovery and reconstruction of financially stressed businesses, that is not the main focus of this article. Beyond financial support policy, what we are interested in detailing is as to how the policymakers should prioritise reforms to the enabling framework with an emphasis on addressing insolvencies of corporates and micro, small and medium enterprises (MSMEs). The well-developed insolvency frameworks usually have the elements of both court sanctioned and out-of-court workouts (OCWs) resolution mechanisms or a mixture of both (hybrid workouts). A taxonomy of the different approaches to insolvency systems is given in Table 1, which is adopted from the World Bank Note.⁴

Table 1:

Type of Procedure	Advantages	Disadvantages	Level of Distress	Key considerations for framework
Workouts				
1. Out of court Workouts: London approach; INSOL Principles	No legal or court involvement, cost-effective, flexible and expeditious	Risk of creditor holdouts and enforcement, avoidance transactions	Imminent insolvency	Availability of financial information, culture of cooperation among creditors and debtors, strong legal and contract enforcement
2. Enhanced: Istanbul Approach (as in Korea and Thailand) workouts	No legal or court involvement, fiscal and regulatory incentive, inter-creditor agreement to bind dissenting creditors	Incentives may prop up unviable firms, no debtor or excluded creditors involvement in workouts, fiscal costs, limited effectiveness for borrowers with one financial creditor	Imminent insolvency	A strong coordinating agency, cooperative financial institutions and strong debt and contract enforcement
3. Hybrid workouts pre-packaged bankruptcies (as in US, UK, France, Netherlands and India for MSMEs)	Combines flexibility and speed of contractual reorganisation with formal court process to preserve value and reduce stigma	Unfair to minority creditors, court may refuse reorganisations	Imminent insolvency	High Court capacity, financial information availability, enabling legal framework
Formal Insolvency				
1. Preventive hybrid workouts: pre-insolvency scheme and safeguard procedure (Germany and France)	Moratorium, court monitoring, creditor cram-down, debtor-in-possession	Unfair to minority creditors, court may refuse reorganisations and could be costly	Imminent insolvency	High Court capacity and insolvency professionals, legal framework, debt enforcement

2. Judicial reorganisation (as in France, US, India and UK)	Preservation of value, strong enforcement, substantial court and insolvency practitioner oversight	Costly and lengthy, disruptive, invite stigma, process is driven by court and insolvency practitioners	Insolvency	High Court capacity and insolvency professionals, legal framework, debt enforcement
3. Liquidation (As in UK, Korea and India)	Orderly exit, value preservation	Low creditor recovery, lengthy and non-transparent auction procedure	Insolvency	High Court capacity and insolvency professionals, legal framework, debt enforcement

Usually, the developed insolvency and restructuring frameworks include a sanctioned (usually by a judicial authority) debt restructuring process as one of the tools to resolve financial distress of businesses. There is a greater reliance by countries now on hybrid processes which combine the characteristics of both OCWs and formal insolvency proceedings in the expectation of increased workload of formal court mechanisms post withdrawal of COVID-19 pandemic support measures. The common features of these processes are the following:

- The restructuring plan is discussed outside of the formal bankruptcy proceedings;
- There is a time-limited moratorium on enforcement actions against the debtor;
- The debtor can access the process in the case of imminent insolvency;
- The ‘cross-class cram down’ is possible on dissenting creditors;
- There is no court-assessment when the procedure begins;
- The process permits the debtor-in-control regime, sometimes assisted by a neutral third party;
- New financing is protected from avoidance actions.

Many countries have reformed and strengthened their insolvency systems by introducing new fast-track insolvency (restructuring and liquidation) procedures, specifically for MSMEs. Therefore, it would be instructive to review the country experience and facilitative regulatory framework to assess the effectiveness of such hybrid resolution frameworks as the pre-packaged insolvency framework has been recently introduced in India also for MSMEs. Under a hybrid debt resolution procedure, the court intervention is required only at critical points—usually, at the beginning, to prevent creditor action against the debtor, and at the end, to confirm the agreement concluded between the debtor and the creditors—but in between the process progresses without any judicial intervention. This is the approach adopted by the EU in its 2019 European Restructuring Directive following the experiences of some members during the euro area crisis, and the UK in its recent insolvency reform as part of the 2020 Corporate Insolvency and Governance Act. The reduction in judicial intervention is expected to economise on limited judicial resources and increase efficiency of the debt resolution process. A simple and most efficient hybrid restructuring procedure is reckoned as the pre-packaged reorganisation plan. After creditors and the debtor informally negotiate and agree on a plan, a reorganisation procedure is unlocked just to confirm the pre-packaged reorganisation plan. This procedure results in huge time reductions and minimal use of the resources of the judicial authorities. It was found that, in the US the ordinary reorganisation procedures during the period from 2011 to 2018 continued for 504 days, while pre-packaged reorganisations lasted only 77 days,

on average.⁵

The objective of the reform of resolution system of any country should be to provide for easy and quick liquidation of nonviable businesses—irrespective of size—so that their capital can be saved and reallocated quickly to the competing uses in the economy. Countries could introduce reforms to rationalise their liquidation regimes. The use of new technology offers encouraging opportunities for the organisation of online auctions of assets (the recent examples include such systems introduced in Italy, Greece, and Ukraine).⁶ Such reforms require not only enabling legal provisions, but also the introduction of new technology and capacity building of judicial and private players. Other reforms could enable acquisition of alternative assets by creditors in exchange for their debt claims. For those medium and small enterprises, which often have no major assets, the most important objective of the insolvency process could be to provide a debt discharge to ‘honest but unfortunate’ entrepreneurs, so that they can go into other economic ventures. An analysis of the data from the World Bank’s Doing Business 2016 report indicates a relationship between the design and operation of insolvency procedures and recoveries in insolvency. The data demonstrates that reorganisation proceedings produce higher recovery rates than foreclosure, receivership, or liquidation.⁷ Moreover, reorganisation proceedings are positively correlated with greater amounts of domestic credit provided by the financial sector. Strong insolvency and creditor rights (ICR) regimes are instrumental in improving loan repayment and decreasing borrowers’ risk-taking behaviour. When the borrowers face stronger creditor rights they tend to diversify acquisitions, invest in high recovery assets, reduce cash-flow risk, and deleverage their balance sheets.⁸ The evidence suggests that, *ceteris paribus*, reforming ICR systems could help reduce non-performing loan (NPL) occurrence. Few inquiries have been made into the impact of alternative enforcement mechanisms on NPL levels. However, the available evidence in India suggests that out-of-court mechanisms for the enforcement of creditor rights might help reduce bank losses from NPLs.⁹ Considering the beneficial impact of reduction of NPLs on economic growth and financial stability, countries could either (i) target reduction in NPLs through active strategy of early recognition, recovery and resolution (through reform of ICR regimes) or (ii) foster higher loan growth. The 2016 study of 100 countries covering the period between 1997 and 2014 found that countries that actively tried to reduce NPLs (category (i)) achieved a higher economic growth than countries (in the control group) that failed to take any action to reduce their NPL levels; a 3% to 4% increase in GDP growth and a 13% increase in investment growth.¹⁰

OUT OF COURT WORKOUTS IN INDIA

A brief discussion follows about the variety of OCW and hybrid OCW in vogue in India. This will then be contrasted with the similar frameworks available in other jurisdictions as also with some international principles to derive policy recommendations. The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes (WB-ICR Principles) and the United Nations Commission on International Trade Law Legislative Guide on Insolvency Law (the Legislative Guide) are construed as Insolvency and Creditor Rights Standard (ICR Standard) which is recognised as one

of the Financial Stability Board Key Standards for Sound Financial Systems. The ICR Standard is recognised as the international consensus on best practices for evaluating and developing national insolvency regimes, including enhancing creditor rights. This provides best practice benchmarks for guaranteeing that ICR regimes can enable the survival of viable but distressed businesses, help diminish the risk associated with lending to such businesses, and ease the exit of nonviable, insolvent businesses.¹¹ The ICR Standard combines the WB-ICR Principles and the Legislative Guide. The relevant principles of ICR Standards would be examined from the perspective of assessing efficient OCW and hybrid OCW mechanisms.

The Reserve Bank of India (RBI) released the Prudential Framework for Resolution of Stressed Assets vide circular dated June 7, 2019 (Prudential Framework) which is a principle-based framework for debt resolution with bright-line tests for desired outcomes. Prudential Framework is the *de facto* OCW available to lenders and borrowers of banks and non-banking financial companies (NBFCs). The Prudential Framework was extended to enable the lenders to implement a resolution plan in respect of eligible corporate exposures without change in ownership, and personal loans, without classifying them as non-performing but subject to certain conditions. Borrowers classified as standard, but not in default for more than 30 days with any lending institution as on March 1, 2020 were eligible for resolution under the Prudential Framework. The Prudential Framework could be invoked till December 31, 2020. To facilitate revival of MSMEs adversely affected by COVID-19, lenders were permitted to restructure the loans of MSME borrowers in default but not classified as NPLs and to whom the aggregate exposure of lenders were ₹ 250 million or less, without classifying the restructured exposures as non-performing. In view of the resurgence of COVID-19, RBI has announced the Resolution Framework 2.0 dated May 5, 2021, subsequently revised on June 4, 2021, which permits lending institutions to restructure personal loans as well as loans to individuals for business purposes, MSMEs and other small business with aggregate exposure up to ₹ 500 million, without classifying the exposures as non-performing upon implementation subject to the conditions specified therein. The facility, available in respect of eligible borrowers which had not been restructured under earlier restructuring schemes, can be invoked up to September 30, 2021.

India has recently introduced the pre-packaged insolvency resolution process (PPIRP/pre-pack) through an ordinance amending the Insolvency and Bankruptcy Code, 2016 (Code/IBC) - Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021, in order to provide a consensual, expeditious, cost-effective, semi-formal and less disruptive framework for insolvency resolution of MSME corporate debtors (CD) in distress. The MSMEs having a unique nature of business and representing a sizeable portion of India’s labour force are critical for India’s economic growth. Pre-pack framework provides for initiation by the MSME CDs eligible to submit a resolution plan, with the approval of 66% of unrelated financial creditors and special resolution of its shareholders. The framework envisages a consensual approach wherein the creditors and the CD reach a mutual understanding about the course of action for insolvency resolution before the formal initiation of the process. It provides for debtor-in-possession model wherein the management stays in control of the CD during the process but to prevent moral hazard situations, features of creditor-in-control

model, where all major decisions are approved by the committee of creditors (CoC), and resolution professional acts as the process manager, who not only facilitates the process but also oversees it, are also incorporated. The pre-pack is largely an informal process as it empowers stakeholders to resolve the stress of a CD as a going concern, with minimum intervention of the Adjudication Authority. It would be a time bound process with 120 days for completion. For better value discovery of the assets of the CD, the Swiss Challenge method has been envisaged and on approval of the resolution plan for the CD, the regulatory benefits available in case of a normal corporate insolvency resolution process (CIRP) are also applicable in case of pre-pack process.

WB-ICR Principle B3 encompasses the essential criteria for establishing an enabling legislative framework in a country—one that is favourable to directing negotiations and undertaking analysis to preserve sustainable businesses. Such a framework may include¹² (i) availability of accurate and reliable information; (ii) incentives to invest in or recapitalise viable, financially distressed enterprises; (iii) a range of restructuring tools that the stakeholders can use to achieve their goals; (iv) appropriate tax treatment that enable debt restructurings; (v) effective debt enforcement and insolvency procedures; and (vi) removal of regulatory impediments in associated laws.

WB-ICR Principle B4 on informal workouts recognises that informal restructurings take place in the ‘shadow of the law’—that is, they do not usually follow a legislative or regulatory framework because they are private, contractual arrangements that occur outside the domain of courts. However, the WB-ICR Principle B4 encourages the use of voluntary dispute resolution tools to help facilitate such negotiations. Further, the Legislative Guide recommendations 160-168 cover procedural features, such as, commencement of expedited reorganisation proceedings, application requirements, commencement, the effect and notice of commencement, and the confirmation, effect and failed implementation of a confirmed restructuring plan. The purpose of these recommendations is to make provisions relating to insolvency procedures that combine voluntary restructuring negotiations and acceptance of a plan with an expedited procedure conducted under the insolvency law for court confirmation of that plan. Many countries have adopted hybrid procedures which combine both the informal negotiated restructuring and formal court-sanctioned procedures.

WB-ICR Principle B5 emphasises the importance of promotion of any guidelines or code of conduct by the financial sector authorities on how to conduct informal workouts. Some countries have introduced memoranda of understanding between the central bank and the bankers’ association to ensure that there is strong promotion of principles among the key financial sector players. Other countries have adopted more formal hybrid models which are backed by statutory mandates.

Thus, the first requirement for an effective insolvency regime (WB-ICR Principle B3) is that there should be an environment that enables restructuring of debt and enterprise and encourages participants to engage in consensual arrangements. This includes laws and procedures that ensure access to timely, reliable, and exact financial information on the distressed enterprise, encourage lending to, investment in, or recapitalisation of viable but financially distressed businesses and flexibly accommodate a comprehensive range of restructuring activities, involving asset sales, discounted

debt sales, debt write-offs, debt reschedulings, debt and enterprise restructurings, and exchange offerings (debt-to-debt and debt-to-equity exchanges). The operational and legal framework for Prudential Framework and pre-pack subsumes these principles. The first and foremost ICR Standard which is relevant to any effective OCW is an efficient debtor information and early warning system which allows both debtors and creditors to anticipate an impending financial stress, recognise the extent of the problem and take early and timely debt resolution measures. There is no scarcity of financial information of debtors as there are multiple financial information agencies in India. Creditors in India generally use central repository of information on large credits (CRILC) for large exposures, obtain credit scores and reports from credit rating agencies (CRA), Ministry of Corporate Affairs’ portal for charges on company’s assets and also check central registry of securitisation asset reconstruction and security interest (CERSAI) for checking for any previous mortgage charges on immovable properties of the prospective borrowers. Under IBC, the information utilities (IUs) have been envisaged to reduce the information asymmetry between the creditors and debtors. IUs are envisaged to be holders of record of default and financial information of CDs and creditors. Recently, the sole registered IU, National E-Governance Services Limited has launched a digital loan document execution platform which will act as a repository of all loans given to debtors by the partner financial institutions. It is expected that it will reduce the disputes regarding the loan disbursement and dues between the creditors and debtors. Account aggregators (AAs) aim at bringing disparate customer asset information in a consolidated manner on a single platform. By reducing paperwork, AA allows speedier access to consented data of individual customers and small businesses, allowing lenders to assess a potential borrower’s credit risks and process more loan applications faster, without compromising due diligence and safety. Going forward, the integration of the system of AAs, Trade Receivables Discounting System (TReDS), financial information systems, digital lending platforms, digital payments and digital identity and consent mechanisms would be expected to not only eliminate the informational asymmetry between the borrowers and lenders, but would also increase the transparency of the financing processes and reduce the transaction costs without compromising on safety and privacy of customers of financial services. Therefore, there is so much financial information available that there is a need to establish a master financial information system which could integrate and synthetically produce consolidated financial information of debtors from disparate databases. In this connection, technological innovations in the form of open digital public infrastructure, as mentioned above, could transform the functioning of financial systems and may also improve the informational efficiency of financial markets.

WB-ICR Principle B4 and the Legislative Guide recommendations 160-168¹³ are adequately subsumed in the Prudential Framework and pre-pack. As mentioned above, the RBI encourage the use of voluntary dispute resolution tools to help facilitate such negotiations in the form of the Prudential Framework. This framework operates in the shadow of the legal framework of IBC and the anecdotal evidence suggests that IBC has forced responsible behaviour on the part of defaulting promoters who now dread losing control over their own businesses. By fastening personal liability on directors for wrongful transactions and disqualifying defaulting promoters from participating in the CIRP, the IBC has also contributed to embracing of higher standards of corporate governance

by debtors. It is felt that the IBC has been successful in effecting an attitudinal change encouraging defaulting debtors to voluntarily settle their outstanding dues with creditors. As per the information provided in the report of the Standing Committee on Finance on the subject 'Implementation of Insolvency and Bankruptcy Code (IBC)-Pitfalls and Solutions' submitted to Parliament on August 3, 2021¹⁴, about 17631 corporates have withdrawn applications for CIRP before admission with realisable value of ₹ 5,46,763 crore. This amount is much more compared to the approved resolution plans of 404 corporates with a realisable value of ₹ 2,54,431 crore. So, going forward, more CDs would be incentivised to go for a negotiated settlement of their disputes outside the formal CIRP by using alternative debt resolution mechanisms. Further, it may be stated that the procedural provisions relating to eligibility conditions, application requirements, commencement, effect of commencement, notice of commencement, confirmation of the plan and its effect, and failure of implementation of a confirmed plan contained in recommendations 160-168 of the Legislative Guide are subsumed in the pre-pack provisions.

The guidelines by the financial sector authorities (RBI, in case of Prudential Framework) on how to conduct informal workouts provide adequate guidance on workout procedures and good risk-management practices (WB-ICR Principle B5), supported by norms that facilitate effective internal procedures and practices supporting the prompt and efficient recovery and resolution of distressed assets. The prudential norms¹⁵ for provisioning, income recognition, additional finance, change in ownership and regulatory forbearance all seek to create an effective OCW procedure and ensure meaningful restructuring of distressed assets. Further, IBC has adequate provisions to stipulate standards of good governance of CDs and effective anti-abuse provisions to nudge the management to preserve the value of business during the debt resolution process and any violation attracts deterrent penalty. There are other safeguards such as taking over of the management of the CD by CoC in certain cases of abuse of the resolution process by the debtor-in-possession. Therefore, to preserve the sanctity of the process, it is essential that good corporate governance principles for the CD (both listed and unlisted entities) may continue to be prescribed, imposed and monitored by the relevant regulatory authorities under law.

CONCLUSION

To summarise, in view of the above analysis, it may be stated that the alternative debt resolution mechanisms, whether in the form of a purely voluntary OCW mechanisms in the form of Prudential Framework or a hybrid procedure in the form of pre-pack generally conform to the WB-ICR Standard, which is the emerging international norm for effective insolvency resolution frameworks. However, the functioning of the alternative dispute resolution mechanisms may be improved further if the operational and technological improvements for relevant ICR Standard are effected as suggested above. While the alternative debt resolution mechanisms may be useful in resurrecting a financially viable, but distressed business, transparent and targeted support to solve the financial stress of businesses may be required in the form of grants, fresh financing, and subsidies¹⁶ to aid the process of restructuring and recovery.

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¹⁵ RBI (2019), Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019, 7 June.

¹⁶ Supra Note 4

COVID BLOW TO INSOLVENCY REGIME: A CATASTROPHIC CATALYST

Ashok Haldia

'That which does not kill us outright makes us stronger', was observed by the German philosopher, Friedrich Nietzsche over a hundred years ago. The quote affirms our belief in man's inherent resilience to transcend the sufferings that come along as inevitable accoutrements during the journey called life.

This eternal message cannot be more relevant when applied in the context of the calamitous disruption that COVID-19 pandemic has brought about in the recent past. In this backdrop, this article attempts to analyse how the pandemic, as a Black Swan event, has impacted the insolvency regime in India and upended, as a catalyst, its dispensation in myriad ways.

The Insolvency and Bankruptcy Code, 2016 (Code/IBC), in India has been considered as showcase legislation and a major economic reform in India, hailed, among others, by the World Bank as reflected in improvement in India's 'Ease of Doing Business' ranking.

The founding principle of IBC was to rescue ailing businesses as a going concern rather than simply recover dues through liquidation. The promise of IBC framework is reflected in the outcomes in the form of realisations. Realisation by financial creditors (FCs) under resolution plans in comparison to liquidation value, is 189%, while the realisation by them in comparison to their claims is 39%, much better than that in earlier regime. As against 348 corporate debtors (CDs) rescued via resolution up until March, 2021, 1277 CDs have been referred for liquidation. This data should be appreciated in light of the fact that CDs that got rescued had assets valued at ₹ 1.11 lakh crore as against ₹ 0.46 lakh crore valuation of those CDs under liquidation. In terms of value, 70% of distressed assets were rescued in the process. Having begun on a positive note, the IBC regime in India had been gearing up for the next phase comprising cross-border, pre-packaged, individual and group insolvency

framework(s) amongst others, when the pandemic struck the economy hard, in an unprecedented manner, one wave after another.

Mankind in India and across the globe, as an ignominious first in recent history, watched the horrors of COVID-19 crisis wreaking havoc on human lives and livelihoods. So much so, the calamity has divided the human history into pre-COVID-19 and post-COVID-19 times, for the posterity. The pandemic came across not merely as a health crisis but has shaken the very foundation of societies by crippling most businesses resulting in shutdowns, job losses, and labour-migratory challenges. This halted the Indian economy in its tracks, adversely affecting several development agenda of the Government and aggravating the income and growth disparity even further. The recent data of the Ministry of Statistics and Program Implementation (MoSPI) reveals that the country's Gross Domestic Product (GDP) shrunk by 7.3% in 2020-21. The estimates suggest that about 10 million skilled and non-skilled workers migrated from metro-cities and urban areas to villages.

In the context of insolvency regime, these developments meant impending surge of distressed businesses and least probability of finding a suitor or rescuer as resolution applicant (RA), given the priority of conserving cash. As an unintended outcome of the said predicament, this also meant that more businesses would be pushed into liquidation as against the preferred course of resolution. The small and medium business segment was even more vulnerable in this context. As per an initial estimate, the non-performing assets (NPAs) in Indian banks were likely to nearly double from ~7.5% of gross bank advances in September, 2020 to ~13.5% in September, 2021, stung by the twin balance sheet problems, not to talk of consequent cascading impacts. The financial meltdown seemed imminent and drastic efforts were need of the hour.

The catastrophe has, however, led to ameliorating measures, besides transforming the approach and attitude of stakeholders towards resolution of stress and preservation of the CD's value, innovation and use of technology in IBC processes and the likes. The newer regulatory dispensation has also been necessitated to respond to emergent scenario. Notably the post-COVID-19 era has witnessed regulatory dynamism, responsiveness, and flexibility commensurate with the magnitude of pandemic.

INITIAL SETBACKS AND RESILIENT RESPONSE

Upon onslaught of first wave of COVID-19 and amid the country-wide lockdown, the Government and regulatory bodies launched many ameliorative and counter-offensive measures. Within insolvency resolution ecosystem, the stakeholders tried best to come to terms with harsh reality marred by lack of technological solutions. In this backdrop, some positive developments worth noting are captured in the following paragraphs.

The Ministry of Corporate Affairs (MCA), through a notification, on March 24, 2020, increased the minimum default from ₹ 1 lakh to ₹ 1 crore for filing insolvency cases. Furthermore, the MCA prohibited filing of fresh insolvency cases on account of default due to COVID-19, by suspending

sections 7, 9, and 10 of the IBC for a period of three months w.e.f. March 25, 2020. However, the suspension continued till March 24, 2021, through three consecutive extensions. Any defaults occurring during the pandemic period effective from the date of said notification and co-terminus with said suspension was deemed to be COVID-19 induced and hence were made ineligible for initiating insolvency during such period. The Insolvency and Bankruptcy Board of India (IBBI) also came out with clarification in the regulations for excluding COVID-19 period from the mandated timelines under the IBC framework.

Leading from the front, the Hon'ble Supreme Court of India started virtual hearing of the cases beginning March, 2020 through video-conferencing and has heard about 7,000 cases till June, 2020. The continuation and pendency of insolvency cases initiated earlier under IBC, came across as a main concern. In response, the National Company Law Appellate Tribunal (NCLAT) started virtual hearing from June 1, 2020, of all urgent cases with detailed standard operating procedures (SOP) for filing the matter before NCLAT for online hearing. Subsequently, the National Company Law Tribunal (NCLT) benches also resorted to online mode of hearing.

The MCA took upon the project for implementation of e-courts in all 16 benches of NCLT with e-filing starting at nine benches in first phase.

The Government relaxed the timelines and manners for various compliances under the Companies Act, 2013 and other corporate laws. IBBI, through a circular in March, 2020, directed the Insolvency Professional Agencies (IPAs) to conduct Pre-Registration Educational Course (PREC) on virtual mode. Besides, IBBI provided the professionals the facility to file and view regulatory forms, virtually. Undoubtedly, virtual proceedings provided much needed succour to the stakeholders reeling under the pandemic.

To ease the distress in economy and unburden IBC regime, the Reserve Bank of India (RBI), rolled out 'Resolution Framework for COVID-19 related Stress – Financial Parameters'. During the second COVID-19 wave, RBI further announced Resolution Framework 2.0, in May, 2021, expanding the scope to small businesses, after the Government decided not to extend the suspension of IBC beyond March 24, 2021. These apart, RBI took series of fiscal measures to ease the liquidity and facilitate lending to stressed businesses - small, medium, and large.

Indian Institute of Insolvency Professionals of ICAI (IIPI) as front-line regulator and the largest IPA in India, also re-oriented its strategy and work-plans to align with changing paradigm. This led to networking with Insolvency Professionals (IPs) and regulators in different countries and institutions like World Bank and International Finance Corporation (IFC) for experience sharing and collaborative efforts. IIPI focused on COVID-19 centred capacity building measures including webinars, virtual trainings, web-based discussion forum for members, e-publications and COVID-19 helplines for members.

Moreover, research studies were conducted on contemporary issues including response to COVID-19, with a view to promote best practices and provide policy inputs to the regulator. IIPI launched many

new initiatives and recorded quantum leap in its activity level. IIIPI is in the process of developing a best practice guide for IP and committee of creditors (CoC) for dealing with COVID-19 related contingencies.

Amidst highly challenging and uncertain environment wherein businesses were facing stress due to COVID-19 with increasingly grim prospects of resolution of corporate stress, in April 2021, the Government focused on alternative mechanisms. There was a sense of urgency to release the pressure on IBC and preserve and enhance the value of existing and potential CDs. The IBC was amended through an ordinance introducing a new regime – the pre-packaged insolvency resolution process (PPIRP) providing for a quicker, more cost-effective, and less invasive insolvency regime for micro, small and medium enterprises (MSMEs). The amendment offers MSMEs the option to resolve financial stress through a semi-formal regime which allows for out-of-court resolution to some extent, while preserving the sanctity of a formal insolvency process under law. To be able to trigger the PPIRP by any MSME, the minimum threshold for default has been announced at ₹ 10 lakhs as compared to ₹ 1 crore under corporate insolvency resolution process (CIRP).

The limitations of CIRP amidst COVID-19 scenario have prompted the lenders and the CDs to increasingly opt for out-of-court settlement. Of late, a perceptible trend has been emerging in favour of mediation as a preferred option for resolution, particularly for MSMEs.

Amid second wave, during first quarter of fiscal year 2021-22, and aggravating stress in banking and financial sector, the Government launched National Asset Reconstruction Company Limited (NARCL) or Bad Bank. It is expected that upon resuming regular operations during the current year, 22 stressed loans amounting to over ₹ 80,000 crore shall be transferred from various banks to NARCL for resolution through a focused approach via IBC framework. This has a potential of upending the manner of managing and resolving stressed assets and is certainly a positive step forward.

COVID-19 AND A PARADIGM SHIFT

Amidst the chaotic environment triggered by COVID-19, a paradigm shift had been playing out without probably getting much attention. This shift in mindset and approach by multiple stakeholders in the insolvency ecosystem, is by no means, a small development. The public interest is the soul or underlying theme of insolvency law, that can be served through ethical conduct of its stakeholders. The pandemic has triggered, heightened, and amplified the imperativeness of public interest and ethics in the minds of stakeholders across the insolvency ecosystem, resolutely.

Moreover, as a parallel narrative, stakeholders across the board including courts, regulators, lenders, professionals, and others resorted to technology as an enabler and a force multiplier, in unimaginably swifter ways.

The usage of these solutions available even earlier, though hiding in plain sight, has been advanced by the constraints posed by the pandemic. Expanding the adoption of technological solutions as

indicated in the list below, besides keeping impact of any more COVID-19 waves at bay, can go a long way in improving the dispensation, efficiently and effectively:

(a) By courts

- E-filing and virtual hearings by NCLT and NCLAT even during post-COVID-19 times, would be quite beneficial. In fact, NCLT has embarked on a major initiative to digitise its services and that is work in progress.
- Allowing template-based e-filing by the litigants instead of lengthy applications.
- Real time online mechanism for panel of IPs in context of admitting cases under section 9 of IBC.
- Automated or template-based delivery of orders instead of lengthy orders, cutting down timelines and pendency substantially.

(b) By regulatory bodies

- Providing software utilities for submitted forms/compliances by the IPs.
- Automating processes like providing continuing professional education (CPE) hours for IPs and others involving manual processes.
- Development of market of distressed assets in India.
- Dissemination of knowledge sharing, awareness, and training programs virtually.
- New and innovative financing products and institutional structures compatible with financing stressed assets.

(c) By stakeholders

- Taking remote control of and managing CD's operations using technology e.g. virtual security solutions.
- Resorting to innovative solutions to manage logistical challenges while managing CD's operations and CIRPs under IBC.
- Artificial intelligence (AI) based solutions to expedite proceedings on avoidance transactions, forensics, etc.
- Using platform for distressed assets solutions viz. or record of default, case management, virtual data room, e-voting, platform for e-auction covering expression of interest and even interim finance.
- Lenders availing services offered by Information Utilities (IUs) including for recording debt and default.
- Data storage and retrieval solutions aligned with regulatory requirements of document retention.
- There is scope for further development of credible software solutions in the space above especially in developing market for distressed assets.
- Virtual CoC meetings by lenders as CoC members, allowing senior officials from remote locations, to participate and hence enhance the quality and pace of decisions.

CONCLUSION

How and to what extent, the second wave of the pandemic has impacted and can further impact the economy and IBC regime in India? This vexed question has confounded one and all. Though many agencies are engaged in gauging the impact with a view to direct corrective actions needed, a recent report by Investment Information and the Credit Rating Agency, ICRA has sparked a glimmer of hope. As per its estimates, the lenders or FCs will realise about ₹ 55,000 – ₹ 60,000 crore from successful resolution plans in FY-22 which is more than double of ₹ 26,000 crore realised in FY21. However, these predictions are contingent upon factors like suppression of second wave because of vaccination drives and restoration of normal economic activity from second wave, etc. Recent perceptible dip in coronavirus cases and mortality has resulted in gradual unlocking across different metros and states and this augurs well for a positive future. How the future of insolvency regime in India shapes, would depend a great deal on its stakeholders, their commitment to public interest and ethics, ably supported by efficient use of technology. In this context, COVID-19 has indeed proven to be a catastrophic catalyst.

The pandemic struck the Indian economy in a most disruptive and devastating manner, pushing countless businesses, large or small, into distress. However, the manner in which the stakeholders including Government, regulatory bodies, creditors, and IPs, have responded has mitigated the challenges convincingly. The innovative approach adopted, and proactive measures taken, and those in pipeline would hold IBC regime in good stead, steering it through the second wave and much feared third wave. In fact, the swift e-transformation taken place as a consequence of the pandemic has strengthened the IBC and its processes. This has enhanced its efficacy and efficiency and it is bound to stay even during the post COVID-19 period.

The Indian experience as aforesaid is a perfect case study of successfully sailing through a turbulent sea. Essence lies in what Michael Jordan has said, *'Obstacles do not have to stop you. If you run into a wall, do not turn around and give up. Figure out how to climb it, go through it or work around it.'*

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PRE-PACK INSOLVENCY RESOLUTION PROCESS: JUDICIOUSLY STRENGTHENING IBC IN TIMES OF CRISIS

Vellayan Subbiah and Pranay Mehrotra

Since its enactment in December, 2016, the Insolvency and Bankruptcy Code, 2016 (Code/IBC) has had a meaningful impact on the efficacy of debt resolution in India. The specific debt recovery option, namely corporate insolvency resolution process (CIRP), enabled a recovery rate ranging¹ from 45% to 49% during the period FY2017 to FY2020. The recovery rate has at least doubled in comparison² to the most effective pre-IBC debt recovery tool, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). The average time to recovery has also improved from 4.3 years to 406 days. The time to recovery is now comparable to many OECD countries and better than some of them. The post-IBC experience has also generated valuable insights which will help the system to make better decisions with respect to the recovery process. At the same time, the Indian bankruptcy resolution process can be strengthened and improved further. For example, the average recovery rate in OECD nations and several emerging nations is in the range of 70% - 80%.

Encouraged by the positive experience with CIRP, the system has already been in exploration mode on the additional steps to further improve the resolution process. To broaden the choice of bankruptcy resolution procedures beyond CIRP, various stakeholders have been evaluating the pre-packaged insolvency resolution process (PPIRP/pre-pack) as an additional option. In most mature bankruptcy regimes, PPIRP as an alternative resolution procedure is already available. PPIRP enables pre-emptive, out-of-court negotiations between the borrower and lenders, facilitating the

joint development of a bankruptcy resolution plan. Based on the experience in other countries, the flexibility associated with PPIRP often translates to higher recovery rates and lesser recovery time.

The sudden emergence of COVID-19 and its ensuing impact on the economy has added a sense of urgency for the introduction of an alternate bankruptcy resolution method to complement CIRP. Generally, micro, small and medium enterprises (MSMEs) are amongst the most affected sectors in any economic crisis. There is a possibility that the MSME stress increases further due to the impact of COVID-19, despite the various supportive and accommodative steps taken by the Government and the regulator. In case this happens, a significant number of MSMEs may end up in CIRP in the absence of any alternative. To the extent CIRP does not allow existing owner/promoters to be a part of the bankruptcy resolution process, such MSME owners will have to give up ownership of their businesses. The lenders on the other hand will find it challenging to find new buyers of such MSME businesses in the current economically challenged environment. If many assets are put up for liquidation, it will cause an over-supply of assets in an environment of muted economic activity. This will see realisations from asset sales being much lower than in normal times. In the end, neither the lenders nor the borrowers will benefit from such a situation.

Against this background, the Ordinance promulgated on April 4, 2021, which amends the IBC and introduces PPIRP within the IBC framework, provides an additional option for bankruptcy resolution. The Ordinance has since then been passed by the Lok Sabha on July 26, 2021. The Bill allows MSME³ corporate debtors (CDs) to initiate pre-emptive, informal discussions with their lenders to formulate a debt resolution package. After reaching an agreement, the parties may jointly approach the National Company Law Tribunal (NCLT) to formally approve the resolution package.

PPIRP may provide a second chance to MSMEs ravaged by the economic fallout from the COVID-19 crisis. In addition, the lenders would not be forced to find buyers for the business or assets of such MSMEs during periods where asset prices may be under pressure. PPIRP, if executed and adopted judiciously, with suitable checks and balances, could revive a significant number of stressed MSMEs while ensuring the lenders get higher recovery.

The proposed PPIRP law draws upon the learnings and challenges of pre-pack bankruptcy resolution process in countries such as the UK and the US and has built-in certain checks and balances. However, to ensure wider adoption and minimise potential misuse of PPIRP, certain additional steps might need to be taken. These steps may be in the nature of regulatory enablement from the Reserve Bank of India (RBI) assuring suitable transparency in the process. In addition, the Board of Directors of the banks should aim to create a tight governance framework around the PPIRP process in their respective banks.

Successful implementation and adoption of PPIRP in India with robust checks and balances could help provide an alternative resolution mechanism to MSMEs, potentially reducing the economic value erosion. As highlighted in the latest data released by the Insolvency and Bankruptcy Board of India (IBBI), barring the top 9 accounts, recovery rates are sub 25%. A mechanism like PPIRP can help uplift recovery rates in the MSMEs segment.

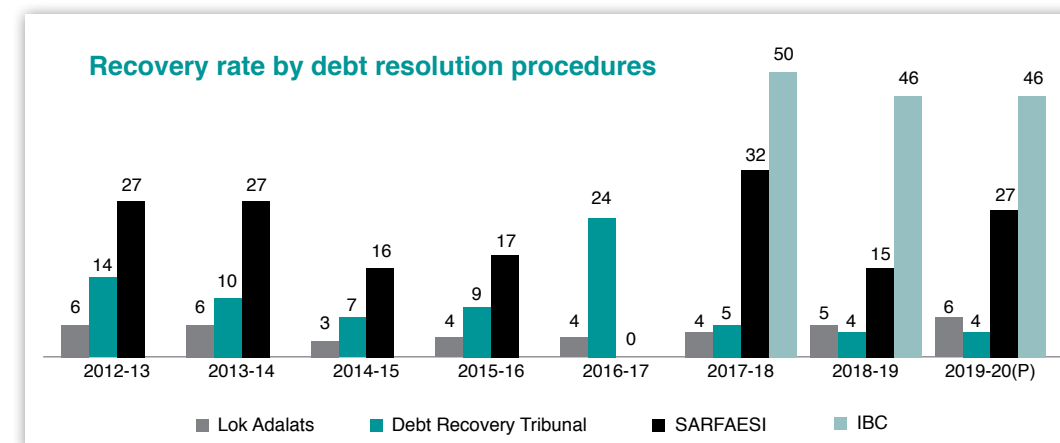
While PPIRP will provide benefit to MSMEs⁴, some enablement in restructuring will also be required for larger enterprises that fall outside the ambit of PPIRP. Leveraging the existing Prudential Framework for Resolution of Stressed Asset (PFRSA) circular issued by the RBI on June 7, 2019 could provide a viable option. Consideration may be given to suitably altering PFRSA to extend it to larger enterprises as well as reduce the timeframe of restructuring actions to make it comparable with PPIRP. To ensure its successful adoption and enabling impact, it would be helpful to allow the protection offered by section 32A of IBC to restructuring done under the aegis of RBI guidelines. These two steps may facilitate quick and efficient restructuring for enterprises that are currently not covered by PPIRP.

IBC: THE JOURNEY THUS FAR

Since its introduction in 2016, CIRP has had a material impact on improving bankruptcy resolution in India. As per the exhibit below, recovery rates during FY2017-FY2020 improved to 45-49%, which is a material improvement over the pre-IBC recovery rates under SARFAESI Act. In SARFAESI, the recovery rate ranged between 15% and 32% with an average of 23%.

The average time to recovery has also improved to 406 days from 4.3 years⁵, which makes this comparable to the experience in OECD countries. Pre-2016, the absence of a bankruptcy code had been a significant void in India's business environment. The improved recovery rates bear testimony to the fact that IBC via CIRP has successfully addressed an important part of that void and set the stage for further improvement in the future.

Figure 1: Recovery rate by various debt resolution processes.



Source: Off-site returns, RBI and IBBI

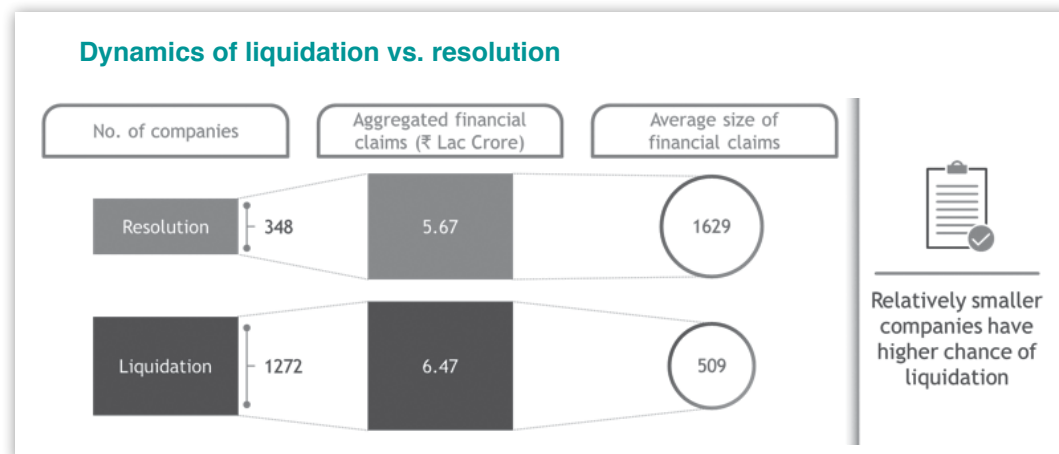
Note: P=Provisional

Building on the success of CIRP, there is scope for further improving and strengthening bankruptcy resolution in India. For example, while recovery rates have improved under CIRP, these still lag

behind OECD countries and several emerging nations, where recovery rates are typically in the range of 70% to 80%. Once referred to CIRP, there are typically two primary end-states that the process can deliver. One is a resolution plan where a new buyer takes over the company with active support from the lenders, and the other is liquidation. Globally, liquidation is usually adopted as a last resort and preference is to resolve the bankruptcy by restructuring the debt or finding an alternate buyer for the business. Based on the IBC experience till March 2021⁶, 1277 companies were liquidated while the resolution mechanism was able to lead to recovery of 348 companies.

Even if we adjust the liquidation data by the number of companies that were already in the Board for Industrial and Financial Reconstruction (BIFR) or were non-functional before being referred to IBC (and therefore, had lower chances of recovery), the number of companies that failed to avoid liquidation is still high. Out of the 1277 CDs that were liquidated till March 2021, the data respect to 1272 CDs is available. 946 out of 1272 CDs were either in BIFR or non-functional before being referred to IBC; that still leaves approximately 326 companies that were liquidated. In comparison, an estimated 348 companies were rescued by resolution.⁷

Figure 2: Dynamics of Liquidation v. Resolution



Source: IBBI Quarterly newsletter

In addition, based on the financial claims of companies that have gone through the process, liquidated companies had an average financial claim against them of an estimated ₹ 509 crore. On the other hand, the companies which remained functional post-resolution had financial claims of ₹ 1629 crore when they were admitted to IBC. It suggests that smaller companies tend to end up in liquidation more often than larger companies.

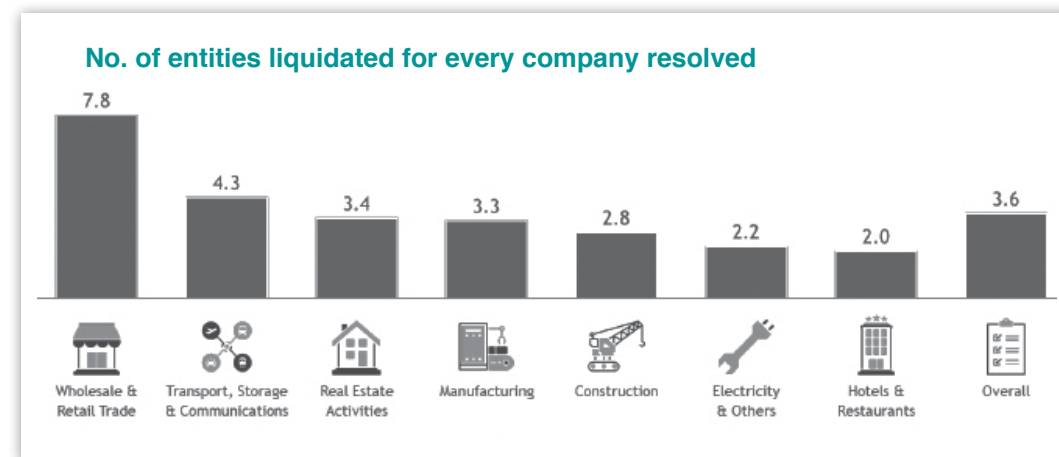
Analysis of the latest data released by IBBI also reveals that the recovery rate has been positively impacted by top 9 accounts. Arguably, without IBC, recovery from such accounts would have been limited. The top 9 accounts had large steel accounts where recovery rates have been particularly

good taking the overall recovery to 45%; excluding these, the recovery rate is approximately 24% under IBC. This also highlights that the recovery rate for smaller entities has not improved as much under CIRP.

Further analysis of the data indicates that the likelihood of liquidation varies by industry. Complex assets especially in infrastructure sectors like power have been difficult to resolve as there have not been many takers/buyers for these assets.

As Figure 3 shows, in wholesale and retail trade for every one entity which is resolved, approximately eight companies are liquidated. This is much higher than the overall average where for every one company which survives, 3.6 companies are liquidated. In general, industries with high quality fixed and real assets tend to have a higher turnaround rate, while industries with relatively lower intensity of real assets but higher intensity of current assets (say stocks and inventory) tend to see higher liquidation.

Figure 3: Variation of liquidity rates by industries



Source: IBBI newsletter

The abovementioned analyses are early results and additional research needs to happen as more data becomes available to draw firmer conclusions. However, these results give useful pointers on the scope for improvement and how amendments to the IBC (including PPIRP) can further enhance bankruptcy resolution in India.

THE COVID-19 CHALLENGE

The economic crisis due to COVID-19's impact further necessitates the need to expand bankruptcy resolution procedures in the country. In response to COVID-19, further admission of defaulted CDs under CIRP was suspended for defaults arising post March 25, 2020 (with the suspension being valid for defaults till March, 2021). Given the magnitude of the economic shock, the Government

and RBI have stepped up to help business borrowers by extending support in the form of credit guarantees and one-time restructuring (OTR) of loans. However, the economic crisis is likely to eventually increase stress in the system – with a large number of companies requiring bankruptcy resolution support.

Of the 1723 cases currently outstanding in CIRP, 499 cases were added in FY2021. The incremental numbers are smaller than the number of cases admitted annually in the pre COVID-19 period. The 499 companies got added during this period (FY2020-21) when there were moratoriums in debt servicing and limitations in taking companies to IBC. The full impact of wave 2 of COVID-19 and its impact on business balance sheets is not captured in these numbers. As restrictions to admitting companies in IBC is removed one may expect the number to start increasing. While various enabling financing options provided to companies impacted by COVID-19 would provide some relief in the short term, there may be a stock of bad debt waiting to be admitted in IBC over the next 12-18 months.

Uncertainty calls for more flexibility: Even in normal times, where the businesses environment is stable, the process of valuations or debt restructuring of unlisted firms without active management support is challenging. The current uncertain and evolving economic conditions require constant transparent communication and joint assessment of the CDs along with the lender. Detailed plans with built-in contingencies may be better developed in closed-door discussions between lenders and borrowers. The current CIRP does not allow the existing management to be a party to the resolution discussions.

Economic stress to impact value realisation: In depressed markets where CAPEX revival is still awaited, the chances of a new management finding a stressed business viable for takeover is quite low. The potential short supply of business buyers is likely to push a significant number of cases to liquidation. The latest information from IBBI suggests that only 614 cases were closed in FY21 in comparison to 1203 cases in FY20. However, a trend is emerging during this COVID-19 impacted period. 55% of the 614 closed cases were closed by liquidation in comparison to 45% of the cases being closed by liquidation in FY20. These early signals suggest reviving companies in an extreme economic environment is a challenge under the current CIRP scheme.

However, liquidation may not generate enough value, since the supply of assets of stressed corporates is significantly higher than the number of prospective buyers who are in expansion mode. Additionally, for smaller businesses (MSMEs) it is challenging to find buyers even in normal times.

The current situation, therefore, increases the need for an insolvency procedure to complement CIRP which provides more flexibility in the resolution process.

PPIRP: POSITIVE STEP FORWARD

The PPIRP introduced in India is a well-considered one. It attempts to add an alternative to CIRP, which is more flexible, potentially less time-consuming in terms of legal process but not

compromising on the legal sanctity of the process. If executed judiciously, PPIRP offers certain benefits which could further enhance the efficacy of bankruptcy resolution mechanisms in India. These include:

Increased chances of business turnaround and value maximisation: During any downturn or economic crisis, the rate of business failures increase. This factor is even more accentuated during the current economic situation. When system-wide risk events occur, such as the COVID-19 shock, a number of businesses will fail for factors entirely out of their control. PPIRP potentially is better placed to offer a second chance to business owners, whose businesses are impacted due to events such as the COVID-19 crisis.

The extant CIRP is a creditor-in-possession (CiP) insolvency resolution approach. As the bankruptcy process starts, the Resolution Professional (RP) takes over the day-to-day functioning of business and works with the committee of creditors (CoC) in finding alternate owners of the business. If within a specified time they are unable to find a buyer, meeting all the economic and legal criteria, then the company is liquidated. Often, not only can this be a costly and time-consuming affair, the operations of the company suffer during the process.

The proposed PPIRP is a debtor-in-possession (DiP) restructuring scheme where the pre-pack management retains the operating control of the company and could have a higher chance of retaining the same at the end of the process. Thus, the businesses already under stress can avoid further disruption resulting due to a change of management.

Optimising the load on the legal system: PPIRP allows closed-door negotiation between the CD (subject to restrictions of section 29A) and the lender. This allows for the development of an agreed-upon base plan for the resolution with which the parties approach the NCLT. Then within the following 90 days, the plan must be finalised after which NCLT may provide its approval based on the merits. Potentially, this can reduce the recovery period for such cases to 90 days or less. Given lesser legal involvement, dependence on the legal system could be optimised leaving it with a better ability to handle a spike in cases.

LEARNINGS FROM OTHER JURISDICTIONS

The proposed PPIRP resolution seems to draw on learnings⁸ from comparable frameworks in the US and UK. In these jurisdictions, the PPIRP option was inbuilt into the act and seems to have played a role in significantly improving the recovery rate and time to recovery.

However, with the learnings from potential risks of misuse of the mechanism in these jurisdictions, the PPIRP option introduced in India includes certain checks and balances to address such risks. For example, it will hopefully check instances of ‘Phoenixing’ as it happened in the UK. One of the shortcomings of the UK pre-pack version was that the Administrator (equivalent to the Resolution Professional) could have sold off the assets without the explicit approval of the lenders. This led to

a phenomenon called ‘Phoenixing’. Here the management or related parties of the management of the bankrupt company could ‘buy-back’ the company at a significant haircut to the outstanding debt amount.

In the PPIRP mechanism introduced in India, safeguards are placed to the extent that no asset sales are possible without the explicit approval of the empowered creditors. The valuation process and rigour remain the same as CIRP. Additionally, PPIRP introduces a Swiss Challenge mechanism to the proceedings. After getting the bid from the current management, the CoC can publicly disclose the bid and invite proposals for counter bids. If the bids coming from other bidders are better, the management will get a chance to match it, failing which the reins of the company will move to the highest bidders.

Therefore, the lawmakers have done well in framing the guardrails for introducing PPIRP in India. These guardrails can be further complemented by additional actions by the RBI, bank boards and banks themselves to mitigate risks. Doing this successfully will facilitate the implementation of PPIRP as an additional mechanism further improving bankruptcy resolution in India, especially for MSMEs.

FURTHER ACTIONS FOR CONSIDERATION TO ENSURE SUCCESS OF PPIRP

The following actions could be considered to further complement the guardrails laid down as part of the PPIRP resolution:

Regulatory Enablement: While PPIRP provides flexibility in terms of structure of the work-out, lack of a framework for closed-door negotiation may create a hesitancy in bankers due to concerns of future scrutiny. Enabling guidelines by RBI will ensure that PPIRP is judiciously adopted.

Considerations for RBI

For wider acceptance of PPIRP, the RBI may consider enabling guidelines on the following aspects:

Identification of Standalone MSMEs: MSMEs’ which are part of a large conglomerate of companies may be placed outside the purview of PPIRP since these are better supported through a larger ecosystem. This will help avoid misuse - including the perception of misuse of the law.

Disclosure: Banks may be required to track the number of loans where the PPIRP enabled closed-door discussions of restructuring have been initiated. Such exposures may be suitably reflected in the bank’s internal ratings as well as early warning systems (EWS). Additionally, in their financial statements, banks may be required to separately disclose the exposure of such loans which are in various stages of PPIRP.

Provisioning: To the extent of post-execution of PPIRP, the CD may not be taken for bankruptcy

resolution for another three years, some may be tempted to use it indiscreetly to bypass issues of bad debt identification giving rise to ever-greening in a different form. The RBI may suggest provisioning and capital requirement for such loans, with the explicit purpose of addressing issues of provision and capital arbitrage. This could thereby ensure that PPIRP is applied for the right reasons with a lower risk of misuse.

Mandatory hind-sighting: Hind-sighting or post-deal disclosures may be made mandatory for banks. The banks may either use the platform of NCLT or the Information Utility, NeSL to report details of pre-pack deals within six months of the formal approval of the PPIRP procedure by the NCLT. Sufficient details should be provided so that a third-party can assess the sufficiency and validity of the deal. This will enable oversight on the pre-pack deals by all relevant stakeholders and thereby curtail collusion to a large extent.

Bank’s Board of Directors

Consistent PPIRP decision based on economic rationale: The decision for a bank to pursue either PPIRP or CIRP may often turn out to be discretionary. Policies which are broadly defined and thus lack specificity will be unhelpful in checking unsubstantiated discretionary decision-making. On an *ex-post-facto* basis when such decisions are evaluated, they could appear inconsistent and irregular. Irrespective of the outcome, the quality of the decision-making process and the decision could itself lose credibility. Therefore, boards of banks should consider the formulation of consistent and specifically defined policy with strong quantitative character, which leverages the best principles of risk and corporate finance.

Upgrade the monitoring and surveillance process: While all exposures are regularly monitored, the monitoring is often either scheduled at certain intervals (e.g. quarterly, annually) or reactive i.e.; after a risk event has happened or based on financial statements which are at least a couple of quarters old. Given that cases under PPIRP are more susceptible to downside risks, banks may consider evolving more proactive risk surveillance using transaction and alternate data while leveraging advanced analytics. Conventional surveillance may be inadequate for such exposures.

Focus on select industries: In the initial phase of PPIRP, banks may do well to extend PPIRP to certain industries which have exhibited either low recovery rate or high likelihood of entering into liquidation- namely, industries which are light on real assets such as entities in the service sector and trade. Sectors such as real estate, and other sectors with significant real assets in their balance sheets where the likelihood of liquidation is low may continue to be handled under CIRP.

LOOKING ABOVE AND BEYOND MSME⁹

The current PPIRP is likely to provide an economically viable solution to stressed asset problems, particularly for MSMEs.¹⁰ However, there are enterprises beyond MSMEs which are also vulnerable to the current shock, arguably lesser than their smaller peers who will be covered by PPIRP.

However, the stress would still be significant and a lot of them may lack the resources to successfully service debt during the period. Of course, PPIRP being more in the experimental mode may not be immediately rolled out to them but a framework to facilitate debt restructuring for these entities is also imperative in today's environment. Two of the existing constructs in the regulatory and legal domain can be considered in this context for further deliberation and discussion.

Firstly, the RBI's circular, namely PFRSA may provide a useful starting point. The exposure size of loans covered under this circular is ₹ 5 crore or above at the lender level. This ensures limited overlap with the proposed PPIRP framework. Lenders of these enterprises may be encouraged to proactively identify companies in incipient stress. Additionally, the restructuring actions may be made more time-bound. PFRSA requires successively higher provisioning if restructuring is not completed within 180 days and 365 days. For the current purpose, these timelines may be aligned closer to the timelines of PPIRP and be made 90-120 days.

Secondly, a feature of IBC, namely section 32A which provides legal immunity to new buyers of the distressed corporate asset may be extended to bank driven restructuring. Specifically, it may be made more applicable for cases where the assets are sold to a new buyer. This of course would require a change in the IBC Act itself. But given the massive effort the Government and regulators are already making to cushion the Indian economy; this hurdle looks a relatively smaller one.

Limiting misuse of this provision and ensuring successful large-scale adoption would again require strengthening the guardrails with similar provisions as we discussed for PPIRP.

CONCLUSION

PPIRP is a useful addition to India's bankruptcy resolution toolbox. Between CIRP and PPIRP, the financing ecosystem will have an entire range of choices on how best to resolve stressed assets, especially for MSMEs. While the law has drawn significantly from global learnings with respect to PPIRP, a lot of its success depends on how it is implemented on the ground. Prudent deployment of PPIRP, using objective decision frameworks and transactional transparency is critical for the success of PPIRP. Some suggestions have been made in this article to this effect.

NOTES

¹ Economic Survey 2020-21, Volume 2, Department of Economic Affairs, Ministry of Finance, Government of India, January 2021.

² *Ibid.*

³ MSME as defined in section 7 of the Micro, Small and Medium Enterprises Development Act, 2006.

Manufacturing sector has the following classification, based on investment in Plant and Machinery:

1. Micro Enterprise: Up to ₹ 25 Lakhs.
2. Small Enterprise: More than ₹ 25 Lakhs but less than ₹ 5 Crores.
3. Medium Enterprise: More than ₹ 5 Crores but less than ₹ 10 Crores.

For the service sector, the classification on the basis of investment in equipment is as follows:

1. Micro Enterprise: Up to ₹ 10 Lakhs
2. Small Enterprise: More than ₹ 10 Lakhs but less than ₹ 2 Crores.
3. Medium Enterprise: More than ₹ 2 Crores but less than ₹ 5 Crores.

Central government under Atmanirbhar Bharat Scheme redefined MSME as:

1. Micro Enterprise: Investment up to ₹ 1 Crore and Turnover up to ₹ 5 Crore.
2. Small Enterprise: Investment up to ₹10 Crore and Turnover up to ₹ 50 Crore.

⁴ The MSME should fulfill the following conditions.

1. It should have failed to pay a due and payable debt of INR 1 million or more.
2. It should not have undergone a PPIRP or CIRP (the regular insolvency process under IBC) during the past 3 years.
3. No liquidation orders should have been passed against it.
4. It should not be a person who is disqualified under section 29A of the IBC.

⁵ IBBI Quarterly Newsletter, January-March, 2021.

⁶ *Ibid.*

⁷ *Ibid.*

⁸ Rammohan M. P. and Raj V. (2020), "Pre-packs in the Indian Insolvency Regime", IIM Ahmedabad, Working Paper, August.

⁹ *Supra* Note 3

¹⁰ *Supra* Note 4

MERITS OF PRE-PACKAGED INSOLVENCY

Jose M. Garrido*

The economy of numerous countries around the world is suffering the consequences of the worst pandemic in a century. The restrictions imposed during the pandemic have particularly affected certain economic sectors (travel, services, hospitality) and have been especially damaging for micro, small and medium enterprises (MSMEs). This widespread distress can generate serious pressure on the judicial system in charge of administering insolvency proceedings.¹ Among the possible responses that countries may implement, one of the most important ones is the use of pre-packaged insolvency as a way of alleviating the burden of the courts.² This article explores the characteristics of pre-packaged insolvency as outlined in the international standard and developed in comparative practice, and assesses the merits of this restructuring technique while considering safeguards that contain the potential risks.

DIFFERENT PRACTICES, DIFFERENT MEANINGS

The adjective ‘pre-packaged’ denotes preparation and rapid execution. The idea is not so distant from that of pre-packaged foods: collection and processing of the ingredients allow for a quick preparation of a meal.³ In insolvency practice, ‘pre-packaged’ refers to the preparation of a reorganisation plan, negotiation with creditors resulting in sufficient support, prior to the filing of an insolvency petition. In this way, the moment that the petition is filed with the court, most of the activities contemplated as part of reorganisation proceedings have already been completed, and in that regard, it could be said that the case is ‘pre-cooked’. The court, of course, has the fundamental role of confirming the reorganisation plan that has been previously prepared by the debtor and supported by the creditors. But the intervention of the court takes a fraction of the time that it would take to conduct full reorganisation proceedings.

In a broad sense, pre-packaged insolvencies can be included into the category of hybrid restructuring mechanisms.⁴ Hybrid restructuring refers to any restructuring mechanism that combines informal restructuring negotiations with an element of judicial intervention. In the case of pre-packaged insolvencies, practically all activities of the debtor and the creditors are conducted out-of-court, in an informal setting, and the only intervention of the court occurs at the point of confirmation of the plan, which is the sole objective of the insolvency filing. The category of hybrid restructuring procedures includes other restructuring mechanisms where judicial intervention is more substantial but still falls short of the usual functions of the court in insolvency proceedings. For example, European law has developed ‘pre-insolvency procedures’ that combine the negotiation of restructuring plans by debtors and creditors with limited court intervention, for instance focused on a stay of creditor actions to facilitate negotiations, and the confirmation of the restructuring plan, together with some other instances of potential court action.

Pre-packaged insolvency and pre-insolvency procedures present similarities and differences. Both hybrid mechanisms have the effect of reducing the length and cost of restructuring and also reducing the use of judicial resources. The main difference is their different functions and complexity: pre-packaged insolvency addresses the problem of binding minority creditors who ‘hold out’ against a reorganisation plan supported by the majority. Pre-insolvency procedures address, in addition, the problem of the interference by creditors taking action to enforce their claims, and for that reason there is a higher level of court intervention, which is necessary to impose a stay on creditor actions in order to protect the restructuring negotiations.

INTERNATIONAL STANDARD

The international standard⁵ recognises the usefulness of prepackaged insolvency, although the standard does not use this term specifically. The first reference in documents issued by international organizations is included in the IMF’s *Orderly & Effective Insolvency Procedures* (1999):

To enhance the efficiency of the rehabilitation process, the law should allow for the approval by the court of rehabilitation plans that have been voted upon (or, at a minimum, negotiated) before commencement of the rehabilitation proceedings.

Reference is clearly made to pre-negotiated reorganisation plans and to pre-approved reorganisation plans. A pre-packaged insolvency generally designates the situation in which the reorganisation plan has already received the necessary votes for its approval; pre-negotiated plans are also frequent in practice, but we will concentrate on the treatment of reorganisation plans that have already attained sufficient creditor support.

In the World Bank Principles, there is a relevant reference to pre-packaged insolvencies in Principle B4.2: ‘*Where the informal procedure relies on a formal reorganisation, the formal proceeding should be able to quickly process the informal, pre-negotiated agreement*’. Again, despite the fact that the term ‘pre-packaged insolvency’ is not used, the text clearly describes the possibility of negotiating a restructuring agreement which can be quickly confirmed by the court. The United

Nations Commission on International Trade Law (UNCITRAL) Legislative Guide provides more details on the regulation of pre-packaged insolvency. In the Guide, the term used is ‘expedited reorganisation proceedings’.⁶ The Guide emphasises the merits of voluntary restructuring, which is typically based on negotiations between the debtor and its financial creditors (FCs) (sometimes, also major non-FCs participate in the negotiations). Pre-packaged insolvency allows the preservation of the benefits of negotiations, minimises time delays and expenses, and provides an effective technique to bind dissenting minorities.

UNCITRAL’s recommendations provide indications on how an insolvency regime should accommodate pre-packaged insolvencies:

- (a) The insolvency application should be made by debtors who are ‘insolvent or likely to become insolvent’. As with ordinary reorganisation, a less demanding commencement standard promotes early restructuring of distressed enterprises.
- (b) The application needs to satisfy the jurisdictional requirements for commencement of full reorganisation proceedings.
- (c) The application must be accompanied by the following documents:
 - i) A negotiated reorganisation plan.
 - ii) A disclosure statement and a description of the negotiations that took place.
 - iii) A certification that unaffected creditors (typically, workers and small trade creditors) are being paid in the ordinary course of business and that the plan does not affect their rights without their agreement.
 - iv) A report of the votes of affected classes of creditors, demonstrating that the majorities required by the law have been reached.
 - v) A report including financial analysis or other evidence that demonstrates that the plan satisfies all requirements that the law generally establishes for reorganisation.
 - vi) A list of the members of any creditor committee formed during the course of the voluntary negotiations.
- (d) Once the reorganisation proceedings commence, the effects of commencement will be the same as with ordinary reorganisation proceedings (except for the fact that unaffected creditors will not be subject to any of the effects of insolvency).
- (e) On commencement, a notice must be given to affected creditors and shareholders, specifying the following aspects:
 - i) Amount owed to each creditor according to the debtor.
 - ii) Time period for submitting a claim if there is disagreement.
 - iii) Time and procedure to challenge claims submitted by other parties.
 - iv) Time and place for confirmation of the plan and for submission of objections to confirmation.
 - v) Impact of the plan on shareholders.

(f) The proceedings should aim at a quick confirmation of the reorganisation plan. Creditor committees should continue during the proceedings, and a hearing on the confirmation of the plan should be held as soon as possible.

(g) In the confirmation decision, the court needs to check whether:

- i) The substantive requirements are met (i.e. creditors receive at least what they would receive in a liquidation, and the order of priorities is respected).
- ii) Notice given and information provided to creditors and shareholders during the voluntary restructuring negotiations was sufficient for an informed decision.
- iii) The unaffected creditors are being paid in the ordinary course of business, and the plan does not modify their rights without their agreement.
- iv) The financial analysis submitted with the application demonstrates that the plan satisfies all applicable requirements for reorganisation.

Once confirmed, the reorganisation plan should bind all affected creditors and the company's shareholders. If the plan fails, parties will be free to exercise their rights.

In essence, UNCITRAL offers a detailed template for pre-packaged insolvency. The main principle is that the resulting reorganisation plan should comply with the same substantive requirements and safeguards, but the negotiations and agreements previous to the reorganisation justify that once the proceedings are commenced, the period to achieve confirmation will be considerably shorter.

Pre-packaged insolvency may also need a revision of some legal rules that could interfere with this practice. One issue, in particular, is the effect of liability rules for company directors. In many countries, directors have the duty to file for insolvency once they know (or should have known) that the company is insolvent. In common law countries, liability of directors is structured in a different way: directors are liable for continuing trading while they knew or should have known that the company had no prospect of avoiding insolvency proceedings (wrongful trading). The problem with these rules is that directors of a distressed company may be engaged in confidential negotiations with creditors while the duty to file or wrongful trading is triggered.

There may also be other impediments in the legal regime that create obstacles for pre-packaged insolvencies, such as restrictions for debt/equity conversions, or inadequate tax treatment of debt restructuring operations, but these impediments are equally applicable to other forms of informal and hybrid restructuring.

COMPARATIVE COUNTRY PRACTICE

There are several examples of insolvency systems where pre-packaged insolvency is a major restructuring mechanism.

Pre-packaged insolvency in the USA

The USA is considered the country where this practice originated⁷ and provides the best example in the use of pre-packaged insolvency.⁸ However, the US Bankruptcy Code does not include a detailed regulation of pre-packaged insolvency: many of the developments affecting the use of pre-packaged plans have been the result of practices, rather than a conscious legal design.⁹ In legal practice, there is a common distinction between 'free-fall' reorganisations (i.e. Chapter 11 reorganisations without any previous preparation, which need to run the full course of the proceedings); 'pre-arranged' reorganisations (where the reorganisation plan has already been prepared and negotiated with the main creditors); and 'pre-packaged' reorganisations (where the plan has not only been negotiated with the main creditors, but has already attained the support of the affected creditor classes for its approval). In both pre-arranged and pre-packaged reorganisations, the reorganisation plan is presented with the petition to commence proceedings.

The pre-packaged plan already relies on the support of the necessary creditor majorities. It is frequent that some classes of creditors will be unaffected by the plan, and these creditors do not need to vote, since their claims will continue to be paid in the ordinary course of business.

Both pre-arranged and pre-packaged reorganisation plans produce very significant savings in time and cost. A study conducted by The Deal Pipeline and FTI Consulting gathered data from Chapter 11 cases between 2011 and 2018. The study showed a marked reduction in time in all cases, included the 'free-fall' cases, but even taking that time reduction into account, the difference in time is remarkable: in 2018, an ordinary, free-fall case took an average of 252 days to be completed, whereas pre-arranged reorganisations took an average of 139 days, and pre-packaged reorganisations lasted an average of 52 days. In 2015, for instance, the contrast was even more striking, with free-fall reorganisations taking 681 days, pre-arranged cases 186 days, and pre-packaged cases 63 days.

These enormous differences in time are especially relevant in times of crisis. Achieving a fast rehabilitation of enterprises is particularly valuable in a crisis environment, and the rationalization in the use of judicial resources allows for the treatment of a much higher number of companies in distress during a crisis, reserving a more intensive use of resources for the more complex reorganisation cases.

Of course, there are also problems in the practice of pre-packaged insolvency in the USA. Nowadays, the main problem is that the speed of the process has probably gone too far.¹⁰ In recent cases, pre-packaged insolvencies have lasted as less as 24 hours from the petition.¹¹ This has raised concerns with the US trustee office about the lack of sufficient notice to parties who may be affected by the reorganisation plan.¹² Speed in confirmation should be reconciled with adequate protections for all interested parties.

English pre-packs

A pre-pack in English insolvency practice is something entirely different from a pre-packaged reorganisation. In England, a ‘pre-pack’ refers to a sale of the business which has been negotiated previous to a reorganisation (in English law, ‘administration’) proceeding.¹³ The goal of this pre-arranged sale is to maximise the sale price without disturbing the ongoing operations of the business. Proceeds of the sale are distributed among creditors according to the ranking of claims: for this reason, it is frequent that secured creditors receive a full payment and unsecured creditors sustain substantial losses. English law does not include provisions on pre-packs, which have developed as an insolvency practice. There are major differences with US practice and with the recommendations on expedited reorganisation proceedings in the standard: The English pre-pack is not a mechanism for accelerated confirmation of a plan that has been previously negotiated and voted. The English pre-pack is an accelerated sale of the business as a going concern, which can raise issues of equitable treatment of unsecured creditors and of general integrity of the transaction, since it is frequent that the businesses are sold to connected persons. In some cases, the directors of the company create a new company (a so-called ‘phoenix company’) and acquire the business of the company under administration. The business continues operating, and the proceeds of the sale can cover secured liabilities, but unsecured creditors may suffer a total loss.

A comprehensive review of pre-pack practice in England (the Graham report)¹⁴ recommended improving the transparency of pre-pack sales. English practitioners reacted to the recommendations of the Graham report by introducing disclosure requirements for pre-packs to prevent problems of collusion with connected parties. The Statement of Insolvency Practice 16 on ‘pre-packaged sales in administrations’¹⁵ was issued by the association of insolvency practitioners with the goal of increasing the transparency for creditors around the marketing of the distressed company’s business and the rationale for the sale transaction.¹⁶ In addition, the Graham report recommended the establishment of a group of experts to assess the fairness of pre-pack sales to connected parties (the so-called pre-pack pool). Although the pre-pack pool was established following the recommendation¹⁷, it seems that the pool of experts has not been used extensively, since the intervention of these experts depends entirely on the will of the parties to the pre-pack transaction.

Recently, the English authorities have enacted regulations to curb abuse in pre-packs. The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations, 2021¹⁸ impose new controls on the sale of businesses by administrators. According to the regulations, administrators will not be able to make a substantial disposal of a company’s business to a connected person within the first eight weeks of the administration, without the approval of a majority of creditors or a written report from an independent evaluator which must offer a conclusion on the reasonability of the transaction. Evaluators need to be not only independent, but also need to have relevant knowledge and experience and professional indemnity insurance. However, it is noted that the evaluator report is not binding on the administrator and it is possible to complete a transaction even if the evaluator provides a negative opinion on its reasonability. As the insolvency law grants wide powers to the

administrator in conducting the sale, it has been difficult to mount challenges against pre-pack sales, but the evaluator report could provide the necessary evidence for legal action. In any event, the differences between pre-packaged reorganisations in the USA and pre-packs in England are so important that it is misleading to use the same term to refer to them.

Other jurisdictions

The use of pre-packaged insolvency has become an international trend. Apart from countries like the Netherlands¹⁹, where ‘pre-pack’ refers to a sale of the business, broadly similar to English practice, pre-packaged insolvency in other jurisdictions corresponds to the meaning of the ‘expedited reorganisation plan’ in the UNCITRAL Legislative Guide and the ‘prepackaged reorganisation’ in the practice of the USA. Countries such as Albania, Argentina, Brazil, Greece, Korea, Mexico, Spain and Thailand, include provisions in their insolvency law designed to regulate a reorganisation petition accompanied by a plan that has been supported by creditors. However, there are some differences in the way these examples of pre-packaged insolvency work which sets them apart from the ideal model included in the UNCITRAL recommendations. Many of these cases do not require that the plan has already garnered all the necessary votes. In this regard, they fall between ‘pre-arranged’ and ‘pre-packaged’ reorganisation plans. An interesting example of a legislative framework for pre-packaged insolvency is the law of the Philippines [Financial Rehabilitation and Insolvency Act (FRIA)]. The law regulates the so-called ‘pre-negotiated rehabilitation’, which consists of a petition with a rehabilitation plan that already has the support of at least two-thirds of the total liabilities of the debtor, including secured creditors holding more than 50% of the total secured claims of the debtor and unsecured creditors holding more than 50% of the total unsecured claims of the debtor. The petition also needs to include the following information: (a) a schedule of the debtor’s debts and liabilities; (b) an inventory of the debtor’s assets; (c) the pre-negotiated Rehabilitation Plan, including the names of at least three qualified nominees for rehabilitation receiver²⁰; and (d) a summary of disputed claims against the debtor and a report on the provisioning of funds to account for appropriate payments should any such claims be ruled valid or their amounts adjusted. The court issues an order within five days of receiving the petition, staying creditor actions, and notifies creditors to give them a 20-day deadline to object to the plan. After notifications and the period for objection expires, the plan will be confirmed by the court. The court will set a hearing and rule on objections where objections are presented, but the grounds for objection are restricted to those specifically included in the law (misleading or false information in the petition or plan, misclassification of claims, support of creditors induced by fraud). The law also indicates that if the court has not approved the plan within 120 days from the presentation of the petition, the rehabilitation plan will be deemed approved.

THE MERITS: ACCELERATION OF INSOLVENCY PROCESS

Pre-packaged insolvency presents an immense advantage for restructuring: ‘Time’. When companies are facing financial difficulties, and there is a pressing need for debt restructuring, complex and

costly reorganisation proceedings often fail to achieve their goal of preserving the business. Reorganisations end up becoming ‘liquidations in slow-motion’. A pre-packaged plan ensures that procedural complications will be reduced to a minimum, ensuring the success of the plan within a very brief period. In this regard, a pre-packaged insolvency may be the best option to address the debt distress problems of a business within a narrow window of opportunity. Pre-packaged insolvency can increase the options for restructuring²¹, thus preserving viable businesses and jobs that otherwise would disappear.²²

Pre-packaged insolvency reduces the intervention of the courts to the bare minimum. The reduction in time also translates into a reduction in cost. This is particularly important in times of crisis, where the number of businesses in need of reorganisation may be elevated. An intensive use of pre-packaged insolvency can rehabilitate many businesses within a short period of time, minimising the use of judicial resources. In countries where procedural law is particularly cumbersome, and where judicial inefficiency is an issue, the use of pre-packaged insolvency can provide good results both in crisis and in normal times.

Pre-packaged insolvency also offers advantages when compared with out-of-court debt restructuring. Informal negotiations between the debtor and its creditors have the advantage of discretion and can be organized in a flexible way. FCs, in particular, have the skills to analyse the prospects of the business and negotiate an agreement to restructure its debts and return it to viability. However, the main problem of this approach is that there may be creditors who reject the terms of the restructuring agreement. Since out-of-court restructuring relies on the voluntary modification of creditors’ rights, the agreements to restructure the businesses’ debt need to achieve unanimity. Small creditors may be left unaffected (and receive full payment), but if a large creditor ‘holds out’ and rejects the agreement, there is no incentive for the other creditors to go ahead with a restructuring where they share the pain and a competitor, the holdout creditor and benefits. For this reason, pre-packaged insolvency offers an excellent solution: after completion of the negotiations, the debtor and the creditors who have agreed a restructuring plan can assess whether the plan has sufficient support to be confirmed by a court. If that is the case, the pre-packaged insolvency application and a rapid court confirmation will have the effect of binding the holdout creditors. In some cases, the mere threat of a pre-packaged insolvency application is sufficient to convince creditors to adhere to the informal restructuring agreement.

Pre-packaged insolvency, therefore, combines aspects of formal insolvency and informal restructuring negotiations. The hybrid nature of pre-packaged insolvency²³ offers the possibility of combining positive aspects of out-of-court and in-court restructuring. Looking at the insolvency system as a toolbox, pre-packaged insolvency is an additional tool that can provide the best solution for many cases, particularly where formal insolvency proceedings are not particularly efficient, or the courts are overwhelmed by a surge of insolvency cases.

RISKS AND CONSTRAINTS

Pre-packaged insolvencies are extremely useful to restructure enterprises, but this does not mean that there are no risks associated with the use of this instrument. Policymakers should pay attention to a series of issues that need to be tackled to ensure that pre-packaged insolvencies are effectively used and do not become a questionable practice.

List of claims

One of the main risks for pre-packaged insolvencies is the reliability of the list of claims. Typically, pre-packaged insolvency will be commenced based on the information provided by the debtor, and this should include a complete list of claims. The accuracy of the list of claims is vital, since the achievement of the required majorities depends on the list being properly drafted, with inclusion of all affected creditors and with their claims properly classified. Conducting a full verification of claims would be entirely incompatible with the speed required to implement the pre-packaged reorganisation plan. However, there are other ways to minimize the risks of an unreliable list of claims: first, it is possible to require a report of an independent professional on the list of claims, which can be provided together with the insolvency petition; second, there should be penalties for cases in which omissions and inaccuracies have been caused by fraud or gross negligence; third, creditors should have sufficient time to consult the list of claims and submit challenges at the confirmation hearing. It must be noted, though, that the plan can be confirmed unless the inaccuracies in the list of claims are so significant that the relevant majorities would not have been achieved (materiality test: for instance, a change in the list affects the overall amount of claims so that the required majority, for instance, two-thirds, is no longer attained by adding the claims of creditors who voted in favor of the plan). Less material inaccuracies can be addressed through amendments to the contents of the plan, but these should not affect confirmation.

Fraud and connected parties

Because pre-packaged insolvencies rely on a much faster procedural treatment, it may be that fraudulent schemes, particularly those involving connected parties, remain undetected. This is especially the case in countries that rely on pre-packaged sales, such as England, but it is also possible to have fraudulent schemes involving connected parties even when a reorganisation plan is adopted, without necessarily including a sale of the business. It is important to identify connected creditors and establish additional requirements when the support of connected creditors is instrumental in reaching the required majorities. The law should include a requirement for the petitioner of a pre-packaged insolvency procedure to indicate the creditors that are connected to the debtor. The court should be able to scrutinize the intervention of those creditors, or adopt any other measures included in the insolvency regime (for instance, discounting the votes of connected parties).

Safeguards for minority creditors

Pre-packaged insolvency plans need to be confirmed within a short period of time, but the level of substantive protection offered to dissenting minorities should be the same as in an ordinary reorganisation. In particular, dissenting creditors should receive at least what they would have received in liquidation (best interests of creditors' test) and the plan should respect the ranking of claims to protect dissenting classes (absolute priority rule).

Integration with rules on directors' liability

Many legal systems have incorporated rules that establish the liability of directors for their actions in the period preceding insolvency (the 'twilight zone'). In many common law jurisdictions, liability derives from wrongful trading, i.e. continue trading when the directors knew or should have known that there was no prospect of avoiding liquidation. The problem that this poses for pre-packaged insolvency is that this restructuring technique requires initiating informal contracts with the creditors and conducting negotiations with them until there is an agreement on the reorganisation plan. If negotiations fail, liquidation may be the outcome, and in that particular scenario, the liquidator could argue that the directors continued trading at a point where liquidation was inevitable. This is probably a misinterpretation of wrongful trading liability, but in order to avoid litigation, it would be useful that the law considers the negotiation of a reorganisation plan in good faith as a valid defense against wrongful trading liability. Directors would be protected by showing that their actions were designed to preserve the viability of the enterprise.

The risk of speed

The main virtue of pre-packaged insolvencies is the speed in execution. In most countries, this means that lengthy court procedures are avoided, and the reorganisation plans are confirmed within a reasonable time. However, recent practice in the USA, as indicated above, has shown that there can be such a thing as 'too much speed' in the processing of pre-packaged reorganisation plans. The law should preserve speed, but also leave sufficient time for creditors to analyze the plan and formulate objections and comments. This is a necessary measure to protect affected creditors who have not supported the plan before the petition.

In addition to these risks, which can be mitigated with appropriate measures, it is important to be aware that pre-packaged insolvency has its own limitations and cannot address all possible cases of enterprise distress. These are the main constraints:

a) Type of restructuring: If an enterprise needs deep operational restructuring rather than mere financial restructuring, a pre-packaged insolvency plan may be insufficient. Operational restructuring typically requires interference with contractual relationships (such as supply or work contracts) and this needs a full reorganisation procedure.

b) Type of creditors: Pre-packaged insolvency works effectively for FCs and large trade creditors. If the enterprise has substantial tax debts, or substantial labor debts, and these cannot be left unaffected by the plan, then it is extremely difficult to negotiate and achieve support for a plan outside a full judicial procedure.

c) Creditor interference: Pre-packaged insolvency is premised on a constructive negotiation of the debtor with its creditors. Confirmation by the court resolves the problem of holdout creditors, but it does not address the problem of creditors interfering with the negotiations, particularly by exercising their enforcement rights. In such case, it may be necessary to open a procedure to impose a stay on creditor actions.

CONCLUSION

The term 'pre-packaged insolvency' or 'pre-pack' captures multiple developments around the world, and there are some key technical differences, especially between the practice consisting of selling distressed businesses as a going concern and the practice of negotiating reorganisation plans that are rapidly confirmed by the courts. The recent introduction of a 'pre-pack' mechanism for MSMEs in Indian law²⁴ is an extremely interesting development, and it is hoped that this new restructuring tool will be deployed to maximum effect.

Pre-packaged insolvency is a useful tool to achieve rapid debt restructuring with minimal court intervention. This is particularly useful in times of crisis, when the number of distressed enterprises may result in considerable backlogs at the courts. The advantages of pre-packed insolvencies outweigh their risks, which can be mitigated with adequate rules and controls.

NOTES

**The views expressed in this paper are those of the author and do not necessarily represent views of IMF, or its Executive Board, or IMF Management.*

¹ Diez et al. (2021), "Insolvency Prospects Among Small and Medium Enterprises in Advanced Economies: Assessment and Policy Options", SDN 2021/002, IMF Staff Discussion Note.

² Liu et al. (2020), "Private Debt Resolution Measures in the Wake of the Pandemic", IMF Special Series on COVID-19.

³ This is obviously, a rough analogy: the result of pre-packaged food is invariably inferior to a traditional preparation, as common experience confirms. Pre-packaged insolvency, however, does not need to result in an inferior outcome. In practice, the opposite may be more accurate.

⁴ McConnell et al. (1991), "Economics of Pre-packaged Bankruptcy", *Journal of Applied Corporate Finance*, 4(2).

⁵ The international standard on insolvency and creditor rights is composed of the World Bank Principles for

Effective Insolvency and Creditor/Debtor Regimes (lastly revised in 2021) and the recommendations of the UNCITRAL Legislative Guide on Insolvency Law (whose second edition was approved in 2019). The standard is drafted in consultation with the IMF.

⁶ UNCITRAL Legislative Guide (2004), Part two, IV. B, recommendations 160-168.

⁷ As a matter of fact, the UNCITRAL recommendations are largely coincidental with the law, and especially the practice of the USA.

⁸ Kirschner et al. (1991), “Prepackaged Bankruptcy Plans: The Deleveraging tool of the 90s in the Wake of OIDs and Tax Concerns”, Seton Hall Law Review, p.661. (*‘A pre-packaged chapter 11 is a procedure designed to conduct a largely out-of-court restructuring which is subsequently consummated under the authority of a bankruptcy court without invoking the procedures of a full-blown bankruptcy case’*).

⁹ There are few legal provisions that can be connected to the practice of pre-packaged reorganisations: for instance, section 341(e) of the US Bankruptcy Code allows the court to dispense with the meeting of creditors; and section 1125(g) allows for the post-filing solicitation of votes on a plan.

¹⁰ Teloni F. (2015), “Chapter 11, Duration, Pre-Planned Cases and Refiling Rates: An Empirical Analysis in the Post BAPCPA Era”, American Bankruptcy Institute.

¹¹ *In re Belk Inc.* (2021), Case No. 21-3060630 (Bankr. S.D. Tex.).

¹² Under the Federal Rules of Bankruptcy Procedure Rules 2002(b) and 3017, creditors, the trustee, and other interested parties must receive at least 28 days’ notice prior to a hearing on either the disclosure statement or plan confirmation. However, it is possible to provide that notice before the petition for commencement, and this is the aspect that is being currently discussed.

¹³ Goldrein A. (2011), “Unwrapping English Pre-Packaged Administrations: A Guide to Pre-Packs”, 7, Pratt’s Journal of Bankruptcy Law, p. 444.

¹⁴ Government of United Kingdom (2014), “Graham Review into Pre-pack Administration”, The Insolvency Service, 16 June.

¹⁵ Statement of Insolvency Practice 16, Insolvency Practitioners Association.

¹⁶ The Statement of Insolvency Practice 16 requires a report provided by administrators to creditors following a pre-pack providing sufficient information for a reasonable and informed third party to conclude that the sale was appropriate and that the administrators acted with due regard for the creditors’ interests.

¹⁷ Pre-Pack Pool, United Kingdom.

¹⁸ UK Government (2021), The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations, 2021.

¹⁹ Aalbers H. et al. (2019), “Does pre-packaged bankruptcy create value? An empirical study of post-bankruptcy employment retention in The Netherlands”, International Insolvency Review, 28(3), pp. 320-339; Kastrinou A. and Vullings S. (2018), “No Evil is Without Good: A Comparative Analysis of Pre-pack Sales in the UK and the Netherlands”, International Insolvency Review, 27(3), pp. 320-339.

²⁰ The ‘rehabilitation receiver’ is an insolvency professional in charge of supervising the rehabilitation of the business.

²¹ Gilson S. et. al. (1990), “Troubled debt restructurings: an empirical study of private reorganization of firms in default”, Journal of Financial Economics, 27(2), pp. 315-353.

²² Studies show that write-downs of debt are lower in pre-packaged cases: Johna K., Matetib R.S. and Vasudevanc G. (2013), “Resolution of financial distress: A theory of the choice between Chapter 11 and workouts”, Journal of Financial Stability, 9, pp. 196–209.

²³ Jose M. Garrido (2012), “Out-of-Court Debt Restructuring”, World Bank Publications, The World Bank, 01 December.

²⁴ Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021; IBBI (Pre-packaged Insolvency Resolution Process) Regulations, 2021.

PRE-PACK : A GREAT ENABLER FOR RESOLUTION OF STRESS IN MSMES

Sunil Mehta

The insolvency regime in India was, in the past, fragmented, owing to multiple central and state legislations including a special act of Parliament *viz.* the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) which dealt with sick notified industries across India but left out other businesses. There were separate acts of Parliament to deal with insolvency in Presidency Towns and other territories of India. Besides, there have been acts made by several States for relief to undertakings in the respective states. All this had led to fragmented insolvency regime making insolvency cumbersome, time consuming and leading to low price discovery.

A new era of resolution was ushered in India by brining on the law book of the country, a brand-new law *viz.* the Insolvency and Bankruptcy Code, 2016 (Code/IBC), consolidating the then existing Acts also incorporating elements from contemporary insolvency law practiced internationally.

NEED FOR PRE-PACK

IBC has certainly helped in resolving several big companies in distress situation thereby helping the banks and financial institutions to sizably reduce their non- performing assets (NPAs).

However, it was observed that the elaborate process of insolvency under the Code was found to be useful and appropriate for big companies and not suitable for smaller companies and businesses, given the peculiarities in India, on the way the latter companies and businesses are run. This is owing to the fact that the smaller companies and businesses, typically all falling into a category called micro, small and medium enterprises (MSMEs) operate in India largely in somewhat an informal manner, like family businesses where reliance is more on the individuals rather than the systems and

processes and therefore, the individuals running these companies and businesses (promoters) need to continue to run them all the more, in the situation of stress leading to insolvency.

The insolvency regime brought in by the IBC was typically a creditor-in-control model which, in the first place after admission of insolvency, envisaged change of control from the individuals running these companies and businesses to the creditors' appointed professional, a Resolution Professional (RP), disturbing the applecart and affecting stakeholder interaction severally. Furthermore, such RP has several handicaps in managing, owing to it, having been run in the past in an informal manner and based more on personal relationships and rapport. Besides, the time bound resolution under insolvency regime brought in by the Code, is encountering some delays as compared to envisaged timelines.

As a result, the Code which has proved to be very useful in case of freeing economic value of big companies, has shown limitations in the context of MSMEs, with adverse consequence of such insolvency leading to liquidation rather than resolution.

This created a room and necessity for bringing in a simpler version of insolvency, typically for MSMEs which has led to introduction of pre-packaged insolvency resolution process (PPIRP/pre-pack) under the Code.

PRE-PACK INSOLVENCY- BASICS

The pre-pack insolvency regime put in place in April 2021, is a consensual process with the assistance of an insolvency practitioner with prior understanding by stakeholders which ensures confidentiality and minimises disputes and litigation. The promoter continues to be in control during the process, minimising disruption to business. The promoter (unless disqualified for being a wilful defaulter etc.) has the right to submit a reorganisation plan. Outcome of pre-pack when approved by the court, becomes binding on all stakeholders.

Benefits of Pre-Pack

Pre-pack in a way combines the best of both worlds so that insolvency proceedings cause minimal disruption to debtors' business activities by combining the efficiency, speed, cost, and flexibility of workouts with the binding effect and structure of formal insolvency proceedings.

It offers several advantages as compared to regular resolution process. Most of these emanate from two elements, namely, (a) the informal process, and (b) shorter time for closure. Since the process prior to commencement of formal proceeding is informal, pre-pack provides the stakeholders flexibility in working out a consensual, but efficient, strategy for effective resolution and value maximisation that may be difficult under the formal insolvency procedure.¹

It takes less time because a substantial part of the proceedings is undertaken before commencement of the formal proceeding by the court. The sub-committee of Insolvency Law Committee (ILC) set

up to recommend the legislative framework for pre-packs took note of benefits of a typical pre-pack process as noted below.²

a) *Quick resolution:* It is difficult to keep a company going on in a stressful state for long. If stress is not resolved quickly, its value may erode and ultimately disappear making resolution difficult. Pre-pack, which enables a faster resolution, preserves and maximises value and increases the possibility of resolution.

b) *Cost effective:* Since the process takes less time, the cost of process linked to time becomes less. Since the corporate debtor (CD) continues with the existing management during pre-pack, it avoids the cost of disruption of business as it does not shift management to an Interim Resolution Professional (IRP), then to an RP and then to a successful resolution applicant (RA) and continues to retain employees, suppliers, customers, and investors. It also saves the cost of IRP/ RP to the extent he does not have to run the business of the CD as a going concern. Since the process remains away from limelight till commencement of formal process, it minimises indirect costs in terms of stigma and loss of reputation to the business. As a substantial part of pre-pack is conducted outside the court and the formal part of the process has minimum involvement of court, the cost associated interface with court is reduced.

c) *Value maximisation:* A distressed asset has a life cycle and the longer it stays in a state of stress, the more value depletion it suffers. Its value depletes further by the costs associated with a longer resolution period. The value depletion is aggravated due to the public nature of a formal insolvency process, whereby the reputation and brand of the CD suffers. Pre-pack preserves value by cutting down these elements of formal process. Early initiation and closure of the process as compared to the formal process, minimises the possibility of liquidation and thereby destruction of economic value in case of otherwise viable businesses. This is often key to saving small businesses that cannot withstand the costs of a prolonged insolvency, and thereby helps in maximising value.

d) *Job preservation:* Many SIP statements³ refer to the preservation of employment as one of the reasons for using a pre-pack administration. Since a pre-pack may commence at the earliest sign of distress, it facilitates continuity of its operations without any job loss. It ensures that a company keeps going, in contrast to a more protracted formal insolvency process which risks losing customers and employees.

e) *Group resolution:* Given that resolution of a group of companies can be value-adding as compared to separate insolvency proceeding for each company in distress, many jurisdictions are contemplating to make available an enabling framework for the same. In the absence of any mechanism to effectively deal with insolvency of a group of companies in most jurisdictions, pre-packs have proved very helpful. A research indicates that the pre-pack sale of enterprise group to a single purchaser has resulted in a successful resolution in around 72% of the cases.⁴

f) *Lighter on courts:* The courts usually have limited infrastructural capacity and can perform its obligations within its limits. A pre-pack has the potential to reduce litigation, due to its informal

and consensual nature. It does not require involvement of the court during the informal part of the process and requires minimum role of courts during formal process. Hence, it reduces litigation cost and delays and helps to decongest the overburdened courts. It is necessary to have a functional out-of-court restructuring process, so that the vast majority of cases are restructured out of bankruptcy, with the National Company Law Tribunal (NCLT) acting as a court of last resort if no agreement is possible.

SALIENT FEATURES OF PRE-PACK IN INDIA

Some of the salient features of the pre-pack regime introduced for corporate MSMEs are as below:

- (a) Unrelated financial creditors, who are not related to the CD, having a minimum 66% of the value of financial debt due, shall approve the filing of the application for the initiation of PPIRP;
- (b) It is available only if the MSME company or LLP-
 - has not undergone pre-pack process/ regular insolvency during the previous 3 years;
 - is not undergoing regular insolvency; and
 - is not already ordered to be liquidated;
- (c) PPIRP is not available to (related) parties under section 29A of the Code;
- (d) Application for PPIRP has to name a RP;
- (e) A financial creditor before approving request of an MSME for PPIRP, to see the declaration of directors/ partners, special resolution/ 3/4th partners majority resolution and Base Resolution Plan (BRP);
- (f) Application for PPIRP is to be filed with the Adjudicating Authority (AA) [NCLT];
- (g) If application for regular insolvency (under Chapter II) is pending on April 4, 2021 then also application for PPIRP could be filed and the application so filed to be dealt with first by NCLT;
- (h) If application for regular insolvency (under Chapter II) is filed after April 4, 2021 then the application for PPIRP could be filed within 14 days and the application so filed to be dealt with first by NCLT;
- (i) The CD, i.e MSME, is required to provide a BRP to RP within two days from commencement date;
- (j) The RP is required to submit the resolution plan approved by committee of creditors (CoC) to AA within 90 days from the commencement date or inform AA to terminate the PPIRP;
- (k) PPIRP is to be completed in 120 days from the commencement date;
- (l) Moratorium starts with the AA admitting the application and declaring it (commencement date) and continues till approval/ rejection of resolution plan by AA;
- (m) During PPIRP the management of the MSME continues with its Board/ Partners. However, CoC can, in certain circumstances and with 66% voting shares, resolve for management to be with RP;

- (n) CoC can approve BRP (which does not impair operational creditors' rights) for submission to AA;
- (o) If CoC does not approved BRP, then RP to invite RA to submit resolution plans and submit the same to CoC for approval;
- (p) CoC can approve one of the resolution plans or reject all;
- (q) If CoC approves a resolution plan, the RP to submit it to AA;
- (r) If CoC does not approve any resolution plan/ nor finds BRP competitive, then RP to file with AA for termination of PPIRP;
- (s) CoC before approval of resolution plan can, by 66% voting majority, decide to go for regular insolvency, viz. CIRP, if eligible.

CONCLUSION

The above evidences the process of pre-pack being a process with statutory backing and with many advantages. It is much simpler, easy on cost, less time consuming, taking care of all stakeholders and above all letting the promotor continue to run the enterprise during resolution period.

Considering the foregoing, MSMEs should avail of pre-pack insolvency in their own interest to come out of stress situation and start a new life.

Industry and business associations, Chambers of Commerce, professional institutions like Institute of Chartered Accountants of India, Institute of Company Secretaries of India and Institute of Cost and Management Accountants of India should educate their members on the pre-pack process and actively promote it for the benefit of the economy.

NOTES

¹ Report on Pre-packaged Insolvency Resolution Process by the Insolvency Law Committee, October, 2020.

² *Ibid.*

³ Statement of Insolvency Practice 16 (2009), Insolvency Practitioners Association (UK).

⁴ Walter P. and Umfreville C. (2014), "Pre-pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration", University of Wolverhampton.

PRE-PACK FRAMEWORK : A STEP IN THE RIGHT DIRECTION

Vijaykumar Iyer and Sanjeev Marwah¹

Only a crisis - actual or perceived - produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is our basic function: to develop alternatives to existing policies, to keep them alive and available until the politically impossible becomes the politically inevitable.

- Noble laureate economist, Milton Friedman

BACKGROUND AND CONTEXT

COVID-19 crisis can be defined as a health hazard which transformed into an unprecedented catastrophic trinity of demand, supply and liquidity shocks. In response to the crisis, the first string of policy responses globally was swift, and policy makers drew references to the measures adopted in earlier economic crises. A range of fiscal, credit guarantee, monetary and macro-financial measures were deployed to arrest the sudden shocks. Furthermore, various relaxations to insolvency regimes were observed across major economies including Australia, UK, Singapore and Germany ranging from moratorium on initiation of insolvency proceedings to simplification of existing regimes in order to save the economies from an avalanche of bankruptcies.² India too observed similar measures in terms of suspension on insolvency proceedings originating out of COVID-19 defaults.³ While such measures have helped address the scale of the challenge, if not underpinned by further interventions in the form of structural reforms/policies, it would be challenging to retract our nation back to the growth path.

Most global economies are now a year into the crisis, and the levels of resilience vary across economies. As vaccine doses get administered, courtesy to an extraordinary feat by global medical research franchises, there is light at the end of the tunnel. Having said that, the overhang of the pandemic on the global economy will probably linger on, given the multiple wave phenomena. Corporate leverage to GDP ratio globally for the non-financial corporate sector is at 91%⁴, reflecting that insolvencies could be much higher in future. In the Indian context too, the risk to banks' balance sheets is well acknowledged by RBI in its latest Financial Stability Report where it has stated that gross non-performing assets (GNPAs) across all Scheduled Commercial Banks, by March, 2022, could be as high as 9.8% and 11.2% in the base and worst-case scenarios respectively.⁵ The same can be validated by the proforma GNPAs' figures reported by various financial institutions during the last two quarters i.e. quarter ended December, 2020 (first complete quarter post lifting of moratorium on servicing loans) and quarter ended March, 2021, being notably higher than prior reports.

As of now the temporary relaxations on the insolvency regimes across major economies have generally continue till first quarter of 2021 subject to any further extensions being granted. Thereafter, with the lifting of suspension on initiation of insolvency proceedings, policy makers and regulators are gearing up with ways and means to contain the economic loss and enable rehabilitation of companies impacted by the pandemic. One such lever is to improve upon restructuring and bankruptcy procedures to encourage speedy resolutions.

PRE-PACK – A POTENTIAL SILVER BULLET FOR DISTRESSED MSMEs

To this end, Indian policymakers have devised a pre-packaged insolvency resolution process (PPIRP/pre-pack) framework which inherits the tenets of the Insolvency and Bankruptcy Code, 2016 (Code/IBC), and leverages a reasonably matured insolvency ecosystem, backed by rich jurisprudence. Although the pre-pack concept germinated in pre-COVID-19 times, the pandemic has only acted as a catalyst in expediting its formulation. The policy makers have made concerted efforts to ensure that the regime stays indigenised while drawing lessons from global jurisdictions. Further, the pre-pack framework is being implemented in phases starting with applicability to micro, small and medium enterprises (MSMEs) as defined in section 7(1) of the Micro, Small and Medium Enterprises Development Act, 2006⁶ and with default sizes of ₹ 10 lakhs or more.⁷

This article attempts to:

(a) First, highlight how the Indian pre-pack framework is identifiably different from the pre-pack regimes as practiced in the US and UK jurisdictions, which are in existence for relatively longer durations of time.

(b) Further, as the famous saying goes, the proof of the pudding is in the eating. The real test of the Indian pre-pack framework would lie in its successful on ground implementation. Keeping in mind the potential issues that might unfold as the framework expands its horizon to cover larger defaults

across complex corporate structures, the article also highlights some of the areas for consideration to ensure effective implementation.

BENCHMARKING OF SELECT PARAMETERS – INDIA Vs. OTHERS

Origin

US/ UK	India
In the UK, the Insolvency Act, 1986 as amended by the Enterprise Act, 2002 does not explicitly provide for a pre-pack administration. Similarly, in the US, Title 11 – Bankruptcy does not have a statutory definition for a pre-pack framework.	The pre-pack framework has been introduced as an amendment in the IBC itself <i>via</i> an Ordinance. ⁸

Remarks:

The pre-pack framework has evolved through market practices in the US and UK and is not explicitly provided in their respective bankruptcy frameworks. In the UK regime in particular, the pre-pack sales framework is a by-product of certain powers vested with the Administrator as per the amendments introduced by Enterprise Act, 2002 which allows him/her to sell assets of the company without the approval of creditors.⁹

In contrast, the pre-pack framework in India has been formally enacted through suitable amendments in the Code. The Indian pre-pack framework complements the existing IBC corporate insolvency resolution process (CIRP) framework and aims to add an element of flexibility to the process while retaining the basic tenets of the Code.

Primary objective

US	UK	India
The purpose of Chapter 11 proceedings is to preserve the corporate debtor (CD) as a going concern by way of restructuring its debt and equity interests to reflect its actual debt serviceability and retain equity value for shareholders. ¹⁰	With an intention to promote a rescue culture, statutory objectives as defined under the Insolvency Act, 1986 (in the order of priority): ¹¹ <ul style="list-style-type: none"> Rescuing the company as a going concern Achieving a better result for the creditors than would likely be if the company were wound up, or Realising property of the company in order to make distribution to one or more creditors. 	While all objectives of the IBC apply to a pre-pack regime, 'Rehabilitation of the CD as a going concern' remains its first order objective. ¹² This could be achieved via quicker, cost-effective and value maximising resolution, ultimately preserving the business and jobs. ¹³

Remarks:

While the primary objective of UK's administration process as engendered through the Enterprise Act, 2002 was the rescue of the company as a going concern, UK has seen pre-pack sales become

more mainstream instead. Rapid acceptance of pre-pack sales and its associated concerns around transparency and accountability has seized attention of the policymakers and regulatory bodies. As a result, certain voluntary measures including the Statement of Insolvency Practice 16 (SIP) and ‘consulting the pre-pack pool’ have been prescribed; however, their adoption has remained insubstantial. In the year 2019 SIP-16 had a non-compliance rate of 23% which is a slight improvement as against 30% in 2018 and 38% in 2017. One of the reasons attributed to this level of non-compliance is to avoid sharing confidential information about the business.¹⁴ Similarly, there were only 23 cases referred to the pre-pack pool in the year 2019 out of a total of 473 pre-packs in the UK of which nearly 54% of the cases resulted in sale of business to connected parties.¹⁵ This marks a reference rate of merely 9% in the year 2019 which is consistent with the reference rate of 7% in 2018 and 11% in 2017.¹⁶

In the US, reorganisation under Chapter 11 lies at the heart of Title 11 of the US Bankruptcy Code and provides one of the two routes to pre-pack. The other route which has recently become popular is offered by section 363 through which assets of the debtor undergoing reorganisation proceedings can be sold without creditor approval but subject to the approval of the bankruptcy court.¹⁷

Unlike other jurisdictions, and more particularly in the UK, wherein ‘sale of assets’ has become a preferred pre-pack practice, the pre-pack framework in India sticks to its primary objective of ‘rehabilitation of the corporate debtor as a going concern’ to be achieved through a Code compliant resolution plan with no sale of any asset or business, except to the extent allowed under regulation 29 of the CIRP Regulations.

Initiation

US	UK	India
Who can initiate? Chapter 11 proceeding is initiated with the filing of a petition with the bankruptcy court; A petition may be voluntary ¹⁸ which is filed by the debtor or involuntary ¹⁹ which is filed by the creditors.	Who can initiate? The company, directors or creditors (including floating charge holder) can apply to the court for an administration order ²⁰ , or can opt for the out of court route to appoint an Administrator.	Who can initiate? Only the CD can initiate the pre-pack framework with consent of a 66% majority of unrelated financial creditors (FCs) along with a shareholders’ special resolution requiring 75% voting. ²¹
Is creditors’ approval required to initiate? No.	Is creditors’ approval required to initiate? No	Is creditors’ approval required to initiate? Yes.

Remarks:

In the US and UK regimes, creditors’ approval is not a pre-requisite to initiate the proceedings. In contrast, Indian pre-pack framework provides for the CD to initiate the process. Additionally, the framework incentivises the CD to initiate by allowing it to submit a base resolution plan. Further, unlike the UK and US regime, the CD in India requires the consent of 66% majority of unrelated FCs and shareholders to initiate the pre-pack framework. A buy-in from key stakeholders at the initiation

stage itself provides a higher probability of achieving consensus between the CD, promoters and creditors to begin with and a higher degree of certainty that the process would yield an acceptable base resolution plan.

Management of the company

US	UK	India
Debtor in possession. ²²	The Administrator takes custody and control of the company and is responsible for management of the affairs of the company. ²³	Debtor in possession under monitoring of FCs. ²⁴

Remarks:

In contrast with the US and UK regimes, the Indian pre-pack framework follows a ‘debtor in possession’ under monitoring of FCs’ model. Retaining the management of operations with the CD prevents the potential value deterioration associated with the disruptions whenever a shift of management takes place from existing promoters to the Interim Resolution Professional (IRP) to the Resolution Professional (RP) under a CIRP. That said, transactions under section 28 of IBC would require creditors’ consent as during CIRP²⁵, providing the creditors necessary levers to control non-routine operational matters. Further, the Code also provides a mechanism to the FCs to vest control in the hands of the RP in case there has been any gross mismanagement of affairs of the CD.

Eligibility criteria for purchaser / resolution applicant

US	UK	India
While section 109 of Title 11 provides certain eligibility criteria for being a debtor ²⁶ , there are no specific ineligibilities for a purchaser in case of sale of assets under section 363 which happens <i>via</i> a court supervised public auction method.	No restrictions on the buyer in case of a pre-pack sale. SBEE Act, 2015 enables Parliament to either ban sale to connected parties or to impose restrictions on such sales through regulation. ²⁷	Applicability of section 29A of the IBC which defines ineligibility to become a resolution applicant is retained. ²⁸ Relaxations of section 29A for MSMEs, by virtue of section 240A ²⁹ of the IBC.

Remarks:

Since the UK jurisdiction does not discriminate against a ‘connected’ person to act as a buyer, sales to connected persons have dominated pre-packaged sales in the UK. In an empirical research commissioned by the Graham Review in 2014, it was found that in a sample of 499 pre-packs, almost two-thirds of purchasers were connected to the distressed company. As per statistics from Insolvency Service, in 2018 alone, there were 450 pre-packs, 241 of which were connected party sales.³⁰ Rising prominence of connected party sale transactions has raised several questions around transparency, objectivity and fairness of the process and invited scrutiny by policy makers and regulatory bodies.³¹

Similarly, under the US bankruptcy law, there are no ineligibilities prescribed for a buyer under section 363 sale which is carried out through an auction process.

In contrast, Indian pre-pack framework regulates the universe of potential resolution applicants through section 29A. The framework has retained its applicability as under IBC.

Requirement of CoC's approval as a pre-requisite

US	UK	India
<p>Reorganisation: Plan must be accepted by every class of impaired parties with at least two-thirds in amount and a majority in number of claims. Interested parties whose interests are not impaired are deemed to have accepted it and class of interested parties that does not receive anything is deemed to have rejected the plan.³²</p> <p>Sale as per section 363: Sale of property outside the ordinary course of business requires the debtor to give a notice, opportunity for objections from interested parties and a court hearing before effecting such a sale.³³</p>	<p>Administrator to seek approval from creditors; however, the same can be bypassed if it is determined that each creditor will be paid in full or that no distributions will be made to the unsecured creditors.³⁴</p> <p>Further, to achieve the purpose of administration, the Administrator has been conferred with certain powers including ability to sell the assets of the company without the approval of creditors.³⁵</p>	<p>Approval of a resolution plan by the Committee of Creditors (CoC) basis 66% of voting share, present and voting.³⁶</p>

Remarks:

In the US, while the reorganisation requires acceptance by every impaired class of creditors, section 1129(b)(1) of the Title 11, provides the option to the court to impose the plan on an objecting class if it finds that treatment provided for the objecting class does not 'discriminate unfairly' and is 'fair and equitable'. Separately, in case the pre-pack is routed through sale of assets in accordance with section 363, while the courts hear the objections of the creditors before approving section 363 sale, the courts are not concerned with whether majority of the creditors would have voted for the proposed section 363 sale or not.

In the UK, pre-packs have evolved using the Administrator's power to sell a company's assets without creditor's approval. UK courts through various judgements are seen to have embraced this, owing to the swiftness associated with this route; for instance, in the cases of *T&D Industries Plc*³⁷ and *Transbus International Ltd.*³⁸, the Courts held that the Administrator had the power to sell the assets of the company prior to creditors' approval without the direction of the court.

In contrast, the Indian pre-pack framework furthers consensus building amongst the stakeholders, disallows disenfranchisement of creditors and necessitates approval of resolution plan in line with the requirement under CIRP. This would not only instill trust and faith in the creditors' fraternity towards the process but also restrict the degree of dissatisfaction and subsequent appeals post its completion.

Value maximisation

US	UK	India
<p>Sale under section 363 is commonly practiced under the 'stalking horse' method.³⁹</p>	<p>Pre-pack sales aim to maximise value for creditors by swiftly trading viable businesses and other assets to potential buyers.⁴⁰</p>	<p>The Indian pre-pack framework encourages value maximisation by adopting a process akin to a Swiss challenge.⁴¹</p>

Remarks:

Sale of assets under section 363 has become one of the popular routes to pre-pack in US. Under this process, the debtor markets the assets to attract potential buyers. The bids are received and the highest one settles as floor price for the court auction process. The bidders in the auction process must bid higher than the 'stalking horse' price to remain as contenders for purchasing the assets of the debtor.

The pre-pack scheme in UK is pivoted on swift sale of the assets or business to a purchaser at the terms as agreed prior to the commencement of formal stage, with the sale coming into effect post the appointment of an Administrator. This is most suited for scenarios where value in the business is primarily attributed to the assets which are susceptible to value deterioration post commencement of the administration.

The Indian pre-pack framework through 'debtor in possession' addresses the potential value deterioration associated with change in management during CIRP as explained above. It takes a step further to ensure value maximisation by allowing an option to CoC to seek resolution plans from resolution applicants other than base resolution plan, retaining a competitive tension such that promoters would be inclined to propose a base plan with minimum impairment to the rights and claims of creditors.

Timeline

US	UK	India
<p>Given that the pre-pack scheme is derived from Title 11 of US bankruptcy law, same timelines apply.</p> <p>The debtor has an exclusive right to propose and file a plan during first 120 days from commencement, which may be extended by the court, but not beyond 18 months from the date of commencement. Post the expiry of exclusivity period, a creditor or trustee may file a competing plan.⁴²</p>	<p>Given that the pre-pack scheme is derived from Insolvency Act 1986, same timelines apply.</p> <p>The administration is desirable to be completed within twelve months from commencement. However, this term may be extended by up to one year with the consent of creditors.⁴³</p> <p>Alternatively, the Administrator can apply to court for an extension for as long as deemed necessary by the courts.</p>	<p>90 days for filing the resolution plan with the Adjudicating Authority (AA) and 30 days for the AA to approve the same.⁴⁴</p>

Remarks:

Unlike India, pre-pack in USA and UK are governed by the timelines as defined under their respective insolvency laws.

In India, given that the pre-pack framework has been formally introduced as being separate from the CIRP, it has its own timelines which are shorter, with 90 days for submission of plans to the AA.

Summary

The above juxta positioning of the pre-pack frameworks across various criteria highlights that the Indian pre-pack regime is similar and yet identifiably different in shape and form as practiced in other jurisdictions. Further, one can see a level of prudent guardedness across various parameters within the Indian pre-pack framework which would be on account of learnings drawn from the experience of IBC. For example, the Indian pre-pack framework:

- emphasises on rehabilitation of the CD as a going concern rather than being myopic by facilitating sale of assets for recovery to creditors;
- promotes consensus building amongst stakeholders right from the stage of process initiation and discourages disenfranchisement of creditors;
- emphasises on value preservation; and
- provides a mechanism for value maximisation.
- The above parameters become much more persuasive when applied to the MSME sector in India, for which the pre-pack framework has initially been rolled out for.

KEY AREAS OF CONSIDERATION FOR EFFECTIVE IMPLEMENTATION

While the framework upholds the tenets of the IBC along with necessary safeguards to avoid potential pitfalls, the real test lies in successful on-ground implementation. Some of the areas for consideration by readers to ensure an effective implementation are mentioned below.

Collaboration – Key to effective consensus building

Collective efforts undertaken by all stakeholders during an informal stage would lay the foundation of a successful resolution under the pre-pack framework. Hence, it is imperative that the stakeholders are forthcoming in shouldering their responsibilities and contributing meaningfully and in a time bound manner during the informal stage. For instance:

(a) Expectations from CD would be to put together a viable and feasible base resolution plan which is in the best interest of all and by taking due guidance from the insolvency professional (IP).

(b) Expectations from the lender fraternity would be to analyse the alternatives being put forth and accordingly to take a pragmatic view on the same in a time bound manner lest the value deterioration

of the CD continues. Further, it is well known that the lenders face significant oversight and supervision within their own institutional systems as well as through their regulators. This high degree of scrutiny may arguably, lead to a certain level of diffidence at the time of decision making. Thus far, our bankers have shown a high degree of professionalism while resolving some of the large sized insolvent cases. The pre-pack framework would once again require them to step up, provide an empathetic approach (given that the stress is in the MSME sector) and, boldly, provide the benefit of doubt to the incumbent management.

(c) Expectations from the IP would be to foster transparency and adopt a collaborative approach in his/her line of action to facilitate consensus building during the out of court phase. It might appear from a cursory reading of the framework that the role of the IP is curtailed during the formal stage. However, one cannot undermine the fact that the role of a RP starts much before the formal stage when he/she dons the hat of an IP. He/she will have to play the role of a mentor, philosopher and guide to the promoter of the MSME CD, demonstrate softer skills in behavior and be more visibly transparent in his/her actions to ensure integrity of the process. As Joseph Barber Lightfoot has said, 'there is no persuasiveness more effectual than transparency of a single heart, of a sincere life.'

Preparedness at the informal stage imperative for successful implementation

Given the framework envisages stricter process timeline of 90 days, more deliberate and purposeful groundwork is required at the informal stage to orchestrate a successful pre-pack implementation and harness the best outcome for the stakeholders. Quality of resolution plans would be directly proportional to the effort put in towards the planning and preparation at pre-initiation stage. In other words, a sub-par effort at the informal stage would result in inferior alternatives for the stakeholders.

To this end, during the informal stage, the IP should encourage and enable the CD to prepare a complete information memorandum and keep the virtual data room populated with all relevant information.

The information should be as comprehensive as possible covering all dimensions of the business and operations in an intelligible and transparent manner. This would enable all stakeholders to undertake their respective roles efficiently; for example, (a) Swiss challengers / third party applicants during the diligence phase, (b) professionals such as Registered Valuers (RV) and forensic auditors in carrying out their respective mandates and (c) creditors in their decision making while evaluating alternatives.

Further, the CD with the guidance of IP and feedback from creditors should make every effort to finalise contours of a base resolution plan during the informal stage, so that the same could be immediately tabled to the CoC post its constitution. This will leave more time for Swiss challengers to undertake diligence and submit a resolution plan within the stipulated timeline.

Enabling third party resolution applicants to participate effectively

Of the 90 days' timeline, initial couple of days are allotted to the CD for submitting a base resolution plan⁴⁵ with last few weeks utilised by lenders to seek requisite approvals within their institutional systems. It might so happen that third-party resolution applicants/Swiss challengers are left with few weeks in between to undertake due diligence, draft, and submit a compliant resolution plan. The apparent challenge of information asymmetry between promoters and prospective bidders will have to be addressed by the RP. The strict timelines to submit a plan should not become a limiting factor in garnering interests from potential resolution applicants. Hence, every effort must be made to enable the applicants with all required information to submit plans within stipulated timelines in interest of value maximisation. It is only then will the Swiss challenge option provided for in the Indian pre-pack framework be real and will work effectively and not become a mere eyewash.

While level of preparedness at pre-initiation stage in terms of collating relevant information would contribute significantly towards a smoother diligence phase, timely and accurate dissemination of information during the diligence phase would also play a vital role for a robust plan to be devised.

A successful 'sale' process in the pre-pack framework requires promoters/entrepreneurs who have values, a growth vision and who are rational when making large investment decisions and creating a base plan as a benchmark allowing other players to match or beat.

It is understandable that there might be a certain degree of reluctance from CD in sharing information with the potential resolution applicant in a timely manner. Therefore, responsibility lies with the RP to supervise the process and bring such lapses to the knowledge of the stakeholders as red flags.

Leverage learnings from past experiences

Pre-pack framework aims to address a growing whitespace in the distressed debt ecosystem created on account of dearth of takers for large number of businesses. To this end, the pre-pack framework envisions a second chance to the existing promoters in the all-encompassing MSME sector while ensuring that adequate guardrails to prevent any moral hazards are in place. Further, in such cases, the probability of the base resolution plan ending up as the final resolution plan is very high due to lack of resolution applicants in the MSME sector.

Hence, it becomes extremely critical that the stakeholders invest reasonable time in analysing the causes of business failure which could have been avoided earlier and accordingly ensure that the resolution plan addresses the same in a sustainable manner. While some of the reasons could be outside the control of the company such as cyclicality associated with an industry, *force majeure* reasons etc. making them unavoidable, there could be some on account of imprecise business calls such as mis-assessment of working capital requirement, misallocation of capital and diversification into non-core businesses which were within the control of the company, and hence avoidable.

Reskilling and upskilling of IPs

The pre-pack framework places a more onerous responsibility on IPs.

(a) Firstly, as the cases in the MSME sector would be relatively smaller in size, the IP cannot take the shelter of a team and will have to largely himself/herself demonstrate professional skills and capability.

(b) Secondly, the promoters in the MSME sector are skillful businessmen/entrepreneurs with outstanding hearts (to face challenges) and minds (to come up with innovative '*jugaad*' solutions). But they will need support to maneuver through the complexities of the Code. The promoter would need guidance, mentorship and most importantly, not mere advice from a professional counsel, but more tellingly, counsel from a trusted business advisor. The IP must be willing and enabled to stand up to the task.

(c) Thirdly, the IP will also have to deploy skills of a corporate finance / investment banker who knows the art and science to 'sell' a company. While important to run a successful CIRP process, it is that much more important in the pre-pack framework for the IP to actively scout for resolution applicants, present the positives of the CD and value proposition to potential buyers.

The entire professional eco-system comprising of the Insolvency Professional Agencies (IPAs), Insolvency Professional Entities and IPs, will have to, necessarily plan out and speedily roll out training of IPs to reskill and upskill all IPs to be able to take on the onerous responsibilities stated above. The Continuing Professional Education (CPE) program is a positive initiative and would need to be further strengthened to ensure continuous learning and development of IPs.

WAY FORWARD

While the aforementioned considerations would be crucial for a successful implementation of a pre-pack process, application of the same in a sustained manner, would require a significant behavioral shift across stakeholders. The stakeholders would need to adopt a more proactive and disciplined approach in their line of action keeping in mind an over-riding principle of '*mutual benefit, joint responsibility and shared destiny*'.⁴⁶

To achieve true collaboration, the IP must (a) allow the creative combination of different people's information, perspectives, and expertise, (b) emphasize the common objectives and interdependence amongst all stakeholders and (c) eventually turn 'us and them' into 'we'.⁴⁷

Further, as mentioned earlier, the pre-pack framework is being implemented in phases starting with applicability to MSMEs. Adoption of the regime in a phased manner would increase scope for course correction and pre-empt the possible hurdles which might come up as the framework expands its horizon across larger default cases with complex corporate structures.

Having said that, it would be over optimistic to state that the framework would not require any

recalibrations post implementation. All major economic reforms in recent times such as Goods and Services Tax and the IBC have undergone certain recalibrations basis feedback from the market with the support from relevant authorities and regulators who have acted responsibly by plugging perceived deficiencies in a deft manner. Pre-pack framework would be no different.

Therefore, one would respectfully submit that the primary onus is on the IPs, (a) to take ownership and lead and monitor the implementation of pre-pack process closely, (b) to be the trusted business advisor to promoters, (c) to take on the responsibility to visibly demonstrate integrity and transparency of the process to creditors and (d) to update the IBBI and the IPAs, of any messaging from the market, so that appropriate measures could be taken in a time bound manner to ensure that the framework stays relevant, updated and useful to the system.

The true measure of success of the pre-pack framework will be expressed in its 'active implementation' i.e. speedily moving an idea from its legislative intent to reality through appropriate means as compared to a compulsive enforcement of a law. And it is ultimately, whether we, IPs step up and work to achieve the stated results, enable successful resolution of stress assets in the MSME sector and consequentially accomplish a more effective utilisation of assets for the benefit of society and our country, as a whole.

NOTES

¹ The authors would like to kindly recognise and acknowledge the assistance of Mr. Sarthak Ohri, Student of Graduate Insolvency Programme (2019-21), for his extensive research for this article.

² Reviving and Restructuring the Corporate Sector Post-Covid, Group of Thirty, p. 34.

³ The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, No. 9 of 2020.

⁴ Supra Note 2, p. 11.

⁵ Financial Stability Report, Issue No. 23, Reserve Bank of India, July 2021, p. 16.

⁶ The Micro, Small and Medium Enterprises Development Act, 2006, No. 27 of 2006.

⁷ The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021, No. 3 of 2021 read with Notification S.O 1543(E) dated April 9, 2021 issued by the Ministry of Corporate Affairs.

⁸ The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021, No. 3 of 2021.

⁹ Insolvency Act 1986, Schedule 1, Paragraph 2 and Schedule B1.

¹⁰ Chapter 11 of the United States Bankruptcy Code: Background and Summary, Bracewell and Giuliani.

¹¹ Insolvency Act 1986, Schedule B1, Paragraph 3.

¹² Report of the Sub-Committee of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process, Ministry of Corporate Affairs, p. 33.

¹³ Preamble to the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021, No. 3 of 2021.

¹⁴ Pre-pack sales in administration report, The Insolvency Service.

¹⁵ Pre-Pack Pool Annual Review for the year ended December, 2019.

¹⁶ Supra Note 14

¹⁷ Section 363 - Use, sale, or lease of property, 11 U.S. Code.

¹⁸ Section 301 - Voluntary Cases, 11 U.S. Code.

¹⁹ Section 303 - Involuntary Cases, 11 U.S. Code.

²⁰ Insolvency Act 1986, Schedule B1, Paragraph 10 to 34.

²¹ The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021, No. 3 of 2021, section 54A(2)(g) and section 54A(3) - CDs eligible for pre-packaged insolvency resolution process.

²² Section 1101(1) - Definition of Debtor in Possession, 11 U.S. Code.

²³ Insolvency Act 1986, Schedule B1, Paragraph 67.

²⁴ Supra Note 8, section 54H - Management of affairs of CD.

²⁵ Section 28 - Approval of committee of creditors for certain actions, IBC.

²⁶ Section 109 - Who may be a debtor?, 11 U.S. Code.

²⁷ Section 129 of Small Business, Enterprise and Employment Act 2015 made changes to schedule B1 of the Insolvency Act 1986 by inserting part 60A which is to be read with Para 60.

²⁸ Section 29A - Persons not eligible to be resolution applicant., IBC

²⁹ Section 240A - Application of this Code to micro, small and medium enterprises, IBC.

³⁰ Supra Note 14

³¹ Graham Review into Pre-Pack Administration (2014).

³² Section 1126 - Acceptance of plan, 11 U.S. Code.

³³ Section 363 - Use, sale, or lease of property, 11 U.S. Code.

³⁴ Insolvency Act 1986, Schedule B1, Paragraph 51 and 52.

³⁵ Insolvency Act 1986, Schedule B1, Paragraph 70 and 71.

³⁶ Supra Note 8, section 54K(13) - Consideration and approval of resolution plan.

³⁷ *Re T&D Industries*, (2001) 1 BCLC 471; *DKLL Solicitors v. HMRC* (2007) EWHC 2067 (Ch).

³⁸ *Re Transbus International*, (2004) EWHC 932 (Ch); (2004) 2 BCLC 550.

³⁹ Distressed M&A - A Road Map for Potential Buyers of Distressed Businesses in the US in section 363 Bankruptcy (2002), Baker McKenzie.

⁴⁰ Insolvency Act 1986, Schedule 1, Paragraph 2.

⁴¹ Supra Note 8, section 54K(5) - Consideration and approval of resolution plan.

⁴² Section 1121 - Who may file a plan?, 11 U.S. Code.

⁴³ Insolvency Act 1986, Schedule B1, Paragraph 76.

⁴⁴ Supra Note 8, section 54D(2) and section 54L(1) - Time-limit for completion of pre-packaged insolvency resolution process and Approval of resolution plan.

⁴⁵ *Ibid*, section 54K(1) - Approval of resolution plan.

⁴⁶ Western firms are coining it along China's One Belt, One Road, The Economist.

⁴⁷ Learnings from the authors of the book 'Smart Collaboration: How professionals and their firms succeed by breaking down Silos' by Heidi K. Gardner.

SIMPLIFYING VOLUNTARY LIQUIDATION PROCESS: IMPROVING EASE OF EXIT IN INDIA

Sanjeev Sanyal and Aakanksha Arora¹

The ease of doing business is not only about seamless starts or how smooth the journey turns out to be – it is also about the freedom to exit, as and when needed. It is an equally essential aspect of the ease of doing business, as much as entry into business. A sound framework for exit, therefore, is essential for all businesses irrespective of whether or not they are insolvent.

Liquidation can be involuntary as in the case of insolvency or bankruptcy; or voluntary which could be due to personal reasons, subsidiaries being merged, and changes in technology or regulations. An important point to note here is that a company may decide to voluntarily close its operation even when it's viable. In order to improve the overall ease of doing business, there is a need to streamline the process for exit of companies-both voluntary and involuntary. Most of the debate over exit is dominated by insolvency and bankruptcy cases, but this article deals with issues related to voluntary liquidation.

The issue of ease of exit is not new. Several committees, including Goswami Committee (1993)², Eradi Committee (2000)³, and Irani Committee (2005)⁴ pointed out loopholes in processes concerning exit of companies, time taken due to pendency of court approvals and lags in the process.⁵ Almost all the committees, however, focused mostly on involuntary liquidation processes and found that exit is an inordinately lengthy and costly affair. Even the Economic Survey 2015-16⁶ notes that

India has made great strides in removing the barriers to the entry of firms, talent, and technology into the Indian economy. Less progress has been made in relation to exit. Thus, over the course of six decades, the Indian economy moved from 'socialism with limited entry to 'marketism' without exit'.

While the reference in the Economic Survey is meant for insolvency and involuntary liquidation cases, this holds true in case of voluntary liquidation as well.

There has been an overhaul in the winding up process due to insolvency/bankruptcy regime in India with the introduction of the Insolvency and Bankruptcy Code, 2016 (Code/IBC). In fact, after the institution of IBC, India's ranking under the 'Resolving Insolvency' head in the World Bank Group's Doing Business report has improved sharply from 136 to 52.⁷ However, the procedure of voluntary exit of business still needs to be simplified radically. Economic Survey 2020-21 briefly touched upon this issue.

In the current scenario, there are two prominent methods of voluntary liquidation, one is under the IBC and another is through the Registrar of Companies (RoC) under section 248 of the Companies Act, 2013 (Companies Act). In this article, the authors explore the issues in the regulations and processes for voluntary liquidation under both ways and discuss possible solutions.

VOLUNTARY LIQUIDATION PROCESS UNDER THE COMPANIES ACT

Section 248(2) of the Companies Act is currently the most popular way to voluntarily close a company. A company may, after extinguishing all its liabilities, by a special resolution or consent of 75% members in terms of paid-up share capital, file an application in a prescribed manner to the RoC. There must not be any pending litigations against the company. This is considered to be a faster winding up process. However, as per the data available from Ministry of Corporate Affairs (MCA), out of the 28,536 pending cases (as on June 13, 2021), nearly 10% are pending from more than 1000 days and 54% cases (15,310) are pending for more than one year.

Process of voluntary liquidation under section 248(2)

Step 1: Company has to convene a board meeting to approve closure of bank account, pay off all the pending liabilities, and prepare the latest financial statement of the company after closure of bank account.

Step 2: Company files a STK-2 form with the respective RoC.

Step 3: Director shall furnish declaration in the e-form stating that the company does not have any dues towards any government department. This has to be certified by a Chartered Accountant/Cost Accountant/Company Secretary.

Step 4: RoC issues a public notice in a prescribed manner in (i) MCA website; (ii) Official Gazette; (iii) Largest circulating newspaper, one in English and other one in vernacular language giving 30 days' notice time for any claims and objections to be raised. If the company applying for winding up is regulated under Special Act (under section 8), approval of the concerned Regulatory body is required, otherwise not required.

Step 5: After expiry of notice period, RoC may strike off company's name and publish dissolution notice in Official Gazette.

Issues in the voluntary liquidation process

(a) There is no strict timeline in place to be followed by RoC leading to uncertainty among companies applying for liquidation. The companies that file under this section do not have any pending litigations etc., still almost half of the cases take more than a year for processing.

(b) RoC takes a lot of time to publish the final notice of strike off in newspapers. RoCs have to give notice in two leading newspapers – one in English and other one in vernacular language. These notices may run up to five to ten full size pages. Since the cost of publication of notice in leading newspapers are high, RoCs generally wait for accumulation of processing of more STK-2 forms, and once they get substantial number of cases (e.g. 1000 cases) publication of notice in newspapers is done in one go. This is entirely unnecessary in the digital age.

(c) Despite submission of an affidavit and an indemnity bond regarding no pending litigation in the affidavit, sometimes objections are raised by RoC. In many cases, RoC demands that the documents need to be resubmitted for any inconsistency in the notarisation and apostalisation, leading to delays. This is because there is no standard format of affidavit or bond decided by the RoC.

Recommended solutions

First, there is a need to put in place a strict timeline for RoC to follow.

Second, requirement of RoC to publish the final notice of strike-off in newspapers may be dropped and the regulations should allow for notice to be published on the website of MCA.

Third, there should be a standard format of affidavits with clear language that should be displayed on the website of MCA so that there are no rejections or requirements of changes at a later stage. Further, all the documents required to be submitted along with affidavit and forms should be clearly displayed.

VOLUNTARY LIQUIDATION PROCESS UNDER IBC

Section 59 of IBC states that '*A corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under this chapter*'. This is a relatively newly introduced path for voluntary liquidation, and, in theory, it should be an important process. However, as on March, 2021, 907 cases have been filed under this scheme so far and out of them, 7 have been withdrawn. Out of the total, final reports have been received for 400 cases, however, the final order of dissolution has been passed in 226 cases. 500 cases are ongoing.⁸

Process of voluntary liquidation

Section 59 of IBC together with the Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017 (Voluntary Liquidation Regulations) provide the mechanism for voluntary liquidation of a corporate person. The major steps for voluntary liquidation process under section 59 of IBC are as follows:

Step 1: Board meeting is held approving the voluntary liquidation. Section 59(3) (a) of the Code provides that majority of the directors of the company shall pass declaration regarding solvency and that the company is not being liquidated to defraud any person. Such declaration is to be accompanied with (a) audited financial statements and record of business operations of the company for the previous two years or since its incorporation, whichever is later and (b) a report of the valuation of assets of the company, if any, prepared by a Registered Valuer.

Step 2: Passing of shareholder's resolution and appointing a Liquidator. Section 59 (3) (c) of the Code provides that there shall be a resolution / special resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily and appointing an Insolvency Professional to act as the Liquidator. Further, creditors representing two-thirds in value of the debt of the company shall approve the said resolution within seven days of such resolution.

Step 3: Liquidator files the resolution to Insolvency and Bankruptcy Board of India (IBBI) and RoC within seven days as per section 59(4) of the Code and regulation 3 (2) of Voluntary Liquidation Regulations. Regulation 14 of Voluntary Liquidation Regulations requires to make public announcement (in English and regional newspapers) within five days calling stakeholders to submit claims within 30 days (section 38 (1) of IBC).

Step 4: Opening a designated bank account for cash and liquid funds and closure of existing bank account(s) and transfer of funds to designated bank account.

Step 5: Apply for No Objection Certificate (NOC) in Central Board of Direct Taxes, Central Board of Indirect Taxes and Custom, Employee Provident Fund Organisation and sectoral regulators. It is important to note that these compliances are not explicitly mentioned in the Code but these compliances are implied.

Step 6: Liquidator gives final remittance to shareholders and deposits applicable withholding taxes and then closes the bank account.

Step 7: Liquidator then submits a final report to shareholders, RoC, IBBI and National Company Law Tribunal (NCLT).

Step 8: Order is passed by NCLT.

Step 9: File copy of order for dissolution of corporate debtor (CD) with RoC vide Form INC 28 and RoC to strike-off the name of CD from RoC. This is also not specified under the Code; however, this task is also implied.

Issues in voluntary liquidation process

As on March 2021⁹, out of the 907 cases filed for voluntary liquidation under IBC, 674 cases have not yet been closed. Of the 500 cases where closure report has not been filed, nearly 30% (144 cases) have been ongoing for more than two years. Therefore, the procedure for voluntary liquidation needs to be streamlined. Some major issues are listed below:

(a) The Code does not specifically mention the need for taking NOCs from departments, however, it is implied to be taken. It is implied that NOCs from various departments including the Central Board of Direct Taxes, the Central Board of Indirect Taxes and Custom, Employee Provident Fund Organisation and other sectoral regulators needs to be taken. However, it is not explicitly mentioned in the Code. This leads to confusion regarding the procedure to be followed among the departments, Liquidators etc. as to the exact procedure to be followed.

(b) There are no Standard Operating Procedures (SoPs) in the departments for granting NOCs. The departments have no well-defined SoPs to grant NOCs for the voluntary liquidation applications. As per the current practice, the Liquidators write a letter to the head of the departments asking for any claims that the department has on the company and to grant NOCs. The department then assesses the application and responds. Since there are no SoPs, the claims raised by the departments come with a lag and not within stipulated time period.

(c) There are conflicting timelines between Income Tax Act and IBBI regulations. There are some timelines in the Code which conflict with other existing laws. One such example is section 14(2) of Voluntary Liquidation Regulation which mentions that 'last date for submission of claims, which shall be 30 days from the liquidation commencement date', whereas section 178(2) of the Income Tax Act provides that the assessing officer shall within three months from receipt of notice of appointment from the Liquidator provide details of any tax arrears.

(d) There is a lack of standard guidelines on requirements by NCLT bench. Discussion with market participants shows that certain benches of the NCLT specifically require an NOC from the relevant RoC to be submitted before taking the application for dissolution on record, even though this requirement does not emanate from regulations. This leads to lags in the processes as the company has to then go back to take the specified clearances.

(e) There is hesitancy in the banks for closure of existing bank accounts and also for opening of the new liquidation bank account by the Liquidator which is a mandatory step in the liquidation proceedings. The bank employees are not fully aware of the requirements leading to hesitancy among them.

Recommended solutions

First, the requirements of taking NOCs from various departments should be explicitly mentioned in the Code.

Second, there is a need to create well-defined SOPs with clear timelines in each department. There should be a standard form to apply for NOCs which should be available on the website of IBBI and MCA. If no response is received from the concerned department within specified time period, then it shall be deemed that the department has no objection and no pending claims. SoPs should be properly disseminated to the field officers/ assessing officers and clearly displayed on the website of each department. There should be a senior level nodal officer for making sure that the process is followed.

Third, there is a need to work on making the timelines in IBC consistent with the other existing laws.

Fourth, consistent SoPs in the form of documents, checklists, etc. required across NCLT benches should be issued. This is important for clarity among relevant stakeholders, i.e., registry, Liquidators and claimants regarding documentation. Another option that may be considered is that in ordinary cases where there are no pending litigations, there may be no need for the liquidation process to involve NCLT and the case may directly go to an Adjudicating Authority, maybe IBBI. This process is followed in some countries, including, UK, Singapore, Hong Kong and Malaysia.

Fifth, there is a need to issue guidelines to banks making them aware about the liquidation process, and powers of Liquidator for opening of liquidation accounts and closure of existing accounts. Department of Financial Services (in Ministry of Finance) may issue an internal checklist to the banks clearly specifying the list of items required for closure of accounts/opening of bank accounts of companies under voluntary liquidation and undertakings required for account closure and opening up.

CONCLUSION

There is a case for simplifying the voluntary liquidation process to improve the ease of exit for businesses in India, both under the IBC and under section 248(2) of the Companies Act.

Most importantly, there is a need for creation of a 'single window' for the entire process of voluntary liquidation. A portal should be created which combines all the steps of the liquidation process. Companies should be able to apply and submit all the forms on the portal and departments can process the applications and update it on the portal accordingly. This will help in fast-tracking and streamlining the entire process.

In the process under section 248(2) of the Companies Act, there is a need to put in place a strict timeline for RoC. The requirement of publishing the final notice in newspaper by RoC that creates

a lot of delays needs to be dropped and replaced by publishing notice on the website instead. MCA along with RoC should decide and come up with standard format of affidavits, and also deliberate on whether declarations can replace affidavits to make the process faster by avoiding the step of notarisation.

In the IBC process, there is a need to explicitly list down taking of NOCs as a part of the process. Further, well-defined SoPs with clear timelines for all departments to grant NOCs as well as for NCLT should be in place. The SoPs should detail out all the required documents, checklists etc. and should be displayed clearly on the website of departments and IBBI. A nodal officer from each department should be appointed to ensure that this is followed. There is a need to move away from Liquidators writing letters to all relevant departments for getting NOCs to having standard forms to be filled to apply for NOCs.

Overall, slight procedural changes to the voluntary liquidation process will go a long way in improving ease of doing business in India by facilitating the voluntary exit process.

Notes

¹ Opinions expressed in the article are personal and do not necessarily reflect those of the Ministry of Finance, Government of India.

² Report of the Committee on Industrial Sickness and Corporate Restructuring, Ministry of Corporate Affairs, July, 1993.

³ Report of the High-Level Committee on Law relating to Insolvency and Winding up of Companies, Ministry of Corporate Affairs, 2000.

⁴ Report of the Expert Committee on Company Law, Ministry of Corporate Affairs, 2005.

⁵ Bansal S. and Mittal M. (2020), "Ease of exit for businesses in India", Chartered Secretary, The Institute of Company Secretaries of India, Vol. 50, pp. 63-67.

⁶ Economic Survey 2015-16, Ministry of Finance Vol. I, p. 37.

⁷ Doing Business Report 2020, World Bank.

⁸ IBBI Quarterly Newsletter, January-March, 2021.

⁹ *Ibid.*

MARKET FOR DISTRESSED ASSETS IN INDIA

C. S. Setty

The enactment of the Insolvency and Bankruptcy Code, 2016 (Code/IBC) was a watershed moment in the regulatory and economic landscape in India. The Code was launched with the intent of seeking time bound resolution for non-performing assets (NPAs) and to free and reallocate resources and capital held up in these assets for a more equitable distribution of power across stakeholders and entrepreneurs. For the first time, the Code brought a collective resolution framework for insolvent companies through a creditor-in-control approach based on internationally accepted principle of insolvency resolution. The Code thus allowed a transparent and market-driven change of ownership as a route to resolution.

Over the years, with the efforts of banks, the Reserve Bank of India (RBI) and the Government, stressed assets have been significantly brought down. However, the stressed assets market in India is still approximately worth ₹ 15 lakh crore (USD 200+ billion) which includes ₹ 11 lakh crore of NPAs and another ₹ 4 lakh crore of written off loans. As a logical corollary, this indicates significant potential for investments, either through IBC or mechanisms outside IBC. The entry of global capital in this space can strengthen the process.

MAJOR PLAYERS IN DISTRESSED ASSETS MARKET IN INDIA

RBI has come out with draft guidelines for sale of stressed assets under which the transferors are free to sell stressed assets to any regulated entity with the only condition that the transferee is not disqualified in terms of section 29A of the Code. This may subsequently open the market for stressed assets to not only asset reconstruction companies (ARCs), non-banking financial companies (NBFCs) and banks but also corporates, hedge funds, Special Situation Funds etc.

Currently, there are two types of buyers in the stressed assets space- (a) strategic players focused on long term vision of building up their business through the inorganic route, and (b) non-strategic players like distressed asset funds focused on internal rate of returns (IRR).

Strategic Players

Large Corporates

Large conglomerates like Tata, Reliance, JSW, Vedanta, Arcelor Mittal, Aditya Birla Group, etc. have been active strategic players in distressed asset market in India. There is however a need to further deepen this market to attract large and medium enterprises.

This can be made possible through creation of a virtual marketplace for distressed assets for wider dissemination of information about such assets, quicker completion of corporate insolvency resolution process (CIRP), reduction in transaction costs and litigation. Delays in admission and eventual approval of resolution plans at the National Company Law Tribunals (NCLTs) have been the biggest dampeners for these investors. Addressing the gaps in infrastructure and capacity building at NCLTs is essential for widespread participation of strategic investors.

There are already examples of such strategic players in the steel sector. Several integrated and downstream steel companies were admitted to CIRP and achieved successful resolution. These include top names like Essar Steel, Bhushan Steel and Bhushan Power and Steel. Under IBC, steel sector has produced best outcomes for investors like Arcelor Mittal, Tata, Vedanta and JSW. This was largely driven by an upturn in the global and domestic steel sector following an increase in international steel prices. This sector still presents a lot of attractive opportunities for investors of stressed assets. These strategic investors were also able to raise required finance from domestic banks for acquiring these assets because of their existing strong relationship, establishing that if the acquirer and target are acceptable, banks would not shy away from financing such acquisitions.

Banks and Financial Institutions

Domestic banks, financial institutions and NBFCs are also permitted takeover of stressed assets from other banks/NBFCs provided they comply with the takeover guidelines. However, since these guidelines are quite stringent, such purchases of distressed loans never really took off in India.

However, proposed revised framework for sale of stressed assets by the RBI, as and when it is implemented, could open the market for stressed assets for both domestic and foreign banks and other regulated entities. This will also facilitate development of an active secondary loan market in terms of liquidity and price discovery and thus prompt banks to promptly dispose stressed assets from their books. This will reduce delinquency risks, accelerate proactive decision making and create a feedback loop from banks to a market for distressed loans which will become a self-fulfilling prophecy over a period of time.

Non-Strategic Players

Distressed asset and Special Situation Funds

The stressed assets and Special Situation Funds have been setting up operations in India either through local tie-ups or on standalone basis. These funds have attracted funds from Pension Funds, HNIs (high net worth individuals) and other institutions.

These funds are basically driven by quantity of supply of stressed assets, regulatory transparency and robustness and potential for returns *vis-à-vis* global return. India scores high on first two of these factors although on the third, the investors claim that Indian stressed assets cannot be considered cheap due to competition from a few strategic players. On the other hand, the lenders feel these funds drive down the asset prices because of their higher IRR expectations.

But, for Indian distressed asset market to develop, these funds are very important as they not only bring much needed capital but also their global turnaround capabilities.

To appreciate how these funds can strengthen the market, it is important to understand the role played by hedge funds in the American distressed debt market. In the 1980s and early 1990s, market dynamics coupled with deregulation fueled an active market for trading claims in companies undergoing resolution under Chapter 11 of the US Bankruptcy Code. This market provided even better opportunities than equity markets for acquiring control of distressed businesses. Consequently, hedge funds hired entrepreneurs with industry expertise who could play a more active role in turning around distressed companies. Over time, these hedge funds had a significantly salutary impact on turnarounds under Chapter 11.

Distressed debt investors could similarly turnaround failing Indian businesses under the aegis of the IBC. Currently, investors can potentially use three kinds of domestic investment vehicles - Alternative Investment Funds (AIFs), NBFCs and ARCs - to invest in companies undergoing IBC resolution. While AIFs can invest in debt as well as equity subject to certain limitations, they don't enjoy enforcement rights under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). NBFCs enjoy the enforcement rights but are subject to provisioning norms for NPAs they purchase from banks. None of these limitations applies to ARCs.

Asset Reconstruction/Securitisation Companies

SARFAESI Act created the legal framework for establishing multiple private ARCs. With the implementation of IBC and its focus on seeking to maximise the value of distressed businesses through a market related change of corporate control, ARCs should be able to fully participate in this market and attempt successful turnarounds by acquiring strategic control over distressed businesses.

A company can undergo successful resolution under the IBC and emerge solvent. In a solvent company, shareholders have stronger incentives than creditors to maximise enterprise value. This is because an increase in enterprise value automatically increases the value of its equity.

In contrast, creditors do not benefit from increases in enterprise value beyond their individual claims. Hence, if an ARC can hold more equity instead of debt in a resolved company, it would have a stronger incentive to take strategic control and ensure successful turnaround.

The SARFAESI Act, therefore, should enable ARCs to invest in a distressed company's equity, whether by infusing fresh capital or by converting debt into equity. The SARFAESI Act should also allow ARCs to acquire assets exclusively through resolution under IBC. Effectively, an ARC must act more like a private equity fund. This in turn would provide much more liquidity to the stressed asset market, improving *ex-ante* recovery rates for banks.

PREFERRED MODES OF PURCHASE OF STRESSED ASSETS BY INVESTORS

Purchase of assets under non-INR debt from lenders

As the sale and purchase of foreign currency debt by Indian banks is covered by overseas regulator where the branches are located, there have been many transactions of purchase of non-INR foreign currency debt by foreign banks and distressed asset or Special Situation Funds. With the establishment of GIFT City (Gujarat International Finance Tech-City), this market is likely to grow deeper, and we may see a greater number of transactions happening in future.

Purchasing assets through ARCs

Due to limited access to stressed asset market in India available to foreign banks and distressed asset funds, purchasing assets through ARCs have been the preferred mode of acquiring assets in India.

Bridge funding of distressed companies

Another developing area of funding of distressed assets is bridge gap funding, which can be by way of interim finance or part funding of resolution plan.

Purchases through CIRP or through liquidation as a going concern

Purchases through CIRP route can be the cleanest route for any stressed asset fund or investor for acquiring stressed asset. Hence, it is important to evaluate certain aspects of IBC which are of major concern to investors to make IBC the preferred mode of investment in stressed assets.

FUNDING OF ACQUISITION OF STRESSED ASSETS

Funding of resolution plans under ICA/CIRP

A new area of underwriting loans to resolution applicants for acquiring assets under CIRP or Inter Creditor Agreements (ICAs) is evolving in India. Some very successful transactions include Tata Steel's acquisition of Bhushan Steel where a consortium of banks funded the resolution plan.

In the case of Ruchi Soya acquisition by Patanjali group, a consortium of banks led by SBI funded the resolution plan.

This is a good opportunity for banks to fund the corporate debtors (CD) resolved through IBC as they can discover the real price of assets in the market, create new funding opportunity to a known CD under a new management and recover a significant part of their dues from distressed asset through a resolution plan.

Litigation finance in India

The Indian market has been a busy participant in the growing international litigation finance industry after the implementation of IBC and other reforms. There are several examples of Indian parties funded arbitration and litigations outside India. There are also reported examples where foreign parties were funded for claims against Indian parties and are looking to establish presence in India from several jurisdictions. International funders are also looking to invest in India-seated arbitrations and executions. The usual focus is the infrastructure industry which has seen significant claims and awards against Indian state-owned enterprises/ state agencies.

There are also a few domestic players who have entered litigation funding space. There have been a couple of reported deals in the market. The structure of these deals is closer to a debt or equity investment rather than classic litigation finance. Some smaller players are attempting crowdfunding and online funding of local litigations and arbitrations. However, these players have an insignificant market share or lack any real litigation finance experience. Thus, the local market remains largely unorganised with no significant player. Hence, development of litigation funding provides an added attraction to investors in stressed asset markets who would like to reduce their regulatory and litigation risks while acquiring assets.

Compromise funding

Another interesting by-product of behavioural change brought about by the IBC is development of compromise funding in India. The promoters of defaulting CDs are now eagerly looking out to funders who can provide funding of a compromise proposal with lenders before the lenders take the CD to insolvency court and promoters lose control to Resolution Professional. A number of private equity funds, NBFCs and even ARCs are active in developing compromise funding market which bodes well for deepening the secondary market for loans and advances.

The promulgation of IBC (Amendment) Ordinance, 2021 introducing pre-packaged insolvency regime may prove to be an accelerator for compromise funding. In our opinion, many micro, small and medium enterprise (MSME) borrowers may like to submit a base resolution plan in the form of one-time settlement (OTS) proposal, funding of which can quickly conclude the pre-packaged insolvency resolution process.

Rupee denominated loans

To increase the participation and more efficient price discovery, international investors can also be allowed to purchase rupee denominated non-performing loans (NPLs) directly from the banks without having to go through the ARC route, which is the norm as of now. This can make the markets more lucrative for them as it would give them full control over their investment, or at the very least, control along with co-investors whose interests are aligned. It would also help them price the loans better as they would not have to pay ARC fees which affects their IRRs. In the international market, USD denominated loans, whether performing or non-performing are traded very frequently under an assignment from the seller to the buyer and the contract for this is governed by the Loan Market Association guidelines for trading of loans (similar to International Swaps and Derivatives Association for derivatives). If sale/purchase of NPLs is allowed under a similar route wherein non-resident External Commercial Borrowings (ECB) eligible buyers are allowed to buy rupee denominated loans from Indian banks it will cover a vast majority of international investors who want to participate in the NPL market in India without having to set-up local presence.

One Time Settlement

OTS is another effective route for distressed companies to settle with banks. To make OTS more successful and to increase the depth of this market, international investors can be allowed to participate in OTS via ECBs issued by the borrower. Given the borrowers are typically stressed entities, the cap on ECB pricing limits the number of investors as return expectations are typically higher than L+450bp (L stands for London Interbank Offered Rate) which is permitted by RBI. This is of course more relevant for businesses that have at least a part of their revenue which is dollarised and borrowing via ECBs acts as a natural hedge.

CONCLUSION

The stressed asset market is still evolving with a rapidly changing legal and policy landscape, including regular amendments to IBC, the RBI's June 7, 2019 circular, new evolving jurisprudence, expected regulatory changes in ARC landscape etc., that aim to address key concerns faced by different stakeholders, including investors.

IBC has played a pivotal role in evolution of a wide and deep distressed assets market in India. While the Code has proved to be a successful piece of legislation, the Insolvency and Bankruptcy Board of India (IBBI) as regulator has performed an outstanding job of establishing and popularising the insolvency framework under IBC. NCLT, as an institution, plays a crucial role in ensuring a time-bound process, bringing transparency, fairness and certainty and thus maintenance of confidence for both creditors and investors in the CIRP.

However, there are certain areas where the IBC can focus to ease the issues faced by stressed investors. Delayed CIRP cases extending beyond 270 days has left capital of many investors blocked. Since

delays are mostly due to legal issues including frivolous litigations, and the need for clarification on certain judicial provisions, investors face a high degree of uncertainty in their investment outcomes. Investors believe that the Government of India and IBBI may take more capacity-building measures to strengthen the NCLT infrastructure, capacity building of judges and consider having dedicated insolvency benches and supporting administrative teams. Ensuring uniformity of judgments across NCLTs will also go a long way in rebuilding investors' confidence in insolvency regime.

Establishment of the National Asset Reconstruction Company Limited (NARCL) and India Debt Resolution Company Limited (IDRCL) will facilitate a better and seamless interface for investors interested in the stressed assets that are likely to be transferred to these companies as they are required to deal with one entity instead of multiple lenders.

Distressed asset market in India has tremendous potential. Sectors which present opportunities include power, construction, base metals, textiles, electricity, mining, gems and jewelry and food processing, as the bulk of NPAs is concentrated in these sectors.

The Government is focusing heavily on the infrastructure sector to revive growth and it can generate significant returns for investors. For example, India's power sector presents a unique opportunity for distressed investments which can generate decent returns through a combination of financial, operational and contractual interventions. With expected transfer of many of these assets to these newly created NARCL and IDRCL, these sectors offer even better resolution opportunities.

Considering the growth projections of the country for next 10 years, a dollar invested in a distressed asset today has the possibility of giving multiple returns. However, for any investor, time is of great value and a resolution proposal or plan approved within two months or 12 months can make or break the plan. So, all efforts should be made to make the process time efficient. Several progressive steps that are being taken in statutory, judicial and regulatory areas will help in developing a seamless and vibrant market for distressed assets in India.

SIZING UP INSOLVENCY IN INDIA

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The Insolvency and Bankruptcy Code, 2016 (Code/IBC) came into effect a little over five years ago to provide a mechanism to resolve cases of insolvency. The first corporate insolvency resolution process (CIRP) began in December, 2016. Since then, 4,376 such processes were initiated till March, 2021. Given that India has over 1.3 million registered and active companies, insolvency of only a little over 4,000 seems extraordinarily small. According to the Ministry of Corporate Affairs, about 11,000 companies are liquidated or closed in a year. Part of the reason for the low CIRP cases could be that the IBC was suspended in 2020 as a response to the COVID-19 induced lockdown. Still, given that the IBC legislation was billed as a great reform to address a serious impediment to growth, it is odd to find that distress affects an extremely thin sliver of companies in India. The low number of cases is also surprising because the Economic Survey² of the Government of India had repeatedly highlighted the problem of the Twin Balance Sheet (TBS) Syndrome which, it claimed, held up investments and growth in India. TBS Syndrome refers to the stressed balance sheet of banks because of the high proportion of non-performing assets (NPAs) on the one hand and the stressed balance sheets of companies on the other.

How serious could the problem of corporate insolvency be in India? Is the low CIRP a true reflection of the corporate conditions in India or is the TBS problem real? Both cannot be simultaneously true.

Public policy interest in corporate distress is often triggered by the impact it has on the health of the banking system. The focus is mostly on the size of the NPAs of banks. An analysis of the size or nature of the problem of enterprises in distress has been conspicuously absent. The attention that enterprise distress got, as a result, was mostly of suspicion of malfeasance – of wilful defaulters (of select large bank loans) and some dramatic bank frauds. Clinical analysis of broken businesses bereft of the spectacle of dramatic escapades has been largely missing.

We aim to understand the size of corporate distress in India and throw some light on the contradiction

between the low cases of CIRP and the TBS proposition.

Our focus is on understanding the incidence of distress of enterprises in India. We aim to unravel the rise and fall of cases of distress in Indian firms since 1991. Is stress a fixed constant factor over time or does it fluctuate wildly from year to year or are there time trends of corporate distress? A 30-year time period of the performance of the Indian corporate sector is expected to throw some light on such questions.

A business is not required to disclose distress in the normal course of its business. Distress is also not defined. Perhaps, it cannot be defined satisfactorily or objectively. Distress defies definition because it is not a binary state. At best, there can be critical values of select parameters that reflect possible distress of one or more kinds. Default on a promised payment is a potentially useful indicator. But, using a single default as a binary to classify defaulting companies as distressed is unsatisfactory. Worse still, a default on a promised payment could be tactical and even unethical if the enterprise feels it can afford to be brazen. It could be so without being driven by distress. A default is neither a necessary nor a sufficient indicator of distress. It is a good but inadequate indicator. Distress is mostly a process that is often reflected in the steady deterioration of select financial ratios of an enterprise.

Published audited financial statements of companies are arguably the best publicly available source of information to determine distress in firms. Large investors, lenders and clients may demand and possibly get faster and more detailed information than provided by the published audited financial statements. But, a large set of published audited financial statements has advantages over selective detailed information on just few companies. The former helps us draw larger, generalised inferences. We use CMIE's Prowess database (Prowess) that provides a large database drawn from financial statements of companies. The database goes back to 1991.

Prowess contains data on over 51,000 companies. The number of companies for which data is available for a year has steadily increased over time. There were just a little over 2,000 companies in 1990-91. This rose to 8,891 in 2000-01 and 26,873 in 2010-11. It has remained over 30,000 per year since 2015-16. Our interest is in non-finance companies. Their count has risen from 1,948 in 1990-91 to over 25,000 since 2015-16. Prowess offers a standardised database which ensures better inter-year and inter-company comparability of the data than the raw data presented by companies in their financial statements.

Companies can face several kinds of challenges that could culminate into distress. This distress is ultimately reflected in financial statements. We use mostly, two measures of financial health and three measures of operational health to understand the problem of distress in Indian companies since 1990-91.

Financial health is measured by the interest cover ratio (ICR) and the debt-to-equity ratio (DER). If a company is unable to generate sufficient surplus to pay the interest cost of its borrowings then the company is expected to be unable to raise more financial resources and therefore can be considered

of financial ill-health. Of course, in today's world of excess capital, companies can sail through such financial stress if equity investors are willing to fund losses for a long term. That, however, does not deny the fact that a company with inadequate ICR is financially distressed and a company with a low and falling ICR is a company moving towards financial distress.

A high DER is a sign of high financial risk and possibly, financial weakness. Leverage could go up because of debt-funded expansion plans which could indicate some risk to the lenders and to the company. If the expansion fails to deliver additional profits the company may face difficulties in servicing the additional borrowing. A company may also be forced to borrow more than usual because it fails to generate adequate cash revenues from its business. A rise in gearing because of the latter indicates financial weakness. It is easy to see that a combination of increasing leverage and falling ICR is a reasonable sign of growing financial stress.

The main sign of operational stress is when a company cannot create enough surplus from its operations and when the current assets fall short of current liabilities. A combination of low operating profit margin and a low current ratio would be one sign of operational stress.

Arguably, five ratios to indicate stress seem too many. But not many companies fail on all accounts simultaneously. There have been only 245 observations out of a total of 4,21,377 observations over a period of 30 years when a non-finance company failed on all five accounts. These are observations from the audited financial statements of 40,165 companies studied over the period 1990-91 through 2019-20.

We first embark to draw a picture of possible distress of the non-finance companies as a whole. We do this to try and understand if the corporate sector as a whole is facing or whether it did face any financial or operating stress during the past 30 years. Our analysis is based on non-finance companies. Some companies will always be stressed at any point in time. Are these significant enough to impact the performance of the corporate sector as a whole? To answer this question, we add, appropriately, the financial statements of all non-finance companies to build a time-series of their collective performance.

The resultant time-series does not indicate any extraordinary stress in the Indian corporate sector in its 30-year history since 1990-91. Sure, at any point in time there are always some companies that are stressed and the rest that are not. But the sum of all of them does not paint a picture of extraordinary stress.

On an aggregate basis, the ICR of all non-finance companies collectively was never less than 1. In fact, the ICR has been over two-times for most of the years indicating that the corporate sector was collectively in a good position to service its loans. The average ICR during the 30-year period was a comfortable 2.38. The median was also comfortable at 2.08 with an inter-quartile range of 1.79 to 2.56. The minimum ICR of all non-finance companies in any year was 1.56. This was in 1998-99. ICR was low at 1.79 times in the 1990s. It improved dramatically in the 2000s to 3.2 times and then moderated to 2.14 times in the 2010s.

A less useful but relevant ratio is the debt service coverage ratio (DSCR) derived from the published financial statements of companies. Such a ratio can be derived somewhat meaningfully only since 2010-11 when the format of the balance changed to reflect current and non-current liabilities. The ratio, as computed from the financial statements, measures the extent to which cash profits before interest payments can cover principal and interest payments on loans. The limitation of this ratio is that it includes the servicing of short-term borrowings as well which are usually perpetually funded through new short-term borrowings. Nevertheless, the year-to-year change in the DSCR is a useful indicator to understand the direction in which corporate liquidity is moving. Is it getting tighter or comfortable?

In 2011-12, the DSCR was 0.49. This fell to 0.46 in 2012-13 but recovered partially to 0.47 in 2013-14 before springing back to 0.49 in 2014-15 and 2015-16. Then, it improves further to 0.51 in 2016-17 and has remained above 0.5 since then. It was 0.5 in 2017-18, 0.53 in 2018-19 and 0.52 in 2019-20. Evidently, the health of the Indian corporate sector measured by the DSCR has only improved since 2011-12.

The Indian corporate sector was also never over-leveraged – not any time in the past 30 years. The average leverage was 1.2 and the maximum leverage was 1.85, way back in 1991-92. Leverage was high during the early 1990s. It averaged at 1.4 during the 1990s and then declined to 1.09 during the 2000s and 2010s. A handsome increase in profitability during 2003-04 through 2007-08 ensured a drop in the gearing ratio to 0.9. Aggregate gearing has been modest since 2004-05. It has averaged at 1.04 since then with a max value of 1.17 in 2013-14. Companies have been distinctly reticent in borrowing in recent times although the leverage has been very low providing adequate headroom for additional borrowing.

The aggregate values discussed above do not betray any financial stress in Indian non-finance companies during the three decades since 1990-91. But there have been signs of operational stress. In 2008-09 and in 2017-18 non-finance companies reported a current ratio of less than 1. They could not have, apparently, settled their current liabilities using their current assets in these years. This apparent stress continues to persist. In 2018-19 and in 2019-20, the two latest years for which data of a reasonable sample of companies is available, the current ratio was uncomfortably low at 1.01. But this operational stress has not translated into financial stress implying that companies could manage to finance this working capital gap comfortably. The cost of borrowing has been declining since 2015-16. It has fallen from an average of 9% in the year 2015-16 to 8.4% in 2019-20. The gearing ratio did not deteriorate during this period because of the apparent operational stress.

Indian non-finance companies have enjoyed an operational profit margin of over 12% through most of the 30 years since 1990-91. Such margins declined in the 2010s to 11%. Cash profits, that matter the most when studying distress, have been comfortable at about 8%. The median cash profit margin was 7.5%. Like operating profit margin, cash profit margins have also declined in the 2010s. These averaged at 7.2%. Although profit margins have declined, they have been comfortable at the aggregate level.

Profit margins have declined during the 2010s and the current ratio has moved uncomfortably close to 1 during the same period but, there is no financial stress at the aggregate level. ICR is comfortable at 2.1 times and DER is comfortable at 1.1 times.

The Economic Survey of 2015-16 stated '*Corporate profits are low while debts are rising, forcing firms to cut investments to preserve cashflow.*'³ There is no evidence to support this. Operating profit margins were close to 10% and cash profits were over 6% of total income in 2014-15 and net fixed assets grew by 13.3% in the year. The profit margins were only slightly lower than historical averages but they do not reflect even the slightest distress of corporate finances during the times. More importantly, the corporate sector was investing into new capacities at a reasonable pace.

The Economic Survey of 2016-17 says '*firms abandoned their conservative debt/equity ratios and leveraged themselves...*'⁴ Again, the Survey provides no data to back this sweeping statement on the corporate sector. It quotes a study of distressed assets by Credit Suisse. This study does not represent the corporate sector as a whole but only select distressed business groups. The Credit Suisse studies in this regard are about distressed assets of banks in corporate India. They are not a study of corporate India. We see that the DER of the non-finance companies was around 1.16 during 2014-15 and 1.13 during 2015-16. None of this reflects an abandoning of conservative leveraging.

The TBS Syndrome described by multiple Economic Surveys of the Government reflected a concern regarding the rising NPAs of the public sector banks caused by select investments by infrastructure companies. The Economic Surveys were not addressing a problem of the corporate sector at large. The Survey's focus was on the concentration of a large proportion of bank borrowing in companies with an ICR of less than 1. A generalisation of this problem – a risk of the banking system – as a proxy for the financial health of the corporate sector as a whole is a mistake. In that sense there was no TBS problem. Such a TBS Syndrome never existed in India. There was just a problem with the balance sheet of banks which the Economic Surveys incorrectly branded as a TBS Syndrome.

Stress, if any, in the corporate sector was not a cause for a slowing down of investments. In fact, since there was no extraordinary stress, investments continued to grow robustly. Net fixed assets grew by 18.1% in 2015-16. The select business groups that had over-leveraged or the concentration of bank loans in companies with low ICR did not deter the corporate sector from continuing to invest into fixed assets.

The Economic Survey of 2016-17 suggested that the corporate stress that was concentrated in select large groups was spreading to smaller companies by mid-2016 and such a trend was expected to continue to spread in 2017.⁵ Data does not bear out such a prognosis. The DER was 1.13 in 2015-16, which was lower than it was in the preceding two years. Further, it fell to 1.08 in 2016-17 and then to 1.04 in 2017-18.

The financially distressed corporate sector portrayed by the TBS Syndrome in successive Economic Surveys was imaginary or at best, a poor extrapolation of a problem limited to a few corporate houses that had borrowed from banks to invest into large infrastructure projects that failed.

The corporate sector is not financially stressed but, in recent years it is evidently uninterested in making investments. From 2016-17, growth in net fixed assets of the corporate sector has systematically remained below 10%. The average annual growth in net fixed assets of non-finance companies during 2016-17 through 2019-20 was 7.9%. This compares poorly with the average annual growth of 15.7% in the preceding 11 years (2005-06 through 2015-16).

It is noteworthy that the Indian corporate sector slowed down investments during a period when their ICR was improving, leverage was declining and profitability was growing. Poor financial health was not the reason for the slowing down of investments since 2016-17. TBS was not the problem.

On the eve of the pandemic-stricken 2020-21 and during a year of a steep fall in India's growth rate in 2019-20, the Indian corporate sector's balance sheet was reasonably resilient. Its leverage was 1.11 and its ICR was 1.96. It made an operating profit of 11.5% and a cash profit of 7.4% on total income. Its cost of borrowing was the lowest in eight years. But, its growth in net fixed assets at 9.75% was lower than the average annual growth of the 1990s, which was 17.4%, or the 2000s which was 12.2% or even the 2010s which was 11.3%.

Although the Indian corporate sector has not been stressed in the 30 years since 1990-91, we cannot infer that there was no stress. At any point in time some companies are stressed either financially or on operational parameters. It is evident from the earlier discussion that these do not mar in any significant way the overall health of the Indian corporate sector. Now, we see if the count of stressed companies is large or modest. We assess the proportion of stressed firms in the study sample.

We study 40,165 non-finance companies for which normalised data from published audited financial statements was available in the Prowess database for at least some of the years from 1990-91 through 2019-20. These companies yielded 4,21,377 observations where each observation corresponds to the financial statement of one company in one year. The number of companies for which data is available in each year has increased over the 30-year period. There were 2,467 companies for which data was available in 1990-91. By the mid-2010s, the number of companies available in a year was over 25,000. Thus, there were around 2,500 observations per year in the early 1990s and there were over 25,000 observations per year in the mid-2010s.

An ICR that is less than 1 is a clear sign of financial distress. This ratio, more than any other, lends itself to a binary narrative of a clear sign of financial stress when the ratio is less than 1 or a possible no-stress status if the ratio is more than 1. Stress could have begun earlier when a company cannot pay its other bills or more importantly the principal amount of its borrowing. But data on such failures is not directly available systematically for all companies from public sources. As a result, ascertaining the transition towards this distress is difficult. However, when the ICR is less than 1, the stress is almost an indisputable fact.

Only 4.4% of the observations showed such a sign of this stress in the 30 year of history of the Indian corporate sector. Only 8,732 companies out of the 40,165 under study experienced this financial stress over a 30-year period. This is surprisingly small given the scary picture painted by

the Economic Survey. The stress of inability to pay interest on borrowing was more in the 1990s when 6.6% of the observations showed this stress compared to 3.9% in the 2000s and 4.4% in the 2010s.

Economic Survey 2016-17⁶ states

Higher costs, lower revenues, greater financing costs – all squeezed corporate cash flow, quickly leading to debt servicing problems. By 2013, nearly one-third of corporate debt was owned by companies with an interest coverage ratio less than 1 (“IC1 companies”), many of them in the infrastructure (especially power generation) and metals sectors. By 2015, the share of IC1 companies reached nearly 40 percent... IC1 share remained above 40 percent in late 2016.

The Survey mixes the problem of an inability of corporates to service debts with a different problem – that of the share of total corporate debt in stressed companies. The latter is not a measure of the former. In 2013 only 4.4% of the companies could not pay interest on their loans. This ratio rose to an average of 5.3% of the companies. Corporate stress was not widespread. It was limited to 4-6% of the companies. The problem was that bank debt was largely stuck in stressed companies. But, that is a problem of the banking system and the 4-6% companies, but not of the corporate sector as a whole.

Most companies that are stressed are so because of their inability to generate cash profits after having paid interest on their borrowings. On an average, in a year, nearly one-fifth of the companies are stressed by this measure. There is a small increase in this stress over the three decades under study. In the 1990s, 19.3% of the observations showed no cash profits generated. In the 2000s this proportion rose to 21.4%. Then, in 2010s, it rose again marginally to 21.6%. But the period when Indian companies faced the biggest cash profits challenge was during 1996-97 to 2002-03. During these seven years, 27.3% of the companies could not generate cash profits. During 2001-02, nearly 30% of the companies could not produce cash profits. Compared to this period, the mid-2010s when the Economic Surveys raised an alarm, less than 23% of the companies could not generate cash profit.

Lack of cash profits did not lead to other forms of distress in companies. While about 20.8% of companies faced negative cash profits in a year, only 7.5% of companies faced negative cash profits along with a current ratio that is less than 1 and an operating profit margin that is less than 1%.

Now, here is the next question: If a company faces financial stress, how long does it last? Of the 40,165 companies under study, 8,732 companies experienced an ICR of less than 1 at least once since 1990-91. Of these 4,362 companies experienced this stress for only one year. The number of companies that experienced this for two consecutive years is 1,954, for three consecutive years is 1,069 and for four consecutive years is 581. This shows that for more than half of the companies that face financial stress, the experience does not last for more than one year. It does not last for more than two years for a quarter of the afflicted companies.

In 2018-19 and 2019-20, the Prowess database shows 1,754 companies that could not service the

interest component of their borrowing. The number of companies that could not service principal or interest is likely to be higher and, possibly close to the 4,376 CIRPs with the IBC.

It is therefore possible to infer that the number of companies with the IBC is a true reflection of the level of distress in corporate India and the TBS Syndrome was an overhyped reaction to an incorrect analysis of the situation.

There could be financial stress in smaller companies that are not captured by the Prowess database. But the transaction cost for them to go through the IBC process could not be worth the expected outcome.

The apparently small size of the problem of insolvency, however, does not reduce the importance of a framework that deals with insolvency in a market-driven framework.

NOTES

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² Economic Survey 2015-16 and 2016-2017, Vol I, Ministry of Finance.

³ Economic Survey 2015-16, 'Addressing the Twin Balance Sheet Challenge', Box 1.6, Vol I, Ministry of Finance.

⁴ Economic Survey 2016-17, Vol I, Ministry of Finance, para 4.16.

⁵ *Ibid*, para 4.33.

⁶ *Ibid*, para 4.19.

Appendix: Performance of non-finance companies

	Interest cover	Debt to equity ratio	Current ratio	PBDITA net of P&E&OI&FI as % of sales	Cash profit as % of total income	Growth in borrowing	Interest incidence	Growth in net fixed assets
Unit	Times	Times	Times	%	%	%	%	%
1990-91	1.80	1.76	1.12	11.32	6.60	14.84	10.65	14.57
1991-92	1.72	1.85	1.16	12.17	6.74	18.15	11.90	20.32
1992-93	1.61	1.62	1.23	12.75	7.44	16.61	11.52	17.19
1993-94	1.85	1.44	1.23	13.35	7.87	11.83	11.18	19.03
1994-95	2.12	1.19	1.19	13.65	8.95	15.99	11.19	32.65
1995-96	2.14	1.15	1.10	13.56	8.70	14.21	11.46	21.19
1996-97	1.79	1.26	1.09	12.33	7.46	17.82	11.71	15.92
1997-98	1.72	1.33	1.05	12.84	7.62	15.03	11.00	15.78
1998-99	1.56	1.41	1.03	12.60	7.01	8.16	10.89	9.66
1999-00	1.62	1.34	1.06	12.22	7.40	5.02	10.49	7.96
2000-01	1.67	1.34	1.05	11.87	7.17	6.98	10.66	8.29
2001-02	1.71	1.34	1.04	12.58	8.25	5.11	9.76	6.97
2002-03	2.15	1.29	1.06	13.47	9.04	2.19	9.04	4.73
2003-04	3.20	1.12	1.03	13.74	10.59	3.92	7.56	5.61
2004-05	4.00	1.03	1.11	13.42	10.53	6.16	7.17	5.48
2005-06	4.25	1.00	1.12	12.99	10.46	17.99	6.80	15.75
2006-07	4.85	0.91	1.12	13.50	11.18	22.62	6.85	16.48
2007-08	4.44	0.90	1.11	13.36	11.01	25.82	7.39	17.25
2008-09	2.61	1.01	0.98	11.93	8.21	29.31	8.27	22.94
2009-10	3.08	0.96	1.01	12.72	9.71	12.94	7.42	18.50
2010-11	2.95	0.97	1.06	12.23	9.03	18.28	7.45	13.52
2011-12	2.41	1.05	1.05	11.22	6.90	19.43	8.20	13.05
2012-13	2.07	1.14	1.05	10.86	6.68	14.85	8.45	12.40
2013-14	1.95	1.17	1.04	10.00	6.38	10.83	8.62	11.50
2014-15	1.85	1.16	1.06	9.51	6.35	7.35	8.78	13.25
2015-16	1.86	1.13	1.03	10.70	6.74	7.06	9.00	18.07
2016-17	2.02	1.08	1.03	11.35	7.31	4.50	8.93	9.10
2017-18	2.07	1.04	0.98	11.47	7.22	5.46	8.73	7.19
2018-19	2.26	1.00	1.01	11.23	7.47	8.19	8.69	5.55
2019-20	1.96	1.11	1.01	11.50	7.43	11.42	8.40	9.75
2020-21	5.76	0.45	1.31	17.61	15.05	-7.00	7.58	5.52

Average	2.38	1.20	1.07	12.21	8.12	12.60	9.27	13.66
Median	2.05	1.15	1.06	12.28	7.47	12.39	8.86	13.39
First quartile	1.79	1.03	1.03	11.38	7.05	7.00	8.22	8.4925
Third quartile	2.56	1.34	1.11	13.26	9.01	17.52	10.83	17.235
Minimum	1.56	0.90	0.98	9.51	6.35	2.19	6.80	4.73
Maximum	4.85	1.85	1.23	13.74	11.18	29.31	11.90	32.65
Average:								
1990s	1.79	1.44	1.13	12.68	7.58	13.77	11.20	17.43
2000s	3.20	1.09	1.06	12.96	9.62	13.30	8.09	12.20
2010s	2.14	1.09	1.03	11.01	7.15	10.74	8.53	11.34

Year	Count of companies						Proportion of companies						
	Total	Interest cover ratio < 1 & debt-equity > 0.5	Debt-equity ratio > 3	Current ratio < 1 & operating profit margin < 1%	Cash profit < 0	Current ratio < 1 & operating profit margin < 1% and cash profit < 0	Interest cover < 1 & debt-equity ratio > 3 & current operating profit margin < 1% and cash profit < 0	Debt-equity ratio > 3	Current ratio < 1 & operating profit margin < 1%	Cash profit < 0	Current ratio < 1 & operating profit margin < 1% and cash profit < 0	Interest cover < 1 & debt-equity ratio > 3 & current operating profit margin < 1% and cash profit < 0	
1990-91	2,467	151	406	142	324	114	1	6.12	16.46	5.76	13.13	4.62	0.04
1991-92	2,830	174	438	209	372	138	1	6.15	15.48	7.39	13.14	4.88	0.04
1992-93	3,507	249	470	321	517	188	1	7.10	13.40	9.15	14.74	5.36	0.03
1993-94	4,564	218	420	357	581	225	1	4.78	9.20	7.82	12.73	4.93	0.02
1994-95	5,582	231	372	436	728	272	4	4.14	6.66	7.81	13.04	4.87	0.07
1995-96	5,812	330	428	579	1,051	401	1	5.68	7.36	9.96	18.08	6.90	0.02
1996-97	5,559	429	485	696	1,348	535	5	7.72	8.72	12.52	24.25	9.62	0.09
1997-98	5,839	502	599	860	1,605	680	4	8.60	10.26	14.73	27.49	11.65	0.07
1998-99	6,736	558	701	1,069	1,964	866	5	8.28	10.41	15.87	29.16	12.86	0.07
1999-00	7,121	558	748	1,090	1,955	875	4	7.84	10.50	15.31	27.45	12.29	0.06
2000-01	7,417	555	726	1,151	2,052	907	3	7.48	9.79	15.52	27.67	12.23	0.04
2001-02	8,085	539	744	1,388	2,402	1,052	4	6.67	9.20	17.17	29.71	13.01	0.05
2002-03	10,357	507	981	1,616	2,600	1,093	4	4.90	9.47	15.60	25.10	10.55	0.04
2003-04	11,832	356	1,060	1,714	2,550	1,035	2	3.01	8.96	14.49	21.55	8.75	0.02

2004-05	13,886	346	1,277	1,934	2,645	1,036	4	2.49	9.20	13.93	19.05	7.46	0.03
2005-06	15,186	341	1,420	1,967	2,641	973	3	2.25	9.35	12.95	17.39	6.41	0.02
2006-07	16,267	370	1,632	1,973	2,667	886	7	2.27	10.03	12.13	16.40	5.45	0.04
2007-08	17,673	504	1,847	2,167	3,096	965	2	2.85	10.45	12.26	17.52	5.46	0.01
2008-09	19,435	700	2,055	2,450	4,033	1,166	12	3.60	10.57	12.61	20.75	6.00	0.06
2009-10	20,057	607	2,089	2,283	3,743	1,015	5	3.03	10.42	11.38	18.66	5.06	0.02
2010-11	20,351	556	2,225	2,030	3,613	971	11	2.73	10.93	9.97	17.75	4.77	0.05
2011-12	21,209	819	2,652	2,138	4,390	1,198	15	3.86	12.50	10.08	20.70	5.65	0.07
2012-13	20,863	919	2,766	2,015	4,506	1,243	15	4.40	13.26	9.66	21.60	5.96	0.07
2013-14	23,172	1,203	3,304	2,525	4,999	1,586	18	5.19	14.26	10.90	21.57	6.84	0.08
2014-15	25,732	1,401	3,734	2,763	5,576	1,781	19	5.44	14.51	10.74	21.67	6.92	0.07
2015-16	26,339	1,353	3,672	2,849	6,046	1,922	19	5.14	13.94	10.82	22.95	7.30	0.07
2016-17	25,501	1,215	3,317	2,783	5,847	1,849	27	4.76	13.01	10.91	22.93	7.25	0.11
2017-18	25,379	1,103	3,031	2,701	5,672	1,768	19	4.35	11.94	10.64	22.35	6.97	0.07
2018-19	24,247	962	2,603	2,587	5,339	1,670	14	3.97	10.74	10.67	22.02	6.89	0.06
2019-20	18,372	792	1,664	1,920	4,206	1,228	15	4.31	9.06	10.45	22.89	6.68	0.08
Total observations	4,21,377	18,548	47,866	48,713	89,068	29,638	245	4.40	11.36	11.56	21.14	7.03	0.06
Average	14,046	618	1,596	1,624	2,969	988	8	4.97	11.00	11.64	20.78	7.45	0.05
Median	14,536	547	1,349	1,927	2,643	994	5	4.77	10.43	10.91	21.56	6.87	0.06
First Qrtl	6,063	349	625	912	1,693	727	3	3.67	9.24	10.00	17.58	5.45	0.03
Third Qrtl	20,735	812	2,509	2,254	4,344	1,221	15	6.14	12.88	13.68	22.95	8.43	0.07
Minimum	2,467	151	372	142	324	114	1	2.25	6.66	5.76	12.73	4.62	0.01
Maximum	26,339	1,401	3,734	2,849	6,046	1,922	27	8.60	16.46	17.17	29.71	13.01	0.11
Average:													
1990s	5,002	340	507	576	1,045	429	3	6.64	10.85	10.63	19.32	7.80	0.05
2000s	14,020	483	1,383	1,864	2,843	1,013	5	3.85	9.74	13.80	21.38	8.04	0.03
2010s	23,117	1,032	2,897	2,431	5,019	1,522	17	4.42	12.41	10.48	21.64	6.52	0.07

PART V QUICK STEPS

MEDIATION: A POWERFUL TOOL IN INSOLVENCY AND BANKRUPTCY RESOLUTION

A. S. Chandhiok

ECONOMIC SITUATION

The world continues to be in the grip of the COVID-19 pandemic. Economies all over are showing unprecedented downward trends, notwithstanding the increasing hope and expectation that the pandemic is on the decline. GDP growth is in the negative. Corporate entities, partnerships and individuals and industry at large are reeling under crises with non-availability of cash resources, compelling both financial and operational creditors ultimately to resort to proceedings under the Insolvency and Bankruptcy Code, 2016 (Code/IBC) after the statutory embargo which lasted till March 24, 2021. The projected fiscal deficit for the FY 2021-22 are approximately 6.8% as against consensual 5.5%, but for the year 2021, it is 9.5% as against 7.5% of the GDP.

Both empirical and anecdotal evidence suggests that the Code has rebalanced the relationship between the debtors and the creditors to a large extent. Investments, asset monetisation and a timely exit are to be given priority, as they go hand in hand with a sustainable economic growth. The IBC is one of the finest economic laws and has largely achieved its object of promoting entrepreneurship, corporate reorganisation and insolvency resolutions in a time-bound manner. Bankruptcy law, the need of the hour, has also been made operative. Over a short span of just a few years, through the process of government intervention, concurrent regulatory action and adjudication, the Code and its underlying rules and regulations have been proactively interpreted and modified to respond to market needs; the result is the establishment of a renewed insolvency jurisprudence. In fact, the non-

performing assets (NPAs) of the banks have declined since the Code was made operative in 2016, with the total NPAs or bad loans of banks declining by ₹ 61,180 crore to ₹ 8.34 lakh crore at the end of March, 2021, as a result of various steps taken by the Government.

However, owing to a backlog of cases in insolvency, bankruptcy, oppression and mismanagement matters, etc., timely hearing has become a problem. Added to this is the influx of newly instituted proceedings, both under the IBC and the Companies Act, 2013, due to which the National Company Law Tribunals (NCLTs) and the National Company Law Appellate Tribunal (NCLAT) are overburdened. This is further aggravated by the fact that there are a large number of vacancies in the tribunals.

In insolvency, though no provision is incorporated presently in IBC (though there is one under the Companies Act, 2013), yet there are instances where the Hon'ble NCLAT has utilised 'mediation' to bring a fruitful end to an insolvency process (*Parminder Singh v. Intec Capital Limited*, 2020 (1) TMI 150). The Hon'ble NCLAT's order in Jet Airways is a glowing example where the Administrator, appointed in the Netherlands, was allowed to be part of the committee of creditors in India for a collaborative effort to ultimately resolve and make the airlines available as part of economic progress.

Official records indicate that as of March, 2021 49.61% of corporate insolvency resolution processes that have been concluded ended up in liquidation as against 13.41% that got resolved; with recovery under the IBC close to 42.5%. In such a scenario, timely decision whether to adopt a resolution plan or liquidate a company, notwithstanding that a step in this direction, that is, the pre-packaged insolvency resolution process (PPIRP/pre-pack) has already come into being, assumes great importance. Even in the pre-pack, mediation is extremely relevant and would play an important role to iron out differences between the parties themselves.

MEDIATION – A SUCCESS STORY

Mediation is not alien to insolvency and bankruptcy. In 2017, Singapore had recommended use of mediation in insolvency and bankruptcy resolutions; the result thereof is that Singapore is becoming an international insolvency hub. In response to increase in civil disputes and socio-economic changes, reliance on mediation found acceptance instead of walking through the doors of a court and/or tribunal. Affected parties started looking for 'alternative doors' which led to a cost effective and timely resolution of disputes, and mediation provided this by offering an 'effective conflict resolution.'

As debt restructuring and debtor rehabilitation have to expand, the role of mediation in insolvency matters gains significance. Here, specialised neutrals are engaged as mediators in insolvency cases in order to avoid delays and unnecessary costs. The US experience in the Lehman Brothers' insolvency is a case in point in the international context, as a sizeable number of investors claims were solved taking advantage of alternative dispute resolution mechanisms, including mediation.

This case owes its relevancy and importance to the modern-day insolvency regime owing to its intricate complexities *qua* derivative transactions. 245 matters reached the mediation stage, out of which 232 stood settled and only 13 mediations were terminated.

Similarly, the result of the UK's schemes of arrangement in attracting foreign companies that are ready to restructure their businesses proves that it is a means to avoid an expensive insolvency proceeding. Hence, the question whether mediation is suitable for tackling insolvency matters, stands addressed, but the manner in which it will be implemented will have to evolve with time and the settlements arrived at, would clearly indicate the effectiveness of mediation.

Insolvency and bankruptcy mediation in the UK is not unknown. The Court of Appeal (UK) has treated even silence, in the face of an invitation to participate in mediation, as unreasonable and imposed a cost penalty. UK courts have been encouraging mediation especially in the current economic circumstances and have observed that it is appropriate to emphasise the need to resort to mediation by a sanction which operates '*Pour encourager les autres*'.

In 1986, the US Bankruptcy Code for Southern California was the first to use mediation. Greyhound lines went bankrupt and a reorganisation mediation plan for thousands of claimants was set up. This is a relevant example for multi-party dispute resolution where the corporate debtor (CD) dealt individually with each creditor. Mediation is now being used in over 60% of the reorganisation cases in the US. In personal bankruptcy cases, mediation is being frequently resorted to.

Mediation has gradually been accepted amongst the European Union member states as well, that have incorporated it through legislation. This contrasts with Mediation in the US, where it emerged with case law. Several European Union states have constituted pre-insolvency dispute resolution methods which are primarily aimed at restructuring the debtor. For example, the French insolvency law provides for two special procedures - an *ad hoc* mandate and conciliation.

In Germany, the insolvency plan procedure enables the debtors and the creditors to conclude an insolvency plan (*Insolvenzplan*) by negotiation. The Italian insolvency system offers several possibilities to entrepreneurs facing financial difficulties to restructure their debt. Italian Bankruptcy Law (*IBL-Legge Fallimentare*) currently provides three legal instruments for restructuring, all of which have different characteristics. The entire process of negotiating a recovery plan between the parties is confidential and is binding upon the creditors involved in the negotiation. There is also a semi-formal (hybrid) form of mediation.

Freedom under Mediation

Mediation is not conflict management as understood by professional groups. Nor is it disposal of cases as conceived by judicial administrators. It is a well-structured method and process which would help resolve matters faster and economically. The procedures give parties the freedom to decide the resolution or restructure plan, which may range from simple financial operations such as rescheduling of payments or debts, or a more complex strategy combining debt restructuring

with corporate reorganisation measures such as sales of assets, financial commitments, merger or acquisition transactions, etc. Pre-insolvency arrangement with creditors [Article 160 (*et seq* IBL)] comes handy for preventive arrangements with creditors and this process over time has become Italian equivalent to US Chapter XI.

MEDIATION IN INDIAN SCENARIO

Long before courts were established in India, disputes were resolved through various methods of informal dispute resolution according to rules of tribe, village or religious authorities. India has been a fertile ground for mediation and has rich ancient mediation practices commencing from the traditional panchayats and elders in the family resolving disputes. In fact, one of the mediation settlements has been authored by none else but *Sant Tulsidas Ji*, which is exhibited at the Allahabad High Court Museum. Once the current legal system was put in place, the adversarial system has been prevailing. However, amendments to the Code of Civil Procedure, 1908, brought about in 2002 introduced mediation in the statute book. Mediation started taking place in the shadow of the Hon'ble courts. However, amendments to the Commercial Courts Act, 2015 and the Consumer Protection Act, 2019, which provide mandatory pre-mediation measures, are indicators of the intent of the legislature to use mediation as a structured alternative process for resolving all conflicts, commercial or otherwise at the pre-litigation stage itself.

India was amongst the first nations to sign the Singapore Convention (though it has yet to ratify it). The Singapore Convention has become operative from September 12, 2019. This would help resolve cross-border commercial, including insolvency disputes, ultimately facilitating international trade and commerce, and contributing to the sustainable development goals.

It is time to re-evaluate the role of the insolvency and bankruptcy process to ensure timely resolution. Equally, it is time to examine the characteristics of mediation. Corporate restructuring has become highly technical, which requires expertise in different fields.

Mediation, therefore, would effectively resolve many conflicts and disputes and result in 'resolution', if made mandatory before initiation or undergoing insolvency processes, by the creditors, financial or operational. One of the criticisms to the resolution process has been that it too turns out to be interminable, time consuming, complex and expensive. This would now be said for bankruptcy proceedings too. Mediation, on the other hand, is less formal, more effective, speedier and avoids procedural clap traps. Appropriate amendments need to be incorporated in the IBC for this. It is the need of the hour that before passing an order under section 14 of the IBC, the NCLT may resort to mediation (exception being cases of fraud or manifest swindling of assets by the promoters of the CD). It would yield manifold results and save costs. In fact, in the personal bankruptcy proceedings, which are distinct from corporate restructuring, the principles of mediation are incorporated.

Throughout the lockdowns, the NCLTs have been hard pressed to clear the backlog. The resolution process has suffered and is suffering. Mediation would bring some solace to people who have been

suffering due to COVID-19. Despite multifarious hardships faced by one and all in recent times, we as a nation have stood firm against the COVID-19 pandemic and have collectively faced this challenge. We now need to make further endeavours in these challenging times and bring mediation as a compulsory mode to resolve the economic darkness and bring back everyone suffering on account of distressed assets/lack of liquidity into the mainstream, so that the economy thrives and the nation moves up the ladder in its economic endeavor to be one of the strongest economies in the world.

Mediation along with its various online facilities will not only be effective during pandemic-like situations, but also in the long run. It has the potential of ensuring justice in a time bound manner which is what the IBC mandates. Anyway, the multifaceted nature of mediation in insolvency matters brings in interesting acceptability and once adopted, can definitely yield the best results. Creditors and debtors themselves would decide and resolve matters together, notwithstanding timelines laid down in the Code and rigours of delay and costs, and bring about unique solutions which may otherwise not be conceivable, even under the IBC.

THE CURIOUS CASE OF FRESH START PROCESS: AN INQUIRY INTO HISTORICAL ANTECEDENTS, INTERNATIONAL ANALOGUES, AND DOMESTIC SUBSTITUTES

Dwijaraj Bhattacharya and Bindu Ananth ¹

India has made significant strides in the last decade and a half in broadening access to financial services. As a result, we are within striking distance of access to bank accounts becoming universal and can also claim a vastly improved formal landscape for access to credit. However, the ability of low-income households to manage risks, be it idiosyncratic risks like personal accident, hospitalisation, business failure or systematic risks like drought and pandemic remains extremely poor. Without this safety net, merely focusing on access to credit will exacerbate the risks of the informal sector. While multiple mechanisms are needed to tackle this, including deepening the insurance market, this is also an important subject for the Insolvency and Bankruptcy Code, 2016 (Code/IBC) to address. The IBC was an attempt to consolidate and amend the existing laws that dealt with various facets of insolvency and bankruptcy for juridical and natural persons, with a stated objective ‘*to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders*’. Presently, the IBC has only been notified for corporate borrowers and individual guarantors of corporate debt. There is a clear and urgent need for the operationalisation of the remaining sections of Part-III of the IBC², which deals with insolvency resolution and bankruptcy for individuals (as well as partnership and proprietorship).

In this article, the authors investigate the remedies available to natural persons under the IBC, especially focusing on low-income households, for whom the statute prescribes a unique, low-cost,

quasi-bankruptcy process, called the fresh start process (FSP). Given the similarities between the bankruptcy process and the FSP, the discussion is only limited to these, and do not discuss the insolvency resolution process outlined in the IBC. The authors start by tracing the historical trajectory of bankruptcy and insolvency laws, especially under the common law tradition. Thereafter, the authors study four other common-law jurisdictions and the remedies presently available to natural persons therein. Finally, the authors compare the FSP and the bankruptcy process, as outlined in sections 80 and 121, respectively and observe that the current design of the FSP is lacking.

A HISTORY OF INSOLVENCY AND BANKRUPTCY LAW

It is widely accepted that the history of insolvency and bankruptcy laws (hereinafter bankruptcy laws) dates back to the origin of credit, and its presence in formal law dates back to the biblical era.³ As may be expected, over the years the mechanics of the law has evolved significantly from ‘debt slavery’ as was practised during classical antiquity⁴ to the English invention of ‘debt discharge’⁵ co-occurring with ‘capital punishment’ for many defaulters⁶ in 1705, to modern-day FSP.⁷ Despite this evolution, the fundamental underpinnings of various bankruptcy laws remain the same, i.e., in an event a person is unable to pay her debt(s), the creditors have a right to seize all (or a portion of her) assets and (or) impound future income towards the repayment of the debt(s).

In the modern era, however, the treatment of natural persons under the laws has been significantly different than that of their corporate counterparts. This distinction, despite being intuitive, has always lacked a clear articulation⁸ of the exact political, economic or social rationale, which acts as a major impediment in outlining administrative process(es) under the statutes. Examples of this impediment include definitions of dischargeable debt⁹, protected assets¹⁰ and various other thresholds in the case of modern-day FSP.¹¹

The scholarship on the subject attributes two primary rationales behind the distinction. The first strand focuses on economic efficiency and argues that the economic potential of an individual becomes severely restricted in an event of liquidation of all her assets, reducing her productivity and thus contribution towards the society.¹² The second strand focuses on the sociological aspects and argues that economic adversities and social triggers (like the dissolution of marriage) are the primary causes of bankruptcies, therefore if the debt relief mechanisms are non-existent it may lead to degradation of the quality of life of the individual and the social fabric of a nation.¹³

The described social and economic underpinnings also manifest through different legislations, and therefore may provide an articulation from a legal standpoint, from international standards enshrined in the United Nations’ Universal Declaration of Human Rights¹⁴ to constitutional and other domestic statutory protections, which often act as the guidelines for the protected treatment of natural persons under bankruptcy law. Specifically in India, the judicial interpretation of Article 21 of the Constitution, establishes 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 necessities of life such as adequate nutrition, clothing and shelter and facilities for reading,*

writing and expressing oneself in diverse forms’.¹⁵ Thus, the State (through its laws or administrative arms) is rendered incapable of creating/endorsing a process that would encroach on any of the aforementioned rights, especially in cases that do not fall under the ambit of the harm principle. The definition of excluded assets¹⁶ as enumerated in section 79(4) of IBC mirrors the protections as interpreted under Article 21 of the Constitution, and therefore it may be argued that, as such, it establishes a correlation of these legal principles, though not causation.

The scholarship and the jurisprudence, though indicative of the underlying principles, cannot comprehensively capture the objectives and aspirations of the statute, and a clearer articulation of the same is essential to not only define the contours of the stakeholder interests¹⁷ that the IBC seeks to balance, but also guide all subordinate legislation concerning insolvency, bankruptcy and the FSP. The next section, therefore, attempts to situate the IBC amongst its analogues from other common law jurisdictions¹⁸, while focusing on the bankruptcy and FSP(s).

THE BANKRUPTCY PROCESS: ACROSS JURISDICTIONS

An instance of default is a precondition for availing any and all remedies across the four jurisdictions that were studied, namely the United Kingdom (UK)¹⁹, Australia²⁰, Canada²¹, and Singapore²². In these jurisdictions, the debtor may file for either insolvency, or bankruptcy once they are in default. In all four jurisdictions, unlike in India, bankruptcy is an independent process, i.e., the debtor or creditor may file for bankruptcy without going through any insolvency resolution processes. Thus, in the case of India, a borrower is forced to go through an expensive insolvency resolution processes, before ever getting an opportunity to discharge her debt through the bankruptcy process. Since the borrower must pay the cost of the insolvency professional, either directly or indirectly²³, it is an added burden on the low-income households, who often do not have access to avenues that can increase their income suddenly.

Moving to the bankruptcy process, once a borrower accesses it, she can discharge all debts, except a few, which are common across all the studied jurisdictions. Similarly, several assets are protected from attachment to the bankruptcy estate²⁴ (hereinafter estate). These include assets that are required²⁵ for the bankrupt to carry out her business/vocation/occupation. Further, in all the compared jurisdictions, non-luxury household assets that are necessary for the basic domestic needs of the bankrupt are protected against attachment to the estate. Table 1 presents a comparison of the features of the bankruptcy processes across these jurisdictions (Appendix).

Further, in the UK, a motor vehicle with a resale value of less than 1000 GBP is also protected if such a vehicle is essential for the bankrupt’s mobility.²⁷ In all other jurisdictions, apart from the protections described above, investments under approved retirement/provident/pension plans are protected.²⁸ Finally, only in Singapore²⁹, akin to IBC, there is a protection afforded to the single dwelling units, whereas in all other studied jurisdiction there is no apparent protection for the same. Finally, any property which is controlled by the bankrupt but is held by the bankrupt in trust for

another person, life insurance policies, awards by courts, benefits transferred under national schemes are also protected in all jurisdictions, including India.

Thus, the definition of protected assets for a bankruptcy applicant, as outlined in the IBC, is very similar to most of the studied jurisdictions. However, it must be noted that presently the IBC does not quantify the maximum value of assets that may be excluded. This presents a unique problem.

Given that the quantum of asset protection under the bankruptcy process is likely to be significantly higher than that of ₹ 20,000 (the qualifying ceiling of asset ownership under FSP), a household, including a low-income household, is likely to seek refuge under the bankruptcy process, rather than go through the FSP. This is likely to reduce the efficacy of the FSP, and is discussed in the next section comparing the FSP with its analogue from the UK, the Debt Relief Order (DRO).

The Fresh Start Process

A similar mechanism to that of bankruptcy is present for individuals with low-income³⁰, low-asset and low debt in the UK, akin to the FSP as outlined in the IBC. In the UK, under the DROs, the borrower may discharge her debts without any assets being attached to the estate. DROs are therefore very similar to the FSP in design. A brief comparison of the features of the DROs and that of the FSP, as defined in the IBC is given in Table 2 (Appendix).

DROs are a great mechanism for the protection of the rights of the economically vulnerable population given the protections afforded under DROs. However, on a closer comparison between DROs and bankruptcy processes, only one tangible difference stands out. The difference benefits the debtor since the up-front cost of DROs³², as compared to the bankruptcy process, is significantly less. Asset protection is not considered a benefit since in case of bankruptcies most of the assets an individual may own (under the GBP 1000 ceiling) are expected to be exempt, as discussed in the preceding part of the section.

Unlike in the case of DROs, the protection afforded under the FSP is lesser. In the case of the UK, households with debt up to GBP 20,000 (approximately ₹ 6,00,000 in PPP terms) qualify for DROs. Further, in the UK, as of March, 2018, the median household financial debt stood at GBP 4,500.³³ Thus, more than half of the indebted households qualify for DROs. In India however, since only individuals with debt up to ₹ 35,000 may apply for the FSP, the coverage is significantly lesser. Estimates suggest that only 6.59% of indebted Indian households (i.e., 7 out of every 100 households) qualify under the debt ceiling proposed in the FSP.³⁴

When considering the income criterion, in the UK, the disposable income of the debtor is considered, instead of total income, as in the case of India. The disposable income is calculated by taking the total income of the debtor, and contributions by other members of the family, then deducting from it all reasonable household expenditure.³⁵ Thus, instead of an arbitrary ceiling on income, the debt serviceability of the borrower is estimated, to determine her eligibility. In the case of India, the income criterion is absolute, i.e., all borrowers having income over ₹ 60,000 annually do not qualify

for FSP, irrespective of the actual disposable income. In the case of India, it may be impractical to calculate debt serviceability for all applicants given the lack of data from the informal sector. To mitigate such difficulties, appropriate proxies from survey data, or more easily available data on the quantum of assets may be employed. However, it must be noted that such approaches, while expedient, may not always capture the true difficulties, or lack thereof, associated with servicing the debt.

Due to a lack of availability of income data, in the case of India, the coverage, or exclusion caused by the income ceiling of ₹ 60,000 is not quantifiable. However, if one uses the proposed minimum wage in the country (though it was later disregarded) and assumes that every participant of the workforce would earn the minimum wage of ₹ 375³⁶, and would work five days a week for 50 weeks in a year, it emerges that the income of such an individual would amount to ₹ 93,750, i.e., 56% higher than the income criteria proposed under the FSP. Similarly, if there is only one earning member in a household of four, the member must earn ₹ 74,463 annually (24.1% more than the income limit proposed under FSP), to ensure that the household stays above India's poverty line. Thus, it may be the case that the income criterion is severely restrictive in the case of FSP, and therefore leading to potential exclusion.

While this exclusion may be intended by the government, i.e. the policy stance is to only extend the benefits of FSP to a select group of individuals, it is necessary that such position be made clear. Irrespective of whether there is such a policy stance, another vital question emerges, 'Who ought to be the target audience for the FSP?' Although answering this question is beyond the scope of this chapter, it is important that the question be considered by the government. To draw a parallel, in India, an individual with an income up to ₹ 500,000 is exempt from any income tax, i.e. her obligation arising out of the social contract is waived by the state, but the state is only willing to safeguard an individual against private creditors if her income is less than ₹ 60,000. Further, the RBI considers a family to be the part of economically weaker section if the total familial income is less than ₹ 300,000 and allows for micro-finance lending to individuals with an annual income of up to ₹ 125,000 (in rural areas) and ₹ 200,000 in urban areas.

Although at a principle level, FSP appears to be an excellent statutory remedy, a closer examination of it reveals that there are few aspects of the policy that might need redesigning to ensure that the process is capable of safeguarding the borrowers it had set out to safeguard. When one compares the FSP with the bankruptcy process, the need to redesign becomes even more apparent.

BANKRUPTCY Vs. FRESH START

The fresh start and the bankruptcy process are similar in several regards. Unlike in the case of insolvency resolution processes, in both FSP and bankruptcy, the final outcome for the debtor is a discharge from their obligation to repay. However, the process through which the end product, i.e. discharge of debt, occurs is different. In the case of the bankruptcy process, the debtor's assets are attached to an estate administered by a bankruptcy trustee. The trustee has the responsibility

to sell such assets to recover the dues from the borrower, and repay her creditors. Thus, in case of bankruptcy, an alienation of assets occurs. However, such alienation of assets is not absolute, as certain assets are excluded from being attached to the bankruptcy estate.

Section 79(14) of the IBC lists these excluded assets, however, does not assign any value to most. The first two sub-sections read as under:

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

Thus, all assets that are essential for the vocation of the debtor will be protected from attachment to the estate irrespective of their value. The third exclusion on personal ornaments allow the government to set a value beyond which assets will not be excluded, the sub-section reads '*any unencumbered personal ornaments of such value, as may be prescribed, of the debtor or his immediate family which cannot be parted with, in accordance with religious usage*'. Under the Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Rules, 2019, personal jewellery worth up to ₹ 100,000 is excluded.³⁷ Similarly, unencumbered single dwelling units having a value of up to ₹ 2,000,000 in urban areas are excluded. In rural areas, single dwelling units having a value of up to ₹ 1,000,000 are excluded. Thus, the quantum of asset protection under the bankruptcy process is significantly greater than that of the FSP. However, the FSP may have one benefit over the bankruptcy process, i.e. the cost of availing the remedy.

Under the Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Rules, 2019, a borrower (or a creditor) applying for bankruptcy must pay ₹ 2,000 at the time of application.³⁸ Further, the borrower has to pay for the services of the bankruptcy trustee, indirectly, from the proceeds from the sale of the bankruptcy estate.³⁹ In the case of FSP, only a one-time fee is proposed at the time of application.⁴⁰ Since there are presently no rules on the subject, this application fee (for FSP) remains unspecified. Assuming the fee to be half of the bankruptcy process, the disparity becomes apparent. In the case of FSP, a borrower must pay ₹ 1,000 (assuming the cost of FSP to be half of the cost of bankruptcy), to be able to obtain a maximum discharge of ₹ 35,000. In contrast, an applicant may get a significantly larger discharge under the bankruptcy process by paying ₹ 2,000, if her assets do not cross the thresholds prescribed. To be clear, the asset threshold under the bankruptcy process starts at ₹ 1.1 million (assuming the borrower has an unencumbered rural dwelling unit) and can be limitless if one is successfully able to demonstrate that their assets are essential for their vocation.

Thus, the promised benefits of the FSP tend to dilute upon closer scrutiny of other remedies available under the IBC. To take a stylised example, a borrower with a monthly income of approximately ₹ 10,000, having basic assets, like utensils, furniture, a bicycle and a refrigerator will not qualify for FSP, under both the income criterion, and the asset criterion. Further, assuming such an individual

had taken an MFI loan of ₹ 125,000 and had serviced half of it, they will not qualify for FSP under the debt criterion too. However, at a minimal cost of ₹ 2,000, they can avail much greater benefits under the bankruptcy process compared to FSP. Assuming no differential treatment between credit records with either bankruptcy orders or FSP orders, and no expenses during the insolvency resolution processes, in the present form the remedies under the bankruptcy process is much superior to the FSP, almost making FSP redundant in its scope.

CONCLUSION

To conclude, the FSP in India is a significant step in the right direction. It bestows the force of law on the principles on which the discourse of personal insolvency and bankruptcy are based on. Further, the remedy, admirably strives to protect several fundamental rights, as judicially interpreted over the years. However, the comparative analysis of the FSP with other remedies in India, and with similar processes in other jurisdictions reveals that there are several similarities and important differences in the design of the remedies. In light of the stringent eligibility criteria for the FSP, its efficacy is expected to be limited, especially because of its narrow coverage, and availability of competing remedies like the bankruptcy process under the IBC. Thus, to ensure the relevance of FSP it would be prudent to revisit the features of the remedy and redesign a few aspects.

NOTES

¹ Views are personal.

² Most sections of the Part III of the IBC are yet to be notified, thus despite being on the books, any and all remedies, processes, etc. are unenforceable.

³ Levinthal L. (1918), "The Early History of Bankruptcy Law", *University of Pennsylvania Law Review*, Vol. 66, pp. 223-250.

⁴ *Ibid.*

⁵ Tabb C. (1991), "The Historical Evolution of the Bankruptcy Discharge", *American Bankruptcy Law Journal*, Vol. 65, pp. 325-71.

⁶ Kadens E.(2010), "The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law", *Duke Law Journal*, Vol. 59.

⁷ The Fresh Start Process as described in section 80 of IBC has analogues provisions in UK and New Zealand in the form of Debt Relief Order and No Asset Procedure respectively, with both being introduced in 2007; Part 7A, Debt Relief Orders, Insolvency Act 1986; No Asset Procedures of the New Zealand Insolvency and Trustee Service.

⁸ In case of IBC even the Parliamentary Standing Committee Report is silent on the rationale behind the differential treatment of corporate and personal insolvency/bankruptcy process. Report of the Joint Committee on the Insolvency and Bankruptcy Code, 2015 (April, 2016).

⁹ Dischargeable debt refers to debts that may be discharged through the bankruptcy process. Though most

varieties of formal debts are dischargeable, there are few formal debts that are non-dischargeable, e.g. student loans.

¹⁰ Unique to the bankruptcy process for natural persons, protected assets are assets that may not be included in the estate of bankrupt, i.e. sold off to realise any outstanding debt.

¹¹ Unlike bankruptcy process where the assets of the debtor are included in the bankruptcy estate for realisation of their financial value, fresh start processes are low-cost alternatives to bankruptcy where no asset of the individual are attached to the estate, and therefore aren't liquidated.

¹² White M. (2011), "Corporate and Personal Bankruptcy Law", Working Paper 17237, National Bureau of Economic Research.

¹³ Carlsson B. and Hoff D. (2000), "Dealing with Insolvency and Indebted Individuals in Respect to Law and Morality", *Social & Legal Studies*, Vol.9(2), pp. 293-317.

¹⁴ Adopted through UN General Assembly Resolution 217A, the Universal Declaration of Human Rights is an internationally accepted aspirational standard describing the rights of natural persons. UN General Assembly Resolution 217A2010.

¹⁵ *Francis Coralie Mullin v. The Administrator, Union Territory of Delhi & Ors.*, January 1981 AIR 746, 1981 SCR (2) 516.

¹⁶ Excluded Assets are defined as (a) unencumbered tools, books, vehicles and other equipment as are necessary to the debtor or bankrupt for his personal use or for the purpose of his employment, business or vocation; (b) unencumbered furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his immediate family; (c) any unencumbered personal ornaments of such value, as may be prescribed, of the debtor or his immediate family which cannot be parted with, in accordance with religious usage; (d) any unencumbered life insurance policy or pension plan taken in the name of debtor or his immediate family; and (e) an unencumbered single dwelling unit owned by the debtor of such value as may be prescribed.

¹⁷ The long title, IBC.

¹⁸ All commonwealth nations follow the common law traditions, including UK, Australia, Canada, Singapore and India, jurisdictions that are compared in the second section of the note.

¹⁹ The Insolvency Act, 1986.

²⁰ The Bankruptcy Act, 1966.

²¹ The Bankruptcy & Insolvency Act, 1985.

²² The Insolvency, Restructuring and Dissolution Act, 2018.

²³ Section 105(3)(b) of the IBC requires the debtor, in consultation with the resolution professional, to provide a plan for the payment of the fee to the resolution professional. Thus, either the borrower must pay the fee of the resolution professional out of her pocket, or settle for a lower haircut on her loans, so that the fee of the resolution professional may be extracted from the creditors. Hence, irrespective of how the accounting for the fee is carried out, the borrower either directly, or indirectly will have to pay for the resolution professional.

²⁴ The detailed general process of bankruptcy is similar in all four jurisdictions to the process outlined in IBC. The only distinction however is that in all the four jurisdictions studied, bankruptcy can be independently triggered.

²⁵ It is unclear across jurisdictions what is the standard applied to adjudge whether an asset is *required*, since on one end of the spectrum, an asset may be *incidental* to the vocation or on the other end *essential*.

²⁶ In PPP Terms 1GBP (at 2020 rates) = ₹ 29.81

In PPP Terms 1 AUD (at 2020 rates) = ₹ 14.61

In PPP Terms 1 CAD (at 2018 rates) = ₹ 17.82

In PPP Terms 1 S\$ (at 2018 rates) = ₹ 15.49

²⁷ The protection under the clause generally is applicable to persons with disability.

²⁸ *Ibid*; In case of Singapore, the corpus is only protected in case it can't be liquidated by the debtor in normal course [i.e. the lock-in period of the fund hasn't lapsed]; In case of Canada, the exemption doesn't apply to contributions made to such funds in last 12 months (though the rest of the corpus is protected).

²⁹ In Singapore, only Housing Development Board flats when one of the owners is a citizen of Singapore are

exempt.

³⁰ IBC uses income as one of the qualifying criteria, however the Debt Relief Process in UK uses 'disposable income' as one of the qualifying criteria.

³¹ OECD Purchasing Power parities data. (In PPP Terms 1GBP (at 2020 rates) = ₹29.81.)

³² In England & Wales the cost of bankruptcy is 680 GBP, whereas for DRO, the cost is 90 GBP.

³³ Office for National Statistics (2019), Household debt in Great Britain: April, 2016 to March, 2018.

³⁴ Bhattacharya D. (2020), "Estimating Eligibility for the Fresh Start Mechanism under IBC, 2016", Dvara Research, Working Paper Series No. WP-2020-01.

³⁵ Rule 5A.8 of the Insolvency (Amendment) Rules, 2009.

³⁶ Nanda P. (2019), "No single minimum wage under the Wage Code bill", *The Mint*, 27 July.

³⁷ Rule 5(a) of The Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Rules, 2019.

³⁸ *Ibid*, rule 6 and 7.

³⁹ Sections 137(4) and 144(2), IBC.

⁴⁰ Section 81(3), IBC.

Table1: Features of Bankruptcy Process in Commonwealth Jurisdictions

Parameters	India	United Kingdom	Singapore	Australia	Canada
Provisions					
Bankruptcy Process	Yes	Yes	Yes	Yes	Yes
Direct Application to Bankruptcy?	No	Yes	Yes	Yes	Yes
Minimum Qualifying Debt	TBD [$<₹$ 100,000]	GBP 5000 [₹ 149,050]	S\$ 15000 [₹ 232,410]	AUD 5000 (₹ 73,050)	CAD 1000 (₹ 17,820)
List of Excluded Debt	<ol style="list-style-type: none"> 1. Fines by court and Tribunals; 2. Contractual and Statutory Obligations for misconduct (negligence, nuisance or breach); 3. Maintenance (and child support); 4. Student Loans. 5. Any other debt as may be prescribed. 	<ol style="list-style-type: none"> 1. Magistrates Court Fines; 2. Payments to courts under confiscation orders; 3. Maintenance and Child Support; 4. Student Loans; 5. Secured Loans; 6. Debts owing to third party injury/death; 7. Social Fund Loans; 8. Tax Overpayments. 	<p>Non Provable Debt</p> <ol style="list-style-type: none"> 1. Child Support; 2. Alimony; 3. Court Fees; 4. Debts acquired from fraud; 5. Student Loans. 	<ol style="list-style-type: none"> 1. Contractual and Statutory Obligations; 2. Penalties or fines imposed by a court; 3. Student Debt. 	<ol style="list-style-type: none"> 1. Fines and Penalties imposed by courts; 2. Debt arising out of a recognisance or bail; 3. Damages awarded by a court in civil proceedings; 4. Alimony or Alimentary pension; 5. Spousal and Child Maintenance; 6. Proceeds from wrongful or fraudulent acts; 7. Student Loans.
Protected Assets	<ol style="list-style-type: none"> 1. Unencumbered tools, books, vehicles and other equipment as are necessary to the debtor or bankrupt for his personal use or the purpose of his employment, business or vocation; 2. Unencumbered furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his immediate family; 3. Any unencumbered personal ornaments of such value, as may be prescribed, of the debtor or his immediate family which cannot be parted with, in accordance with religious usage; 4. Any unencumbered life insurance policy or pension plan taken in the name of debtor or his immediate family; and 5. An unencumbered single dwelling unit owned by the debtor of such value as may be prescribed. 	<ol style="list-style-type: none"> 1. Such tools, books, vehicles and other items of equipment as are necessary to the bankrupt for use personally by him in his employment, business or vocation; 2. Such clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his family; 3. A Car (worth up to GBP 1,000) may be exempt if it is essential for the individual's mobility. 	<ol style="list-style-type: none"> 1. Properties held on trust by the bankrupt; 2. HDB flats where at least one of the owners is a citizen of Singapore; 3. Central Provident Fund (CPF) contributions; 4. Necessary household furniture, personal effects; 5. Limited tools of trade; 6. Life insurance policies held on express trust for the benefit of the bankrupt's spouse or children; 7. Compensation awarded for legal action in respect of personal injuries or wrongful acts against the bankrupt. 	<ol style="list-style-type: none"> 1. Properties held in trust; 2. Eligible personal property with a sentimental value subject to a special resolution passed by the creditors before the trustee realises the property; 3. Property in use for earning income by personal exertion and within a prescribed limit; 4. Property in use as a means of transport within a prescribed limit; 5. Policies of life assurance or endowment assurance in respect of the life of the bankrupt or the spouse or <i>de facto</i> partner of the bankrupt; 6. Amount held in specified pension funds, retirement savings account, etc.; 7. Payments from specified social security schemes. 	<ol style="list-style-type: none"> 1. Property held in trust; 2. Any property exempt from execution or seizure under any laws applicable in the province within which the property is situated; 3. Goods and services tax credit payments that are made in prescribed circumstances; 4. Prescribed payments relating to the essential needs of an individual; 5. Property in a registered retirement savings plan or a registered retirement income fund, in the 12 months before the date of bankruptcy.

Parameters	India	United Kingdom	Singapore	Australia	Canada
Cost of Bankruptcy	TBD	130 GBP (Application)+ 550 GBP (Deposit) [₹ 20,270]	~ S\$ 2,000 [₹ 30,989]	Debtor: No application fee; Creditor: AUD 470 (₹ 6,867) (Application for Bankruptcy Notice) + filing fee	Provision [All INR figures are at PPP]
Process Type	TBD	Judicial (High Court)	Judicial (High Court)	Judicial (High Court)	Judicial (High Court)
Statute	Section 121, IBC	Insolvency Act, 1986	Insolvency, Restructuring and Dissolution Act, 2018	Bankruptcy Act, 1966	Bankruptcy & Insolvency Act, 1985

Table 2: A comparison of India's Fresh Start process with UK's DRO

Parameters	Provisions	Provisions [All INR figures are at PPP] ³¹
Fresh Start or Analogous Process	Yes (Fresh Start)	Yes (Debt Relief Order)
Eligibility Based on Debt O/S	< ₹ 35,000	< 20,000 GBP [₹ 5,96,136]
Eligibility Based on Income	< ₹ 60,000 Annually	Disposable <50 GBP Monthly [₹ 1,490] i.e., < GBP 600 Annually [17,884]
Eligibility Based on Assets	< ₹ 20,000	< 1,000 GBP [₹ 29,807] (Exception for Car and Essential Goods)
Cost of Fresh Start	To Be Decided	90 GBP [₹ 2683]
Eligibility Based on Home Ownership	No Home Ownership	No Home Ownership (Indirect)
Process Type	Judicial	Administrative (instead of judicial)

IMPEDIMENTS TO INDIVIDUAL INSOLVENCY: A POLITICAL ECONOMY PERSPECTIVE ON THE IBC EXPERIENCE IN INDIA

H. S. Shylendra¹

Implementability more than the legalese may determine the success of any law. The Insolvency and Bankruptcy Code, 2016 (Code/IBC), hailed by the corporate world as a radical reform which has raised dramatically the stature of India with regard to ease-of-doing business, has been framed to deal with both the corporate and individual insolvencies. However, the IBC so far has been given effect only in respect of provisions dealing with corporate insolvency, including the personal guarantors (PGs) to corporate debtors (CDs). The provisions relating to insolvency of individuals or natural persons have, apparently, proved to be the bugbear of IBC both in terms of their actual operationalisation and the willingness of the state to fast-track implementation of legislative provisions. The Insolvency and Bankruptcy Board of India (IBBI), the regulator for the sector, in fact, lamented in its annual report for 2018-19 that '*the matter of individual insolvency and bankruptcy is a complex and challenging issue all over the world*' and the implementation of the provisions dealing with individuals will impact a large population. To this effect, the IBBI's annual report expressed the need for a deeper knowledge about the nature and composition of the relevant credit markets.

Having so admitted the complexity of individual insolvency, the Government has come to adopt a phased approach to implementation of IBC with the initial priority being given to corporate insolvency. Even though IBBI has made some sincere efforts by constituting a working group and advisory committee to give concrete shape to the individual insolvency regulation, the actualisation

so far has proved to be elusive. Given the calamitous impact of COVID-19, while there is considerable uncertainty as to how the field of insolvency would shape up in the post-COVID-19 world, there are arguments that under worsening economic situation, insolvency may emerge even more relevant particularly for the household sector.² Meanwhile, the Government has quickly put in place a new framework under IBC to address the insolvency needs of micro, small, and medium enterprises (MSMEs) by way of a pre-pack scheme, available only to corporate MSMEs, even as individual insolvency is the need of the hour in post-pandemic world.

What ails the IBC regime especially in relation to individual insolvency? One of the early assessments of the new regime hinted at the possibility of a sort of a demand constraint by highlighting that personal insolvency under IBC has been conceived very early even before the maturation of the consumer market segment.³ The personal insolvency provisions were more of an afterthought under IBC scheme given that the priority of the policy makers was corporate insolvency. A study however, indicated that having been legislated proactively and if implemented effectively, the personal insolvency regime may possibly boost the consumer credit market which is constrained by several design level challenges.⁴ Similar assessment for other jurisdictions reveals a wide range of factors being at work in subduing the potential of individual insolvency regimes.⁵ In the Indian context multiple level challenges seem to be influencing the impasse in which the individual insolvency regime finds itself. This is despite the argument that IBC as a modern law has imbibed the best of the theoretical principles pertaining to insolvency and credit markets.⁶

One can identify at least three levels of challenges which seem to affect the working of the individual insolvency. The first level challenge is the prevailing political economy, dominated by global capital and underpinned by neoliberalism, acting as a key determinant of the way larger reforms unfold in terms of the nature of their impact on the sector. The political economy challenge emanates basically due to the nature of the state in terms of its ideology and the competing contestations among diverse stakeholders which are supposed to be moderated by the state. The second level interlinked challenge is about the dynamics of the household sector in terms of the growth and composition of indebtedness and their potential impact on issues like social stability and profitability of the commercial creditors. The third challenge is more at the level of the law itself in terms of the workability and design of the individual insolvency provisions which seem to be sub-optimal for realising the expected goals including that of social insurance. It would be worthwhile to explicate each of these three challenges and draw implications for the working of IBC.

POLITICAL ECONOMY CHALLENGE TO PERSONAL INSOLVENCY REGIME

In a way, the current political economy which has enabled the adoption of a market-friendly insolvency regime for the corporate sector can double-up at the same time as an impediment for the expeditious execution of personal insolvency regulation. The leanings and keenness of the ruling regime to deepen capitalism in the country by way of pro-capitalist reforms was the major factor

which led to unveiling of the IBC. The primary goal was ‘... maximisation of value of assets..., to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders’.⁷ Insolvency which is seen economically as an outcome of market forces in a capitalist economy needed a more enabling law, which the new ruling regime was more than willing to create in 2016 by codifying and modernising all the hitherto existing laws. It is this alignment of interests that explains the expeditious framing and implementation of the new corporate insolvency regime. The same ruling regime which conceived the individual insolvency under IBC, however, has not displayed the same keenness in operationalising the individual insolvency.

It would be instructive to go into the reasons for such a behavior. In addressing the insolvency challenges of the individuals, the ruling regime may not harbor similar kind of interest which it showed with regard to corporate sector insolvency. This in a sense tally with the classic insolvency policy dilemma of trader versus non-traders. Though the household sector translates into a political constituency in respect of various other issues, but its individual insolvency challenge may not be perceived as a potential problem that needs to be resolved with the same interest and urgency. Credit, subsidy, loan write-off, interest subvention, and insurance are some of the well-established mechanisms or schemes in the policy arsenal, however inadequate in terms of their design, to address any prevailing or imminent crisis along with possibly swaying the underlying segments of the sector for political purpose. Insolvency process is a more complicated way to address the needs of the household sector debt crisis and its burden. Moreover, widespread and liberal insolvency may go contrary to the goals of financialisation attempted by economic reforms. Only to the extent it enabled framing a more comprehensive law and boosts the recognition as a business-friendly regime, individual insolvency managed to find a space within IBC. At the same time, the repealing of the old legislations needed alternate legal framework, whether it would be implemented or not.

There are at least two more factors which can help explain how the political economy may be acting as an impediment. The banks and financial institutions, which are considered to be one of the major beneficiaries of IBC, have vested interests to restrain pushing forward individual insolvency more so covering rural and microfinance segments. This dimension or challenge has emerged clearly in the process of framing rules and regulations for individual insolvency under IBBI.⁸ Theoretically, insolvency which is supposed to be a mechanism wherein lenders absorb the cost associated with the discharge of debt as part of their business risk management is expected to boost credit demand given the predictability that it ensures. However, the bankers in this context perceived individual insolvency, especially under Fresh Start Process (FSP), as one which may degenerate into a kind of common debt waiver, and hence flagged their resistance for its operationalisation. The argument put forth was that ‘fresh start’ may lead to a contagion of indiscipline among certain segments of household sector spoiling the ‘repayment culture’ necessary for financialisation to be sound. Though the views of the bankers were in a sense unwarranted and specious⁹, it needs to be seen how far the Government, given its disposition, would respond to such a contention in its attempt to give force to individual insolvency legal regime. This is also a manifestation of the contradictions under neoliberalism.¹⁰ The financial institutions which are supposed to bank on the neoliberal idea of

‘responsible behavior’ by debtors in expanding their outreach are apparently peeved at a legislation which is supposed to encourage entrepreneurial spirits, yet another neoliberal thought at the same time. The argument of de-politicisation expected under neoliberalism in the relations between debtors and creditors owing to any resistance from the former seems to be working in reverse with the creditors here coming together against the perceived liberal bankruptcy provision for the lower end of the household sector. This is similar to the effort of finance lobby in the USA which worked successfully in preventing unrestrained access to insolvency under the US Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.¹¹

Neoliberalism has come to pose challenge in another way in the implementation of individual insolvency provisions. As a new generation policy law which draws on diverse global experiences, the IBC has placed emphasis on systems working outside the conventional civil courts. This necessitates a huge network of Insolvency Professionals (IPs) who intermediate between debtors and borrowers in concurrence with the Debt Recovery Tribunals (DRTs). As individual insolvency is likely to be accessed by a relatively large number of debtors, the need for IPs and adjudicators would parallelly increase. Unlike in the case of corporate insolvency where there is scope for fee-based services, the same may not be feasible to the desired extent in the case of individual insolvency. In such a situation, unless the state or any public agency comes forward to meet the cost of creating and maintaining such a professional support system, individual insolvency of the modern kind is bound to face a major impediment. Given the neoliberal thrust, the state may be reluctant to invest in creating the much-needed infrastructure. The attempt at developing a market for IPs hence is faced with a considerable challenge in the absence of any assured support or incentive to the professionals who may handle individual insolvency cases. This may not help in serving the goal of insolvency as a social insurance.

DYNAMICS OF HOUSEHOLD SECTOR DEBT

Though individual insolvency has existed for years, in the western countries it is the growth of consumer credit in the recent history, more so since post-1980s, which has led to the spurt in reforms in insolvency laws. Goals of encouraging growth in consumer debt as well as resolving the consequential debt crisis have been at the bottom of these new personal insolvency legislations. The Bankruptcy Law Reforms Committee (BLRC)¹², which explicated the rationale of IBC along with its design principles, strongly advocated reforms in insolvency laws despite India having a low credit to GDP ratio. The BLRC’s rationale for insolvency laws was based more on the logic of developing credit markets by overcoming their imperfections arising out of the absence of more holistic insolvency legislation. The larger thrust was encouraging higher investment and GDP growth than tackle any prevailing debt crisis *per se*. Thus, the apparent purpose was to be futuristic in legislation which holds good for both the corporate and the household sector.

A question which becomes relevant in this context is whether at all an individual insolvency market will develop in India, at least in near future, in the absence of adequate growth in the household sector

debt. Feibelman (2017)¹³, who had argued that but for corporate insolvency the government would not have reformed the personal insolvency laws, indicated that India’s early adoption of personal insolvency laws may positively impact consumer credit market. The prominent focus on consumer credit as stemming from the western experiences, however, may not fully explain the household sector debt scenario in India giving rise to insolvency as a social insurance. Simultaneously, the difference in the debt scenarios between rural and urban demographics has to be accounted for in so far as they may have a bearing on insolvency.

The Reserve Bank of India’s (RBI) Committee on Household Finance (2017)¹⁴ revealed that India’s households display some distinctive features with regard to their assets and liabilities position as compared to developed countries. The households hold a large fraction (nearly 85%) of their wealth in the form of physical assets, yet the penetration of mortgage is low (<25%) under liabilities. High levels of debt (56%) are unsecured in nature and are sourced from informal sources resulting in high cost of debt burden. Further, insurance and pension assets account for a very small portion of the wealth.

As per the All-India Debt and Investment Survey of 2013¹⁵, there are also considerable rural and urban differences in the indebtedness pattern. While about 31.4% of rural households were indebted as against 22.4% in urban areas; the urban indebted households had a much higher average outstanding debt (₹ 3.8 lakh) than rural indebted households (₹ 1.0 lakh). A greater proportion (61%) of rural households sourced their debt from informal sources than urban households (46%). A very significant proportion of debt – 39% in rural and 46% in urban areas was borrowed at over 15% rate of interest. Overall, there is considerable growth in indebted households and amount of debt as compared to past decades both in rural and urban areas. Farmers are one of the major categories having higher incidence and amount of debt. As regards the use, though debt is deployed for highly diverse purposes like production, consumption and social purposes; overall non-production purposes account for a major share - 60% in rural and 82% in urban. However, households in the higher deciles of assets tend to use relatively a greater proportion of their loan for production purposes. For the poorer household’s dependence on informal sources combined with greater use for consumption purposes increases the chance of debt becoming burdensome.

Incidentally, in rural areas, there has been an increasing incidence of suicides especially among farming households in the post-reforms period.¹⁶ Debt is identified as one of the major risk factors contributing to this distressing social phenomenon. The growing agrarian crisis more so during the period of economic reforms has played a significant role leading to increased farmers’ distress and suicides. As per a National Crime Records Bureau report for the year 2015¹⁷, bankruptcy and indebtedness taken together was identified as the major reason (38.5%) causing suicide of farmers/cultivators. The farmers suicides linked to indebtedness are a symptom of the underlying social crisis which would need diverse protection and rehabilitative measures. The agrarian crisis and problem of debt has not been helped by the fact that insurance and pension services are accessed by only a very small proportion of households. Though debt in a relative sense is low but debt remains

a major risk factor causing livelihood crisis in rural areas. The excessive dependence on costlier informal debt arises out of this situation besides the uneven access to formal sector debt.

Given the unique situation of household debt and its deleterious consequences, need for social insurance remains acute. Insolvency can be one of such social insurance mechanisms which can help mitigate the consequences. As explained earlier, loan-waiver and interest subvention schemes have been one of the popular measures among the policy makers. However, given their design, loan waivers tend to reach only a smaller portion of households, that too, among those who are able to access institutional loans.¹⁸ Even a variety of insurance schemes gets targeted at those with institutional loans. The prevailing protectional measures are narrow in their outreach leaving out a vast section to fend for themselves during a crisis, either relying on costly informal sources or slipping into distress and destitution. The COVID-19 induced crisis would have aggravated many of these situations in the household sector.

DESIGN AS AN IMPEDIMENT

Though some hail IBC as incorporating the best features of various theoretical models of finance and insolvency¹⁹, the extant design of IBC especially in relation to individual insolvency is proving to be a challenge for implementation. Apparently, elements from different practicing models of personal insolvency have been combined to minimise the dichotomy between the goals of ‘disciplining debtors’ and ‘legitimate needs of insurance’, an imminent dilemma in a neoliberal economy.²⁰ Too much emphasis on ‘disciplining’ would lead to a model which would restrict access to insolvency that grants liberal discharge. Debtors would be expected to pay part of the debt to seek insolvency. It is well argued that many restrictive provisions may lead to higher cost and under-utilisation given also the stigma²¹ attached to insolvency and bankruptcy. The legitimate need for insolvency arises in the context of aggressively promoting consumer credit market or entrepreneurial development, where credit plays a major role. Given the exploitative tendency of consumer credit and the burden of debt owing to failure of entrepreneurial ventures, the legitimacy role of social insurance assumes even greater significance. The promotion of debt culture and its debilitating consequences necessitates a ‘fresh start’ and liberal bankruptcy provisions. Thus, as argued by Ramsay (2017)²², design of personal insolvency faces the challenge of balancing between social and economic goals.

The Indian personal insolvency model has three components: FSP, insolvency, and bankruptcy. Despite arguments of IBC being a blend of the best, critical assessments of the provisions of individual insolvency reveal several lacunae in the design and in balancing the diverse goals. Feibelman (2017)²³ identified that the regime of individual insolvency despite having a fresh start for poorest debtors strikes an uncertain balance of policy goals besides tilting the power in favour of the creditors who may force debtors into insolvency. Neither there is adequate protection to the needy debtors nor possibility of a predictable outcome of repayment plan which may result in many debtors not seeking insolvency voluntarily.

Our own analysis of the provisions of IBC on individual insolvency brought out several issues.²⁴ The FSP meant to give direct discharge is highly restrictive (as elaborated in the next section); the individual insolvency resolution and bankruptcy would result in considerable exclusion of debtors more so those borrowing from informal sources. Seeking relief of informal debt is ridden with enormous hassles. Besides lack of proper data and documentary evidence for authenticating informal debt, certain other behavioural factors also play a role. In 1976, when many State Governments announced moratorium of informal debt, the informal lenders took recourse to legal remedy on the grounds of their own livelihood concerns as lending was one of their means of living.²⁵ The courts, however, upheld the legality of debt write-off. In Karnataka, when the State Government passed a debt-waiver Act in 2018 giving relief to small debtors borrowing from diverse sources, including informal lenders, the pawn-brokers lobby managed to get a stay on the operation of the debt-waiver law.²⁶ In yet another instance, the Kerala Debt Relief Commission constituted in 2004 found to its dismay that its request for applications for relief from informal debt had a poor response as the debtors were wary of making their debt transactions formal.²⁷ The IBC is likely to face similar kind of challenges about informal and unsecured loans which may significantly foreclose insolvency for informal debt.

Restrictive design of FSP

Let us look at the restrictive design features focusing on the FSP. FSP comes as the first component of the individual insolvency in IBC. It is meant to give a ‘fresh start’ to low income individuals who have fallen into debt trap and unable to move forward in livelihood. FSP comes as an opportunity for small borrowers to seek a discharge from the onerous debt. Those concerned with the problem of growing indebtedness among small and marginal borrowers in both formal and informal sector see FSP as a window to address cases of chronic debt. FSP can possibly emerge as a feasible alternative to popular loan waivers. However, as mentioned earlier, the finance sector views FSP as opening of the Pandora’s box leading to a contagion of intentional defaults which may cripple the sector involving micro loans.

FSP in its extant form, let alone leading to any crisis, itself is faced with considerable challenges in its operationalisation. Seeking FSP as per the IBC requires satisfying multiple eligibility criteria which may prove to be burdensome at the stage of scrutiny. FSP applies to unsecured debt incurred three months prior to application and whose aggregate value does not exceed ₹ 35,000. A debtor can seek FSP provided: (a) he has a gross annual income of less than ₹ 60,000; (b) has aggregate value of assets not exceeding ₹ 20,000; (c) does not own a dwelling unit; (d) is not a discharged bankrupt, and (e) has no FSP discharge order secured in the last 12 months. Procedurally, a qualifying debtor may apply for FSP, personally or through a Resolution Professional (RP), to the Adjudicating Authority (AA) which, in this case, is the DRT.

At the first stage itself, the multiple criteria and the suggested procedure are likely to become the bugbear of FSP implementation. The eligibility criteria, however, are very restrictive in terms of practicality and inclusion. Apparently, in proposing such multiple criteria adequate thought does not

seem to have been applied at the time of legislation. Unless the eligibility is made more flexible, FSP itself may become non-workable.

FSP covers only unsecured debt of a borrower. All secured loans obtained through primary or secondary securities become ineligible for FSP. As most formal loans are secured either by primary security (like hypothecation and charge) or secondary security (like collateral and guarantee), they would remain outside the purview of FSP including those of microfinance institutions. Only loans of self-help groups (SHGs) if group guarantee actuated through *inter se* agreement is ignored, and those informal loans lent on purely personal basis by moneylenders, friends and relatives, and traders may be covered under FSP. Irrespective of the security criterion, the eligible loan amount itself may keep away many poor and distress borrowers going by the fact that as per All India Debt and Investment Survey (AIDIS), 2013, the average size of debt of households even in first decile of households itself was ₹ 49,478 in rural areas and ₹ 59,808 in urban areas. Moreover, borrowers of very small loans would be wary of going through formal procedural hassles not to mention the fact that informal borrowers may feel constrained from revealing their source of debt given the social pressures involved.

Similarly, what is prescribed as income criterion only matches the rural poverty line income of ₹ 58,320 for 2011-12. Unless income level is adjusted for current prices, the income criterion again may exclude many low-income borrowers. Another major stumbling block is the criterion of not-owning-a-dwelling-unit. The FSP expects a debtor to be houseless to be eligible. But given the reality that 91% households in rural and 62% in urban own some or the other kind of a dwelling unit, many would be automatically rendered ineligible. Moreover, there is an added trickiness to these criteria given the way they have been specified. Debt, asset, income, and dwelling unit have been specified at the individual level. There would be complication to segregate the individual ownership of these resources to assess the eligibility given their fungible nature. For example, though the title of a dwelling unit could be in the name of the head of the household but other members in the family who also enjoy its benefit cannot be treated as houseless. Similarly, a female member of a SHG owning a house given under a government scheme may take loan for her husband's business which may suffer a loss. Both the husband and wife would be ineligible to seek FSP. The household reality of sharing resources irrespective of ownership is likely to pose difficulty in determining the eligibility.

As regards the procedure, a debtor has to approach a DRT and work through a RP, both of whom are not easily accessible for a vast section given their limited concentration in the country. Thus, the restrictive eligible criteria and limited access may impede effective implementation of FSP.

For FSP to become workable in addressing the acute debt problem of marginal borrowers, a fresh look at its extant provisions becomes absolutely necessary. At the same time, it may become necessary to clarify to the borrowers through a clear dissemination of information that FSP is not a typical loan waiver scheme and that its applicability is only on a case-by-case basis involving due diligence. That said, FSP provisions may be recast in a feasible way by broadly following two

approaches. The first approach is to revise the extant criteria so that FSP becomes more inclusive. A more realistic limit for debt, say up to ₹ 1 lakh, and other criteria reflecting the current prices may be prescribed. At least the criterion of owing a dwelling unit could be dropped. The second approach is to more fundamentally change the FSP yet retaining its original intent of expeditious discharge of small debtors in dire straits. Here FSP may come as part of individual insolvency and could be applicable to only small debtors with less than ₹ 1 Lakh debt. The size of the loan itself should serve as proxy for income and asset. As it is meant for poor in acute state, the distinction between secured and unsecured may be given up eliminating the current discrimination. This becomes necessary as with the introduction of FSP, lenders may start securing their loans directly or indirectly to evade FSP. Instead of multiple criteria, the RP should diligently look at the entire household (immediate family) situation to assess the distress and thereby recommend a fresh start to the AA. If at all, only one or two simple exclusion criteria which are self-indicative, something similar to what is prescribed under socio-economic census (SECC) may be prescribed. If found ineligible for FSP, the debtor may be asked to proceed for insolvency resolution followed by bankruptcy. The period for FSP may be reduced from the current 180 days to 90 days to ensure expeditious settlement.

Regarding the procedure, given the widespread nature of individual cases, the expansion of the DRT network becomes necessary. In addition, alternative mechanisms which are economical and help increase the outreach could be explored within or outside the fold of IBC. For a certain period IBBI may bear the cost of RPs or alternate professionals of FSP while charging some nominal application fee. Formal lenders need to suitably internalise FSP in their risk mitigation mechanism so that loan waivers may become less relevant for such borrowers. The Insolvency Law Committee in its review report (2020)²⁸ on IBC has similarly identified many of the constraining features of the FSP. It has recommended alternatives like making IBBI as the supervising authority of FSP and introducing insolvency advisors in place of RPs. For resolving personal insolvencies more effectively, its suggestions, among others, include introduction of debt settlement, mediation, and debt counselling. Only such a fresh recasting could make FSP and individual insolvency workable. Otherwise, they may remain confined to the statute book rendering IBC an instrument for merely resolving the corporate debt problem.

CONCLUSION

To conclude, IBC for individual insolvencies is ridden with multiple impediments ranging from the unfavorable political economy underpinned by neoliberalism, to design issues which have come to afflict the operationalisation of the legal provisions. The IBC, thus, has remained so far more of a corporate insolvency law in its operations. Unless proactive efforts are made to overcome the impediments highlighted in this paper, IBC faces enormous uncertainty in putting into force individual insolvency, compromising on its ability to balance the economic and social goals. While the new pre-pack scheme for MSMEs, introduced in the IBC as a fallout of COVID-19, has broadened the scope of IBC, the thrust still remains focused on corporate and business enterprises to the neglect of households. A more proactive approach with better clarity and flexibility in the

design as per the ground level realities would enable the provisions of individual insolvency reach their logical end. Further, given the peculiar challenges of household sector debt burden in India aggravated further by COVID-19 and the uncertainty that plagues IBC's individual insolvency, other policy measures for addressing the debt crisis have to be streamlined. Apart from ensuring livelihood security through basic income and wage employment schemes, public health system has to be strengthened in a massive way which can go a long way in mitigating the household level social and economic crisis.

NOTES

¹ The author was a member of IBBI's Working Group on Individual Insolvency. The views expressed are personal.

² Sinha U.K. and Sood S. (2020), "The IBC Imbroglio: Challenges in the light of Covid-19 and Solutions", *Insolvency and Bankruptcy Regime in India: A Narrative*, Annual Publication, IBBI.

³ Feibelman A. (2017), "Legal Shock or False Start: The Uncertain Future of India's New Personal Insolvency and Bankruptcy Regime", *Tulane Public Law Research Paper No. 17-16*.

⁴ *Ibid.*

⁵ Ramsay I. (2017), *Personal Insolvency in the 21st Century: A Comparative Analysis of the US and Europe*, Oxford: Hart Publishing.

⁶ Shekar M. and Guru A. (2020), "Theoretical Framework of Insolvency Law", *Insolvency and Bankruptcy Regime in India: A Narrative*, Annual Publication, IBBI.

⁷ *The Insolvency and Bankruptcy Code, 2016*.

⁸ Such an argument against FSP was put forth by many representatives of the banking and microfinance sector before the Working Group of IBBI on Individual Insolvency constituted in 2018, of which the present author was a member. This issue also has been highlighted in the Report of the Insolvency Law Committee (2020).

⁹ This is because the FSP cannot be equated with a common debt-waiver. Under fresh start a debtor has to voluntarily apply and go through the adjudication process. The adjudication will be on a case-by-case assessment unlike a commonly applicable debt-waiver and involves many hassles.

¹⁰ *Supra* Note 5

¹¹ *Ibid.*

¹² *The Report of the Bankruptcy Law Reforms Committee, Volume I: Rationale and Design, 2015, Ministry of Finance.*

¹³ *Supra* Note 3

¹⁴ *Report of Household Finance Committee: Indian Household Finance, 2017, RBI.*

¹⁵ *NSS 70th Round (2013), Key Indicators of Debt and Investment in India, January- December.*

¹⁶ *Report of the Expert Group on Agricultural Indebtedness, 2007, Ministry of Finance.*

¹⁷ *Accidental Deaths & Suicides in India 2015, 2016, National Crime Records Bureau.*

¹⁸ Shylendra H. S. (1995), "Farm Loan Waivers: A Distributional and Impact Analysis of the Agricultural and Rural Debt Relief Scheme, 1990", *Artha Vijnana*, September, No. 3, pp. 261-275.

¹⁹ *Supra* Note 6

²⁰ *Supra* Note 5

²¹ Stigma can arise even during the bankruptcy process. For example, Section 140 of IBC, 2016 disqualifies

persons undergoing bankruptcy process from holding posts of trustee, and public servant or getting elected to a public office and local authority. They are even disqualified to vote as member of a local authority. Besides taking over all the asset of the debtor, the bankruptcy trustee can make the debtor assist or work (see section 153 (i)) under his supervision in managing the estate.

²² *Supra* Note 5

²³ *Supra* Note 3

²⁴ Shylendra H.S. (2020), "Making IBC work for individuals, too", *The Hindu Business Line*, 07 February.

²⁵ *Kailashchand Khusalchand v. The State of Maharashtra*, 1977, 79 BOMLR 449.

²⁶ Correspondent (2019), "HC cautions against coercive action on pawnbrokers for now", *The Hindu*, 13 September.

²⁷ *Report of the Task Force on Credit Related Issues of Farmers, 2010, Ministry of Finance.*

²⁸ *Report of the Insolvency Law Committee, February 2020, Ministry of Corporate Affairs.*

LEGISLATING FOR CROSS-BORDER INSOLVENCY IN INDIA

Bahram N. Vakil, Suharsh Sinha and Amrita Sinha

The need for a globally recognised framework for addressing cross-border aspects of insolvency is not a recent phenomenon. Various legislative reforms committees have discussed the possible contours of an Indian cross-border insolvency regime since the 2000s. More recent developments in India's insolvency regime, beginning with the near complete overhaul of Indian insolvency laws in 2016, have only amplified the urgency for introducing a cross-border insolvency framework.

It is perhaps now time to take a more definitive step towards a firm cross-border insolvency legislation for several reasons. First, the Insolvency and Bankruptcy Code (Code/ IBC), which was enacted in 2016 has progressively matured into a successful tool for insolvency resolution with a healthy body of judicial precedent, robust market infrastructure and regulatory governance. While there are still parts of the Code that remain to be notified, the corporate insolvency resolution process (CIRP) and the liquidation process provided under the Code for corporate entities have been tested and relied upon extensively over the last five years. The Code and the apparatus that it has set up are well equipped to tackle some of the more complex issues around corporate insolvency.

Secondly, the model law on cross-border insolvency introduced by the United Nations Commission on International Trade Law (Model Law) which was first introduced in 1997 has seen over two decades of evolution. As with the Code, there are aspects of the Model Law which are still seeing new jurisprudence develop. That said, the principles outlined in the Model Law have been adopted by 49 states in a total of 53 jurisdictions with one of the newest entrants being Brazil (which is also the first of the original BRIC economies to adopt the Model Law).¹

Lastly, the jurisprudence under the Code has recently grappled with the issue of cross-border insolvency in some of the big-ticket insolvency cases involving Jet Airways (India) Limited (Jet Airways), Videocon Industries Limited and entities associated with Gitanjali Gems Limited – all of which had significant cross-border assets and liabilities. In the case of Jet Airways, the National Company Law Appellate Tribunal (NCLAT) has approved of a cross-border cooperation protocol between the Indian Resolution Professional (RP) and the Dutch Administrator (appointed in the liquidation proceedings of Jet Airways in the Netherlands).² This protocol has not only been implemented in the on-going proceedings in respect of Jet Airways in India and in the Netherlands but has also been instrumental in facilitating various steps taken by the RP and the Administrator to maximise value. The order of the NCLAT has been welcomed by practitioners and academicians as an important innovation under the new insolvency regime in India.

The Insolvency Law Committee (ILC) was constituted by the Ministry of Corporate Affairs under the Government of India (GoI) to take stock of the functioning and implementation of the Code, identify issues which may impact the efficiency of the Code and make suitable recommendations to address such issues and enhance the efficiency and effectiveness of the current insolvency regime in India.³ The ILC has been evaluating the next steps in formalising India's cross-border insolvency regime. The ILC released its report on cross-border insolvency in October, 2018 (ILC Report) in which it has provided its recommendations on the adoption of the Model Law with some modifications, and has even included a draft of the legislation for this purpose (Draft Law).

This article examines the need for a specialised legislation in the form of the Draft Law, in the backdrop of the existing provisions of the Code on cross-border insolvency. The article then examines certain core elements of a cross-border insolvency regime, namely, its scope of operation and exceptions, the provisions relating to access, recognition, reliefs, cooperation, coordination, and their treatment under the Draft Law. In doing so, it explores the potential need for other tools to supplement the Draft Law to provide a truly comprehensive cross-border insolvency framework.

CURRENT PROVISIONS OF THE CODE AND JURISPRUDENCE

The provisions of the Code currently include two provisions relating to cross-border insolvency. Section 234 of the Code enables the GoI to enter into agreements with the governments of other countries for enforcing the provisions of the Code.

It also enables the GoI to prescribe conditions that will apply to the application of provisions of the Code to assets or property of a corporate debtor (CD) or debtor (including a personal guarantor of a CD) situated in a country outside India with which reciprocal arrangements have been made.

Section 235 of the Code provides that if, in the course of an insolvency resolution process, or a liquidation or bankruptcy proceeding, the RP, Liquidator or Bankruptcy Trustee, is of the opinion that assets of the CD or debtor (including a personal guarantor of a CD), are situated in a country outside India, with which reciprocal arrangements have been made under section 234, he may make

an application to the Adjudicating Authority (AA) stating that evidence or action relating to such assets is required in connection with such process or proceeding, and the AA may issue a letter of request to a court or an authority of such country which is competent to deal with such a request.

These provisions are premised on the GoI having entered into reciprocal arrangements with other sovereign nations to give effect to the principles of recognition, cooperation and coordination. In doing so, the Code recognises the significance of two nations (which are seeking to cooperate in on-going insolvency proceedings relating to an entity) agreeing to a common set of rules.

However, in the five years since the introduction of the Code, India has not entered into any such reciprocal arrangements. While the order of the NCLAT in Jet Airways⁴ has attempted to fill this gap by setting a precedent on cross-border cooperation protocols, the cross-border protocol adopted for Jet Airways was fairly case specific – in that, it was limited to the coordination of actions between two jurisdictions with parallel insolvency proceedings where the respective insolvency practitioners had voluntarily opted to cooperate with each other. It should be noted that in addition to the proceedings in the Netherlands (which was covered by the protocol), Jet Airways had assets and operations spread across various other jurisdictions (including the United Kingdom) – which were not covered by a similar protocol.

Secondly, the scope of the protocol in Jet Airways was to a large extent, limited to facilitating interactions between the two processes while recognising each of the Indian and Dutch court as an independent, sovereign court, with independent jurisdiction and authority with respect to matters before them, even though the protocol draws upon the principles of the Model Law in recognising India as the centre of main interest and setting out a framework for cooperation between the Administrators.

Therefore, the current regime does not provide a comprehensive and consistent framework for cross-border insolvency resolution. While the protocol agreed between the Indian RP and the Dutch Administrator was a path breaking development – it does not go as far as to provide a predictable and certain foundation for administration of cross-border insolvency issues under Indian law. An *ad hoc* precedent based regime is likely to inspire less confidence in global investors seeking to work in or with India Inc., than a comprehensive legislation on cross-border insolvency (which will provide the requisite level of certainty as to their rights in the event of insolvency).

Further, such a comprehensive legislation is likely to minimise delays that would be inevitable if RPs were to approach the National Company Law Tribunals for an order to legitimise cooperation protocols of the kind passed in the case of Jet Airways, in every case where the need arose.

DRAFT LAW: SCOPE AND EXCEPTIONS

The scope of operation of the Draft Law is perhaps one of the most crucial aspects of the discussions around India's cross-border insolvency regime. The very first question in this regard is whether this should extend to persons other than CD under the Code. CDs comprise of Indian incorporated

companies and limited liability partnerships. This does not include individuals or partnerships, and also specifically excludes entities which are ‘financial service providers’.

The arguments against extending the Draft Law to other unincorporated entities/ associations, individuals and partnerships as articulated in the ILC Report are all well-founded. The provisions of the Code relating to individuals and partnerships are yet to be fully enacted and it would be more beneficial to draft a cross-border insolvency framework relating to such persons after jurisprudence in this area develops. Similarly, the provisions relating to group insolvency are still under consideration and in view of this, framing a cross-border insolvency law to cater to group level insolvencies would be premature.

With regard to financial service providers, the insolvency process of such entities would most likely have wider and unique public interest ramifications. Therefore, the drafters of the Code recognised the need to have a specialised regime for insolvency of such entities. In the same vein, a cross-border insolvency regime for such entities would need to be aligned with the policy objectives that will be reflected in the domestic insolvency regime for such entities. Given that an insolvency law for financial service providers (barring a very limited class of non-banking financial companies) is yet to be introduced – it is only fair that the issues around cross-border insolvency of such entities are legislated upon after there is clarity on the domestic insolvency regime applicable to such entities.

The third class of entities that are not included in the definition of CD under the Code are foreign companies (i.e. companies which are incorporated outside India but have operations in India). The ILC rightly recommends that the Draft Law cover the insolvency of such entities. However, since the Code currently does not provide a framework for resolution or liquidation of such entities or their business in India – the most immediate requirement is to introduce a comprehensive regime for the insolvency of such entities under Indian law. It is important to resolve this issue before the Draft Law is enacted because a cross-border insolvency regime would be incomplete if it fails to address cases involving the insolvency of corporate entities incorporated outside India with operations in India (i.e. where the centre of main interest may not be India but where the entities may have an establishment in India with assets and liabilities owed to Indian creditors whose interests must be protected).

In addition to the foregoing, it is imperative to address the issue of reciprocity that is imbibed in the Draft Law. The Draft Law states that its provisions would apply to countries which have adopted the Model Law (as identified in the Draft Law) and certain other countries that may be notified (and with which India has entered into reciprocal arrangements).⁵

It is apparent that the intent is to enable the GoI to enter into standalone arrangements with countries that have not adopted the Model Law and the terms of cooperation with such other countries would then be subject to the conditions specified in the agreement. That said, the Draft Law sets out some guiding principles for such cooperation by bringing proceedings in such countries into the fold of the Draft Law. This offers more certainty on the matter as compared to the existing provisions of the

Code, which provide no parameters or guiding principles that would apply to bilateral agreements that the Indian Government may enter into with other states.

This unfortunately leaves out those countries that have neither adopted the Model Law nor entered into a bilateral agreement with the Indian Government. In such cases, the Jet Airways experience may be leveraged to enable case specific cross-border cooperation protocols which are guided by the principles set out in the Draft Law.

CORE ELEMENTS OF CROSS-BORDER INSOLVENCY FRAMEWORK UNDER THE DRAFT LAW

In this section, the authors examine the treatment accorded to each of the core elements of the Model Law, as incorporated in the Draft Law.

Access

The Model Law has fairly liberal provisions as to access – in that, it allows direct access to both foreign administrators and creditors to the courts of the enacting country. Access would include the ability to commence domestic insolvency proceedings and also to participate in on-going domestic proceedings.

In this regard, as observed by the ILC, the Code already allows foreign creditors full access rights, at par with the rights of domestic creditors, to initiate insolvency proceedings and to participate in such proceedings. When it comes to the rights of foreign administrators or Insolvency Professionals (IPs), the initiation rights available to foreign creditors obviates the need to provide separate rights to foreign administrators to initiate local proceedings.

Other rights as to participation of foreign representatives in insolvency proceedings should further the cause of a holistic resolution process. Allowing foreign representatives to attend proceedings/ meetings of creditors would serve the dual purpose of facilitating a free flow of information between the Indian and foreign administrators and also enable the Indian administrator to rely on the assistance of the foreign administrator in disseminating information to foreign creditors (who may otherwise have logistical constraints in accessing information published in India). This in turn will reduce the burden on the Indian RP/ Liquidator while also ensuring a steady and reliable flow of information to creditors thus aiding the cooperation between the two proceedings.

In assessing the *bona fides* and qualifications of the foreign representatives, while the ILC Report explores the option of requiring such foreign representatives to register in India and/or follow a code of conduct prescribed under Indian law⁶ – the requirement to separately register with Indian authorities might be excessive. Instead, since foreign representatives are also likely to be subject to the laws under which they were appointed, such foreign representatives may be required to provide an undertaking to the Indian court and the Insolvency and Bankruptcy Board of India, confirming

that they will observe the more stringent of the code of conduct prescribed under Indian law and the rules of conduct prescribed in their jurisdiction. This, coupled with the foreign representative's right to participate being predicated on the recognition of the foreign proceedings by an Indian court,⁷ should serve the purpose of ensuring that the foreign representatives follow standard good practices and rules of conduct.

In view of this, the Draft Law may also consider codifying certain specific obligations of a foreign representative – for instance, confidentiality obligations, obligations to disseminate information to foreign creditors and to generally refrain from acts which are in contravention of the Indian proceedings (unless required by their local laws), while stopping short of imposing onerous procedural obligations on foreign representatives which may impinge on the efficiency of the process.

Recognition and Relief

Like the Model Law, the Draft Law includes provisions allowing the AA to recognise foreign proceedings and foreign representatives based on a list of documents that may be provided as evidence of the foregoing.⁸

The Draft Law also recognises the concept of the Centre of Main Interest (COMI) as described in the Model Law. As noted in the ILC Report, assessment of the COMI is 'central to operation of the Model Law', because proceedings in the COMI are given primacy over other proceedings and benefit from immediate and automatic relief.⁹

The Draft Law includes a rebuttable presumption as to the COMI being the jurisdiction in which the CD's registered office is located. There are safeguards against this presumption being used for forum shopping – in the form of a look back period of three months which applies to the determination of COMI. The AA must also consider other factors such as where the CD's central administration takes place in making its determination. Lastly, if these factors are not sufficient to establish the COMI, the Draft Law provides for other parameters to be introduced by subordinate legislation.¹⁰

Given the importance of establishing COMI and the impact that this would have on reliefs available to parties, it would be preferable to have the parameters for assessing COMI included in the principal legislation to the extent possible. This would also serve to provide a clearer legislative mandate to judicial authorities – and indeed experience in more evolved jurisdictions. The United States suggests that a clear legislation on such a crucial element of cross-border insolvency laws would go a long way in reducing the burden on courts.¹¹

Recognition of a foreign proceeding as a foreign main proceeding will, as per the Draft Law result in an automatic moratorium in the nature of the moratorium described in section 14 of the Code. The automatic moratorium is not, however, applicable where the proceedings in India under the Code have commenced before an application for recognition of the foreign proceedings is filed in India.¹²

This moratorium does not restrict parties from initiating proceedings under the Code or filing claims in such a proceeding. Such proceedings may be initiated only if the CD has assets in India and the effect of such proceedings must be limited to assets located in India and to other assets but only, in case of the latter, to the extent of furthering the cause of cooperation and coordination between Indian and foreign proceedings.¹³

The payments that a creditor may receive in corporate insolvency resolution proceedings or liquidation proceedings in India also take into account the payments that such creditor has received in foreign proceedings (to ensure that a creditor does not receive payments in excess of pay-outs to other creditors in the same class on a proportionate basis, by pursuing claims in two or more proceedings).¹⁴

However, the Draft Law will need to consider whether proceedings initiated under the Code in case of corporates having a COMI outside India will follow the 'CIRP' under the Code or will be referred to liquidation or whether an altogether distinct process for resolution shall be suggested for such companies – keeping in mind the general principle of the deference to the foreign main proceedings.

In case of a foreign proceeding being recognised as a foreign non-main proceeding (i.e. a proceeding in a place that is not the COMI of the CD), the AA has been granted wide latitude in the nature of relief that can be granted, subject to the AA ensuring that the interest of the creditors in India are not compromised and reliefs granted with regard to representatives in foreign non-main proceedings relate only to assets which would have been administered in the foreign non-main proceedings (to ensure minimum leakage from the Indian pool of assets).¹⁵

Cooperation

While the Model Law sets out the framework for cooperation between domestic and foreign courts – the ILC Report observes that it may be premature to impose such obligations of cooperation on Indian AAs at this stage.¹⁶ While these concerns are not unfounded, the value of such cooperation cannot be understated and a mechanism to support such cooperation would be crucial to give full effect to the intent of the Draft Law.

Cooperation between Indian IPs/ Liquidators and their foreign counterparts has been provided for and even encouraged in the Draft Law.¹⁷ This could be supplemented with subordinate legislation which outlines the steps that an Indian IP/ Liquidator may need to take and the timelines within which these should be explored to maximise the chances of cooperation, while noting that whether the Indian IP's attempts to so cooperate are fruitful or not will also depend on the actions of its foreign counterparts.

The Draft Law should also provide for similar provisions for proceedings in jurisdictions to which the Draft Law does not apply (i.e. those that have neither adopted the Model Law nor entered into reciprocal arrangements in India) – since cooperation in such cases would be all the more crucial.

CONCLUSION

Global experiences in implementation of the Model Law have indicated that the Model Law may not be sufficient to offer absolute certainty and predictability for creditors and debtors.¹⁸ That said, the Draft Law (and the Model Law on which it is based) is an excellent starting point to formulate a set of guiding principles that is not only aligned with globally recognised best practices but also adapted to uphold the key policy objectives on which the Code was based.

It is inevitable that even after the introduction of a cross-border insolvency law, the jurisprudence around the same will continue to evolve and develop – as has been witnessed in other jurisdictions. It is also inevitable that the law introduced will only provide a framework within which courts and participants across various jurisdictions will operate. The granularities of each case and each experience with another jurisdiction may differ – but this is inimical to any legislation dealing with cross-border issues. As global best practices and policies develop in the area of cross-border insolvency, India if armed with its Draft Law will not only benefit from the experience it gathers but also gain an opportunity to participate in the evolution of an international cross-border insolvency framework. Given the wealth of India’s experience in framing, interpreting, and developing jurisprudence in insolvency laws, India should have as much to offer as it is likely to gain in doing so.

NOTES

¹ UNCITRAL Model Law on Cross Border Insolvency (1997).

² *Jet Airways (India) Limited (Offshore Regional Hub/Offices Through its Administrator Mr. Rocco Mulder) v. State Bank of India and Anr.*, Company Appeal (AT) (Insolvency) No. 707 of 2019.

³ MCA (2017), Notification no. 35/14/2017, Insolvency Section.

⁴ *Supra* Note 2.

⁵ Clause 1 (4), Draft Law.

⁶ Clause 7, Draft Law and paragraphs 6.3 and 6.4, ILC report.

⁷ Clause 9, Draft Law.

⁸ Clause 12, Draft Law.

⁹ Paragraph 11.1, ILC Report.

¹⁰ Clause 14, Draft Law.

¹¹ Byrnes J. (2015), “The Dispute Over Evaluating Center of Main Interests - How Simple Legislation Could Save the U.S. Court System Time and Money”, *Journal of International Business and Law*, 14 (2).

¹² Clause 17 and Clause 25, Draft Law.

¹³ Clause 24, Draft Law.

¹⁴ Clause 28, Draft Law.

¹⁵ Clause 18 (3), Draft Law.

¹⁶ Paragraph 16.2, ILC Report.

¹⁷ Clause 22(1), Draft Law.

¹⁸ Gopalan S. and Guihot M. (2015), “Recognition and enforcement in cross-border insolvency law: A proposal for judicial gap-filling”, *Vanderbilt Journal of Transnational Law*, 48(5), pp. 1225-1284.

ALL FOR ONE, ONE FOR ALL : DECODING GROUP INSOLVENCIES IN INDIA

Sanjeev Krishan and Rabitah Khara

The Insolvency and Bankruptcy Code, 2016 (Code/IBC) was promulgated with the objective of rescuing overleveraged entities, reviving them and maximising value for all stakeholders. The Code consolidated the fragmented laws concerning reorganisation, insolvency resolution and liquidation of corporate persons. Nearly five years since its enactment, one can say that the IBC has evolved into a fairly robust legislation, with successive legislative and judicial interventions plugging gaps and providing a clear implementation path. However, a uniform and clear framework for the resolution of insolvency proceedings involving different group entities is still not available under the Code.

THE PRACTICAL NEED FOR GROUP INSOLVENCY

The existence of group structures is a reality in the modern business world where operations span multiple legal entities and jurisdictions. Depending on a range of factors (such as regulations, market valuation, ease of control and ring-fencing of assets), various legal entities are set up, each having its own primary responsibility. There are numerous instances of well-known global and Indian enterprises with complicated group structures. For instance, the IL&FS Group comprised 348 entities, including various offshore entities.¹ With such structures being commonplace, there must be a solution to deal with them.

A critical feature of any resolution process is the time taken for resolution. After all, a rupee recovered today is not the same as a rupee recovered a year later. While the Code clearly lays out timelines for

the completion of an insolvency process, the average time taken has far exceeded the envisaged time. In fact, nearly 79% of ongoing corporate insolvency resolution processes (CIRPs) have exceeded the period of 270 days². It is likely that if the CIRPs of various group entities individually take this long, then the time to resolve the group debt may take longer. This may lead to significant erosion of asset value and prevent the objective of value maximisation from being met.

While the aspect of extended timelines is troublesome on its own, it does not take into consideration the added uncertainty and complexity when group entities have ‘connected’ businesses, not all of which are simultaneously in insolvency. This can be a massive hindrance to achieving a meaningful resolution of the debt of these companies. For instance, take the case of a business with two connected entities (Company A and Company B), where both are in financial distress, but only Company A is undergoing a CIRP. A resolution applicant (RA) who is interested in the business would have to submit a resolution plan for Company A without any clarity on the fate of Company B despite it impacting the value of Company A. The extent and direction of dependence, the ability to sever such a connection and the subsequent cost could deter an RA from bidding for Company A. Even if a plan is submitted, it is likely to have condition precedents in an attempt to add certainty with respect to the ability to acquire Company B. If the processes related to group entities can be coordinated and run under a formal group insolvency structure, these issues can be dealt with, thereby fostering healthy competition for them.

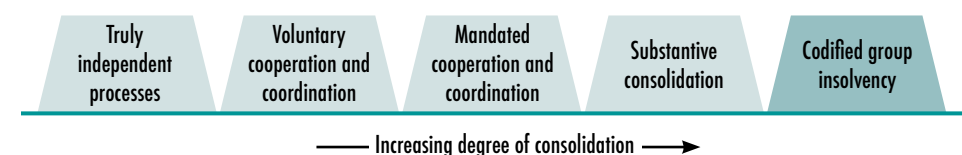
When one looks at group companies, it is fairly common to see interlinkages which could take the form of related-party transactions, interconnected operations, shared assets, inter-corporate loans and cross-collateralisation. It is thus often difficult to understand the operations of each corporate debtor (CD) in isolation. However, the very nature of the CIRP, as it stands today, requires a focus on the CD, and not on a group or a business. Therefore, when an RA participates in a CIRP, there are bound to be questions that cannot be answered as they are outside the realm of the CD in question. But, at the same time, these questions are critical in assessing the future viability of the business. This issue of siloed information can be resolved if the focus shifts from a company to a group.

Next, one must look at alleviating the procedural burden. The Resolution Professional (RP) spends weeks collating and analysing claims; the creditors (usually common for group companies) spend a similar amount of time answering the same queries for each CD; and in cases where the CIRP of each entity ends up in front of a different bench, the basics need to be reiterated each time for the Adjudicating Authorities (AAs). Now imagine a joint process for the group and the duplication of effort that can be avoided, saving time and expenses. Additionally, related matters being under different benches can create further complexity owing to conflicting orders being passed. In the case of the Videocon Group, the principal bench of the AA has passed an order to transfer all matters of the specified companies to the Mumbai Bench to ‘inter alia, serve the basic purpose of tagging of all matters to avoid conflicting orders, if any, in the connected matters’³, indicating the recognition of this risk.

THE STORY OF INSOLVENT GROUP COMPANIES IN INDIA

With the Code having a CD focus, the CIRP of group entities has been dealt with largely independently. However, as the number of such cases and their complexity increased, unique issues came to the forefront, causing various stakeholders to explore other options. We have thus seen group insolvencies evolve from independent processes to coordinated processes to substantive consolidation. The insolvency journey of group entities can be classified into five key categories based on the degree of consolidation. The instances in this section are those where a CIRP retrospectively appears to fit in a certain category; it is however difficult to say whether or not that was the intent of the stakeholders at the outset.

Figure 1: Spectrum of Insolvency resolution involving group companies



Category 1: Truly independent processes

This refers to situations where a CIRP is carried out without paying heed to the other related insolvency proceedings. Any commonality is unintended, and no synergy is gained from the processes. This includes the insolvency timeline, the RP, the process to invite resolution plans and the resolution plan.

One such instance is that of Bhushan Steel Ltd. (BSL) and its subsidiary Bhushan Energy Ltd. (BEL). BSL was engaged in manufacturing steel and steel products, while BEL housed the captive coal power plant supplying energy to BSL. Both CIRPs were run independently with different RPs and different timelines (BSL initiated in July, 2017 and BEL in January, 2018). However, Tata Steel emerged as the successful bidder, first for BSL and later for BEL. In fact, the acquisition of BEL was done through Tata Steel BSL Ltd. (the erstwhile Bhushan Steel Ltd.), duplicating the structure that existed before the insolvency proceedings. If Tata had been unable to acquire BEL, it would possibly have had to rely on the new shareholders of BEL for a critical raw material or even have had to make a large investment to create a new source of power. The financial implications of both these options could have significantly impacted the standalone viability of BSL.

Category 2: Voluntary cooperation and coordination by the committee of creditors

This refers to situations where the committee of creditors (CoC) decides to run multiple CIRPs together with the dual objective of minimising the compliance burden and increasing the odds

of resolution. The likelihood of successful coordination is significantly higher if the CoC files applications for insolvency with this in mind. This allows matching of insolvency commencement dates so that all group companies are at the same stage of insolvency at the same time. Various deadlines, including that for submission of resolution plans, can be closely matched, solving one of the biggest problems of such processes. Another key aspect is cooperation of the CoC(s) and the RP(s) with the overall direction of the insolvency in terms of information sharing and decision making. The more the overlap in the creditors, the higher is the chance of achieving this.

A case in point is the insolvency of the four entities that formed the metals and mining group: Adhunik – Adhunik Metaliks Ltd. (AML), Zion Steel Ltd. (ZSL), Orissa Manganese & Minerals Ltd. (OMML) and Adhunik Alloys & Power Ltd. (AAPL). OMML was engaged in mining and agglomerating iron fines into pellets. It was a strategically located, critical raw material supplier to AAPL which was engaged in steel-making operations. AML was in the business of manufacturing special alloys and stainless steels, with its subsidiary ZSL having an associated and co-located steel-rolling facility. Three of these entities had an obligor/co-obligor loan structure, making the lenders common for the three. A significant overlap for the fourth allowed decisions across the four entities to be taken smoothly as interests were aligned. The creditors filed for insolvency of the four companies at nearly the same time and consequently, the insolvency commencement date of three was identical, while that of the fourth was a mere 20 days later (all in August, 2017). The creditors also appointed a common RP, allowing voluntary alignment of the resolution process of the four group companies. Incidentally, all the processes were adjudicated by the same AA bench. Liberty House emerged as the successful bidder for AML and ZSL, while a consortium of bidders (Atha Group and Misra Group) emerged successful in the case of OMML and AAPL.

Category 3: Cooperation and coordination mandated by the AA

Under this category, multiple group companies are undergoing insolvency, and the AA allows procedural coordination. This implies that the processes will run parallelly and there shall be sharing of information and coordination of processes, including those related to finalising claims and approving the resolution plan. However, the legal entities shall continue to be treated separately with their own independent assets and liabilities, implying that the claims and hence rights of the creditors are in no way impacted. Such cases are typically accompanied by a common RP and a common bench.

The insolvency proceedings of the six entities of the real estate group Adel (Adel Landmarks Ltd., Sachet Infrastructure Pvt. Ltd., Magad Realtors Pvt. Ltd., Mehak Realtech Pvt. Ltd., Sameeksha Estate Pvt. Ltd. and Jamvant Estates Pvt. Ltd.) are an interesting example of such a case. The business in question was that of developing a housing colony where Adel Landmarks Ltd. was the developer (and principal borrower) and the other five entities were land-owning entities (and guarantors of the debt of the principal borrower). When the Appellate Authority was approached for this matter, it ruled that *'a group insolvency is to be initiated and in absence of simultaneous 'Corporate Insolvency Resolution Process' against five 'Corporate Debtors' namely, the*

township project of Town and Country Planning, Haryana, will not be complete'.⁴ The Appellate Authority in its order also appointed the RP of Adel Landmarks Ltd. as the common RP for all six entities and also mentioned a 'consolidated 'Resolution Plan(s)' for total development' of the colony.

Category 4: Substantive consolidation directed by the AA

In this category, the AA rules for substantive consolidation, implying that for the purpose of resolution, multiple group companies in insolvency are to be treated as a single economic unit with pooled assets and liabilities. This pooling of liabilities results in intra-group claims being offset and a 'new order' of creditors emerging from the cumulative claims. Other features include a common bench, common RP, identical insolvency commencement date (ICD), joint information memorandum (IM) and a joint resolution plan.

The first case of this nature was Videocon Industries, where the AA was faced with the consolidation of 15 entities. The AA granted substantive consolidation for 13 entities and kept two entities out of the purview as they could function independently. The order also appointed a common RP for all 13 entities and excluded the time prior to the order date from the calculation of 180 days, effectively resetting the ICD date and arriving at a common ICD for all. Another aspect of the consolidation was that the information memorandum was to be prepared based on the consolidated balance sheet of the group. In arriving at this order, the AA considered many factors, including the fact that no expression of interest (EOI) had been received till the date of the order, showing that actions may need to be taken to boost interest from RAs. As a result, the order states, *'all are to be consolidate which shall create a high value cumulative asset, going to attract an equally high value Resolution Plan'*. The other factors expressly stated to play a role in the decision are:

- common control
- common directors
- common assets
- common liabilities
- interdependence
- interlacing of finance
- pooling of resources
- coexistence for survival
- intricate link of subsidiaries
- intertwined accounts
- interlooping of debts
- singleness of economic units
- common financial creditors
- common group of CDs.

Category 5: Consolidation under a codified law

This category is purely theoretical today and hence aspirational. The idea is to have a codified law which lays out a framework for the applicability and process of group insolvency. While this is likely

to be an amalgamation of the previous categories, the codified framework will lend uniformity, clarity and minimise the burden on the CoC, RP and AAs, which have thus far been responsible for any cooperation and consolidation. The next section discusses the key aspects that such a law must address in greater detail.

Figure 2: Features and examples of various categories of group insolvency resolution

Category	Typical features	Select cases
#1 Truly independent processes	<ul style="list-style-type: none"> Independent process for each company No need for CoC and RP cooperation RAs forced to view all processes as separate No synergy in the processes and resolution plans 	<ul style="list-style-type: none"> Bhushan Steel and Bhushan Energy Essar Steel and Odisha Slurry Pipeline Infrastructure KSK Mahanadi, KSK Water and Raigarh Champa Rail
#2 Voluntary cooperation and coordination by the CoC	<ul style="list-style-type: none"> Nearly same ICDs and other deadlines Common or cooperative RPs Sharing of relevant information Cooperation allows RAs to evaluate assets better Synergy of process and resolution plans 	<ul style="list-style-type: none"> Adhunik Metaliks, Zion Steel, Adhunik Alloys and Orissa Manganese Uttam Galva Metallics and Uttam Value Steels Neo Infra and Brys International
#3 Mandated cooperation and coordination by the AA	<ul style="list-style-type: none"> Same ICDs, common RP and single bench Mandated to share relevant information Processes to run simultaneously Joint IM and resolution plan 	<ul style="list-style-type: none"> Adel Landmarks, Sacht Infrastructure, Magad Realtors, Mehak Realtech, Sameeksha Estate and Jamvant Estates
#4 Substantive consolidation mandated by the AA	<ul style="list-style-type: none"> Same ICD, common RP and single bench Mandated to share relevant information Pooled assets and liabilities Joint IM and resolution plan 	<ul style="list-style-type: none"> 13 entities of the Videocon group Lavasa Corp, Warasgaon Asset and Dasve Convention Centre
#5 Codified group insolvency	<ul style="list-style-type: none"> Process as per statute and not decision of CoC and/or AA Possible features: Common or cooperative RP, joint application, single EOI, single bench, joint resolution plan, pooling of assets 	<ul style="list-style-type: none"> Still awaited

ROADBLOCKS TO CODIFIED GROUP INSOLVENCY

While the need for codifying a group insolvency framework and the related benefits is evident, one must understand and appreciate the complexities involved. The standardisation resulting from a codified framework and the unique needs of every case are at odds with each other, and it seems, for now, that a common solution is still some distance away. There are a few critical questions that a codified law must answer, and these questions are what is standing in the way of a codified framework.

When will the group insolvency framework be applicable?

Any codified law must begin by addressing the instances that should be covered under group insolvency. The report submitted by the Insolvency and Bankruptcy Board of India (IBBI) constituted Working Group on Group Insolvency (WG Report) has done some work in this area and recommends the following:

- defining a ‘corporate group’ – holding company, subsidiary and associate companies, and
- allowing an application to be made to the AA to extend this, where necessary, to companies that do not fall under the purview of the recommended definition.

While it is to be seen what the codified law ends up stating in this regard, even if these recommendations are followed, there are many questions that the fine print will need to answer.

- Will the law automatically apply to companies that fit the definition or is there a need for creditors to validate the decision?
- If creditors have a role to play, is it only the financial creditors (FCs) who can approve such a consolidation? Does, say, an operational creditor (OC) or even an RA have the power to seek such a consolidation from the AA?
- Does the role of the CoC in approving the consolidation differ in procedural consolidation versus substantive consolidation?
- If the different CoCs have approved procedural coordination (or specifically cooperation in a case which falls outside the definition of a corporate group), does one need to burden the AA with validating this decision?

Should the framework be rolled out in a phased manner based on level of consolidation? The WG Report recommends a phased approach with only procedural coordination being dealt with in phase 1. While not the same, this recommendation in a way echoes that of the March, 2018 report of the Insolvency Law Committee (ILC)⁵, which also favoured deferring the subject, stating that ‘*the current system of insolvency law is new, and it may be too soon to introduce a complex subject, like the present issue*’.

At the other end, however, the practical need is very different and interestingly, the *Videocon* consolidation order dated August, 2019 (nearly the same time as the WG Report dated September, 2019) refers to the ILC report and states,

At that point of time the Hon'ble Members of the Insolvency Law Committee have thought that the mechanism of combining Insolvency proceedings in respect of associate or holding companies was 'too soon to introduce', but the jurisprudence on Insolvency Code developed very fast in last 3 years, as witnessed by all, that this problem of 'Consolidation' has also cropped sooner than expected in this Group of cases, so pressing that it cannot be avoided or deferred.

Today, in the year 2021, one cannot help but wonder - if work on framing a comprehensive group insolvency law does not commence soon, then when will it ever become a reality?

What does consolidation mean in the case of group insolvency?

The next question is related to defining the types of consolidation that group insolvency will cover. The WG Report recommends two key categories – procedural and substantive, with procedural consolidation revolving around joint application, information sharing, cooperation, group creditors committee, a single RP and single bench.

- What if there are group companies which are not currently in a CIRP, but are key to the resolution of the companies in a CIRP? Can these be brought under the purview, even if purely from an information-sharing perspective?
- What if group companies not currently in a CIRP are linked to the debt being resolved or are highly dependent on the companies being resolved? Should they be brought under the purview of group insolvency?

A case in point is Lavasa Corporation Ltd. (LCL) which has a subsidiary called Dasve Retail Limited (DRL). The sole business of DRL is operation of retail business for the properties belonging to LCL. As per the AA consolidation order, '*the revenue stream of DRL will cease to exist with the Insolvency of LCL*' and '*entire financial debt of DRL has been admitted as with financial debt of LCL pursuant to the corporate guarantee and security provided by LCL to the lenders of DRL*'.⁶

- How will one determine whether the insolvency is fit and proper for substantive consolidation or procedural consolidation?
- Given that companies are already opting for voluntary cooperation, what are the new rights that a codified law will really add?

How can one achieve pooling of assets and liabilities? While substantive consolidation will only be considered in select cases, it is these cases that pose the real challenges and where the law needs to be robust. A key aspect relates to the impact of consolidating a smaller group entity with significantly larger group entities. Such consolidation may result in loss of voice of the creditors of the smaller entity and may actually result in timelines getting unduly extended with little value to be gained. The motivation for such participants to cooperate with the process is likely to be low. Additionally, while consolidation is done to increase the overall value, it may even cause redistribution of the base value, negatively impacting some creditors. There are many questions that arise on this front:

- How does one even arrive at a consolidated list of claims? Is it a simple summation or are individual rights to be retained to some extent?

- Does the pooling reset the liquidation waterfall or is pooling to happen category by category? In the former case, how does one protect the rights of creditors, say, OCs, who in separate insolvencies were attributed value (as liquidation value), but have lost the same in the consolidation?
- How will the representation of creditors other than FCs be protected in the CoC? Say, an OC who has representation in the CoC of one entity, but does not meet the threshold for representation after consolidation?

UNDERSTANDING THE GLOBAL LANDSCAPE

When one looks at the global group insolvency landscape, a few aspects stand out. Firstly, the journey to a codified group insolvency framework has been a long one for most nations. In the mid-1990s, the UK, while deciding whether to participate in the European Convention on Insolvency Proceedings noted that it did not deal with group insolvencies.⁷ Even the subsequent European Council Regulation on Insolvency Proceedings dated May 29, 2000⁸ did not address the issue. It is only the recast Insolvency Regulation of the European Union (EIR) which came into force on June 26, 2015⁹ that addressed group insolvencies. Germany, as one of the few European countries with a law on group insolvency, only saw relevant provisions being introduced effective from April 21, 2018, despite the process having begun in 2013.¹⁰ Similarly, Working Group V of the United Nations Commission on International Trade Law (UNCITRAL) had, while discussing cross-border insolvency during the 1990s, considered group insolvency to be 'a stage too far'.¹¹ The UNICTRAL Model Law on Enterprise Group Insolvency (MLEGI) was finally approved on July 15, 2019.¹² These long timelines are indicative of the level of complexity linked with group insolvency frameworks.

Secondly, the focus of these laws is on communication, coordination and cooperation, with substantive consolidation either not being considered or being considered only in special circumstances. The EIR for one does not allow any consolidation¹³, despite the same being recommended in the proposal report submitted to the EU Parliament.¹⁴ The German insolvency law, while addressing group insolvency, does not cover substantive consolidation.¹⁵ The UNICTRAL MLEGI also does not explicitly cover substantive consolidation in the text of the model law. However, through the implementation guide, it mentions that procedures such as substantive consolidation can be considered.¹⁶

Thirdly, where substantive consolidation is 'allowed' (to a certain degree) by the legislation, its applicability is typically addressed case by case by the judicial system. Additionally, while basic concepts of substantive consolidation are accepted by all, there is still limited clarity on applicability. A study of the case laws of the USA shows a significant library of related jurisprudence with many interesting observations by courts about key factors to consider while assessing applicability of substantive consolidation. Some of the landmark cases are listed below:¹⁷

- *Sampsell v. Imperial Paper (Supreme Court, 1941)*: Considered as the origin of substantive consolidation, it was anchored in the debtor being 'hopelessly insolvent' and of 'fraudulent character'.

- *Chemical Bank New York v. Kheel* (Second circuit, 1964): Introduced consolidation for ‘hopeless’ commingling of assets and liabilities.
- *Drabkin v. Midland-Ross Corp.* (In re Auto-Train; D.C. circuit, 1987): Established a test for retroactive substantial consolidation.
- *Union Saving Bank v. Augie/Restivo Banking* (Second circuit, 1988): Introduced the two-prong test – treatment as single economic unit by creditors and entanglement leading to consolidation benefiting all creditors.
- *In re Owens Corning* (Third Circuit, 2005): Ruled that deemed consolidation (consolidation solely for the purpose of settling claims and not thereafter) was against the principles of substantive consolidation. It also laid out five overarching themes to consider for substantive insolvency to avoid incorrect application of a checklist. This was a case where the third circuit reversed the decision of the district court for substantive consolidation.¹⁸

Fourthly, the concept of recognition of the enterprise group is not limited to insolvency law. Various countries have either introduced, or at some point evaluated introducing, such a concept to local company law, banking law and competition law, among others. The introduction of such a concept in company law, for instance, can have an impact on how groups are regulated and perceived prior to insolvency. Measures can be taken to increase governance to possibly avoid insolvency. At the same time, it can possibly be used to incorporate safeguards, during the solvency of the corporations rather than *post facto*, to protect third-party shareholders and creditors while penalising related entities if they put the entity in question at a disadvantageous position without adequately compensating for the same. This can be viewed as a combination of a preventative measure and a measure which will solve many of the questions related to consolidation if a group insolvency scenario does arise.¹⁹

LOOKING TO THE FUTURE

Having reviewed the journey of the insolvency law of India and that of other nations, it is clear that group insolvency laws are highly complex, and this often leads to the matter being deferred. But our nearly half a decade of experience in resolutions (including group resolutions) has resulted in various stakeholders coming to accept the requirement of a codified group insolvency framework. This readiness is perhaps the single largest enabler for the success of such a framework and indicates that the time for a codified group insolvency framework is now. While other nations may have taken decades to reach a codified framework, India must no longer defer this issue and seek to learn from their journeys so that the Indian journey to group insolvency can be shortened. The WG Report is clearly a big step in the right direction. But one needs to continue on to the fine print and expedite the journey which is underway.

At the same time, these experiences have raised a slew of questions which a codified law must answer in an easy-to-implement manner while reducing the overall timelines and complexity of the process. It is critical for the framework to address the various consolidation options, their applicability and the nuances linked with each. While one can again seek inspiration from one’s global peers, it is important to note that each country has a unique business environment and one must keep this in

mind when framing a solution. For instance, substantive consolidation (possibly the most complex aspect of group insolvency) is much more common in the US, with the first accepted case being as old as 1941. In contrast, the EU (and most European countries) focuses on procedural consolidation which is essentially cooperation and coordination of proceedings. All options must be carefully studied and only the path that works for our ecosystem should be chosen.

While the need of the hour is to develop a framework, it is equally vital to enable the simplification of group insolvencies in the future. The insolvency proceedings of group entities have helped us learn about the interdependence of these entities and the intricacies involved in resolving them. These learnings can be implemented to make future loan agreements more robust and revamp the entire outlook towards security interest when it comes to lending to such entities. Additionally, the experiences of other nations, including those related to recognition and treatment of groups in company law, can be an interesting area to explore in this context. These measures can enable us to enhance corporate governance and transparency, and possibly even avoid some of the issues being faced today in group insolvencies. All said and done, the Indian group insolvency journey is at an interesting juncture and the future is sure to hold numerous successes in this matter.

NOTES

¹ Report by IBBI Working Group on Group Insolvency, September, 2019.

² IBBI Quarterly Newsletter, January-March, 2021.

³ NCLT (Mumbai Bench) order, MA 1306 -2018 and Ors., MAs CP 02-2018 and Ors. CP, August 8, 2019.

⁴ NCLAT order, Company Appeal (AT) (Insolvency) No. 377 of 2019, September 20, 2019.

⁵ Report by the Insolvency Law Committee, March, 2018.

⁶ NCLT (Mumbai Bench) order, MA 3664-2019 in C.P.(IB)-1765, 1757 and 574-MB-2018, February 26, 2020.

⁷ Report of the European Parliament’s Committee on Legal Affairs on Insolvency proceedings in case of groups of companies, March, 2011.

⁸ European Union Council Regulation (EC) No 1346/2000 on insolvency proceedings, May 29, 2000.

⁹ Regulation (EU) 2015/848 of the European Parliament and of the Council on insolvency proceedings, May 20, 2015.

¹⁰ Bruder F. (2017), “Germany introduces legislation to facilitate corporate group insolvencies (Konzerninsolvenzrecht)”, DLA Piper, 07 July.

¹¹ Supra Note 7

¹² UNCITRAL Model Law on Enterprise Group Insolvency with Guide to Enactment (2019).

¹³ Supra Note 9

¹⁴ EU Commission Report, October, 2011.

¹⁵ Supra Note 10

¹⁶ UNCITRAL Model Law on Enterprise Group Insolvency with Guide to Enactment, February, 2020.

¹⁷ Graulich T. (2006), “Substantive Consolidation - A Post-Modern Trend”, Davis Polk and Wardell, ABI Law Review, Vol. 14, pp. 527-566.

¹⁸ Vron V. (2011), “Owens Corning: To Sub Con or Not to Sub Con?”, Weil, Gotshal and Manges LLP.

¹⁹ Bohlhoff K. and Budde, J. (1984), “Company Groups - The EEC Proposal for a Ninth Directive in the Light of the Legal Situation in the Federal Republic of Germany”, Journal of Comparative Business and Capital Market Law, pp. 163-197.

RATIONALISING GROUP STRUCTURE THROUGH INSOLVENCY LAW

Pratik Datta¹

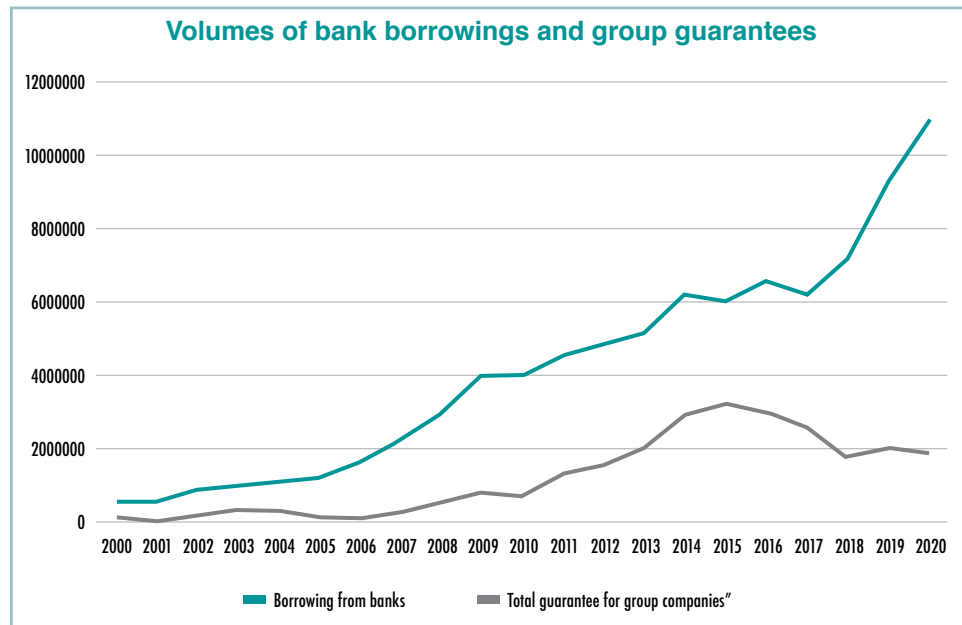
INTRODUCTION

Complicated group structures make insolvency resolution of group companies challenging. The Insolvency and Bankruptcy Code, 2016 (Code/IBC) does not squarely address such challenges. This is the reason why Indian judges and policymakers have been grappling with group insolvency cases like Videocon, Era Infrastructure, Lanco, Educomp, Amtek, Jaypee, Aircel, RCom and IL&FS. Reacting to these challenges, the Insolvency and Bankruptcy Board of India (IBBI) constituted a Working Group on Group Insolvency in 2019 to recommend a complete regulatory framework to facilitate insolvency resolution and liquidation of corporate debtors (CDs) in a corporate group. The Working Group highlighted that key elements of a group insolvency framework must include procedural coordination mechanisms, substantive consolidation mechanisms and rules against perverse behaviour. However, it recommended phased implementation of these mechanisms, with only procedural coordination of companies in domestic groups being implemented in the first phase.² In the meantime, the National Company Law Tribunal (NCLT) in *State Bank of India v. Videocon Industries Limited* used substantive consolidation to simplify the resolution of intricately interlinked group companies.³

A common source of complexity in group structures is the frequent use of inter-corporate guarantees within group companies for external credit, that is, *intra-group guarantees*. Figure 1 shows that the volumes of total group guarantees and bank borrowings by BSE 500 listed companies have grown steadily over the last two decades.⁴ The compounded annual growth rate (CAGR) of total

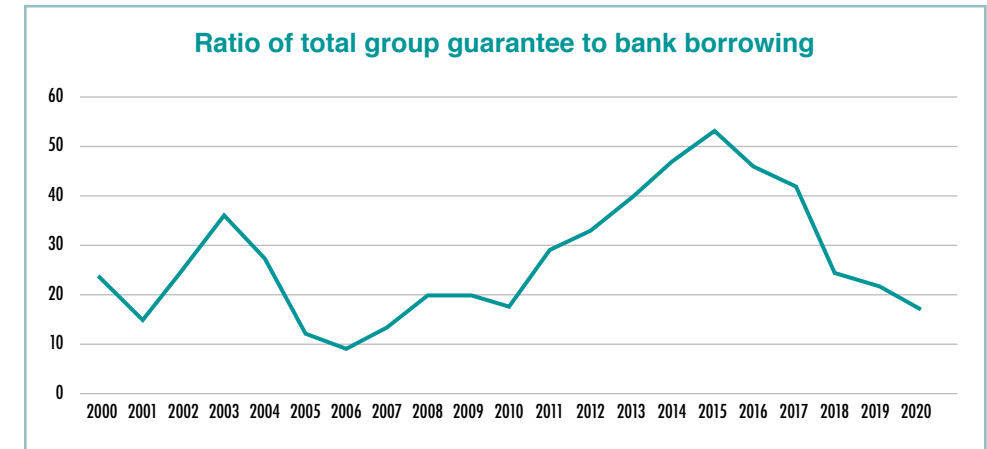
group guarantees by value over the last 20 years has been 13.68 %. Figure 2 plots total group guarantees as a percentage of bank borrowings by value of BSE 500 listed companies over the last 20 years. Since 2006, the value of total group guarantees as a proportion of bank borrowings steadily increased to reach 53.21% in 2015. Since then, the ratio has steadily decreased to reach 17.2 % in 2020.⁵ To better understand this trend reversal, Figure 3 plots the year-on-year growth in total group guarantees against year-on-year growth in bank borrowings by the BSE 500 companies. This reveals that between 2010 and 2015, the growth in total group guarantees was higher than the growth in bank borrowing. After 2015, this trend reversed. However, on average, the value of total group guarantees has been 27.4 % of bank borrowings over the last 20 years. Therefore, it may be concluded that intra-group guarantees have been used quite extensively by listed Indian companies, although their growth in volume terms has been decreasing since 2015-16. Such extensive use of intra-group guarantees creates intricate inter-linkages across group companies complicating the overall group structure.

Figure 1: Volumes of group guarantee and bank borrowings by BSE 500 listed companies



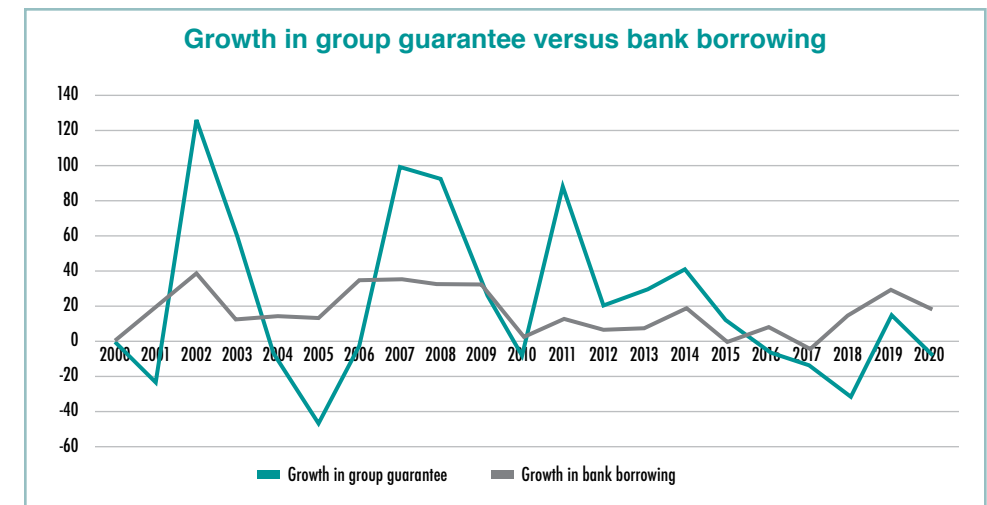
Source: CMIE

Figure 2: Group guarantees as a percentage of bank borrowings by BSE 500 listed companies



Source: CMIE

Figure 3: Year-on-year growth in group guarantees and bank borrowings by BSE 500 listed companies



Source: CMIE

These complications impose huge costs during group insolvency resolution in court as well as in out-of-court restructuring. In a bid to reduce such costs, the NCLT has held that the presence of intra-group guarantees could lead to a decisive conclusion for triggering substantive consolidation of insolvent group companies.⁶ Yet, a conceptual understanding of why Indian business groups frequently employ intra-group guarantees, that complicate their group structures, is still elusive. In this backdrop, this paper uses concepts from contemporary law and economics literature to examine

whether insolvency law could design *ex-ante* incentives to nudge rationalisation of intra-group guarantees to simplify inter-connectedness within group structures.

The paper is structured into five parts. First, the paper reviews the relevant law and economics literature. Second, based on this review, it develops the research question that this paper will focus on. Third, the paper uses two leading law and economic theories to develop a conceptual theoretical framework to understand the economic function of cross-liability provisions like intra-group guarantees in corporate groups. Fourth, the paper uses this conceptual framework to identify the potential perverse incentive for shareholders to overuse intra-group guarantees, complicating group structures. Fifth, the paper argues that this incentive problem could be resolved by tweaking the statutory waterfall under insolvency law to reduce the incentive of an external creditor to extend credit to a group company based on intra-group guarantees when the assets of the corporate debtor and the corporate guarantor are highly correlated. The paper concludes that such a shift in the *ex-ante* incentive of an external creditor would help address shareholders' perverse incentive to overuse intra-group guarantees and simplify inter-connectedness within group structures.

LITERATURE REVIEW

Business groups often structure themselves into multiple limited liability companies. A persuasive theory suggests that such group structure helps create internal partitioning of the business assets into separate companies, enabling each creditor to lend against a particular asset pool within the broader group.⁷ This reduces the information and monitoring costs for creditors, enabling them to extend credit at lower interest to the business group. Although compelling, the internal partitioning theory fails to explain the extensive use of intra-group guarantees within business groups. Such guarantees dilute the internal partitioning of business assets across group companies and therefore, should increase the cost of capital for the group. This shortcoming in the internal partitioning theory has been addressed by a relatively newer theory - the correlation seeking theory.⁸

The correlation seeking theory argues that a positive correlation between the risk that a firm will fall insolvent and the risk that its contingent liabilities (such as guarantees issued by it) will be triggered enriches the firm's shareholders at the expense of its unsecured creditors.⁹ Applied to corporate groups, if there is a high degree of correlation in the insolvency risks of companies within the group, intra-group guarantees would enhance shareholder value at the expense of the unsecured (non-guaranteed) creditors of the group companies. As long as the group is solvent, the guarantees would help reduce their cost of debt capital. Consequently, lesser amounts would be spent to service the debt, enhancing shareholder value. On the other hand, if the group companies go insolvent simultaneously due to their highly correlated insolvency risks, invocation of the guarantees would not affect the shareholder value since the equity value of the group companies would have already been wiped away due to insolvency. The guaranteed creditors would recover their dues from the assets of the insolvent group companies at the expense of the unsecured (non-guaranteed) creditors. Effectively, the group could use contingent liabilities (such as intra-group guarantee) to sell to the guaranteed creditors a part of a group company's future insolvency estate that would otherwise have

gone to the unsecured (non-guaranteed) creditors. Therefore, this theory posits that shareholders have a perverse incentive to form too many subsidiaries and then create intra-group guarantees to enhance shareholder value through correlation seeking opportunities at no cost to themselves, complicating the overall group structure.¹⁰

An even newer theory however suggests that there are genuine commercial benefits for which groups develop sophisticated legal mechanisms to partition assets across some dimensions but not others - tailored partitions. At the time of lending, neither the creditor nor the group knows which state of the world will materialise in the future. In certain states of the world, there may be group-wide failure and the creditor may need to exit from the entire group. In some other states of the world, there may be a project-specific failure and the creditor may need to exit from that particular project but not from the entire group. The challenge is to design an *ex-ante* legal mechanism such that the creditor has the *ex-post* option to address group-wide risks as well as project-specific risks and failures, depending on the signal that the creditor receives in the future. Tailored partitioning helps create such *ex-post* option for the creditor, reducing cost of monitoring and enforcing loan agreements. This in turn helps reduce the whole group's cost of debt capital. Therefore, the 'tailored partitioning' theory suggests that there are genuine commercial motivations for a group to structure itself into a complex web of affiliates interconnected through cross-liability provisions like intra-group guarantees.¹¹

It is important to note here that business groups have also been extensively studied by non-legal academics across a vast range of disciplines including economics, finance, business history, and sociology. This literature throws light on the potential factors behind formation of business groups. For instance, it has been suggested that business groups may make up for the lack of mature economic institutions and rule of law which are necessary for entrepreneurship. In countries with poorly developed capital markets, business groups provide an alternative mechanism to raise capital through their own internal capital markets. For example, a group may include a main bank or a cash-rich group company and provide funding to affiliated companies which are too small or opaque to have easy access to funds from external capital markets. Similarly, in countries with poorly developed labour markets, groups provide an alternative through their own internal market for talent. For instance, the Birla group in India has founded and financed new firms, which were later spun-off using entrepreneurial talent of its employees. The process of 'spawning' new companies by established business groups may be potentially beneficial to an emerging economy where starting new businesses *de novo* may be otherwise difficult.¹²

RESEARCH QUESTION: SCOPE AND LIMITATION

Against the backdrop of this vast literature on business groups, the research question that this paper aims to address is relatively narrow and specific - whether insolvency law could design *ex-ante* incentives to nudge a business group to simplify inter-connectedness with its structure by rationalising the use of intra-group guarantees?

The paper addresses this research question in three parts. First, the paper uses the correlation seeking theory and the tailored partitioning theory to develop a conceptual framework to understand the economic function of cross-liability provisions like intra-group guarantees in corporate groups. Second, the paper builds on this conceptual framework to explain why in certain circumstances shareholders may have a perverse incentive to overuse intra-group guarantees to complicate group structures. Third, the paper identifies the specific feature in the Indian insolvency law that may be tweaked to provide incentives to a business group to use intra-group guarantees optimally such that they minimise the overall cost of debt capital without enhancing risks of wealth transfer from unsecured (nonguaranteed) creditors of the guarantor group company to the shareholders of the insolvent principal borrower group company.

A critical limitation of this paper is that it does not address various other potential causes of complicated group structures like related party transactions, taxation, regulatory arbitrage and similar factors. Further, it does not deal with various potential commercial reasons behind use of intra-group guarantees (for example, bidding requirements etc.) other than external credit transactions. Moreover, this paper does not specifically address the merits and demerits of substantive consolidation. This paper is intended to provide only initial steps to understand how insolvency law could possibly be used to nudge rationalisation of group structures.

A CONCEPTUAL FRAMEWORK

The performance of two or more assets of a business could be perfectly correlated, perfectly uncorrelated or partially correlated. For instance, if a business owns two similar hotels next to each other in the same location in a city, the performance (or risk) of these two assets is likely to be (nearly) perfectly correlated. In other words, there will be no failure of one asset without failure of the other. On the other hand, consider a business that owns a hotel in a city and an oil refinery in another country. The performance (or risk) of these two assets are likely to be (nearly) perfectly uncorrelated. In other words, the failure of the hotel would have no implication on the health of the oil refinery and *vice versa*. A third possibility could be that the assets of the business are somewhat correlated and somewhat uncorrelated. For instance, if a business owns a luxury hotel in the city and a budget hotel in the suburbs of that city, these two assets are likely to be somewhat correlated but not fully correlated. For example, the price of their real estates would be affected by the general economy of the city. But a decline in local tourism may affect the luxury hotel more than the budget hotel. Such assets would therefore be partially correlated.

When a creditor extends credit to a group, such correlation between the group's assets is likely to have structural implications. If the assets are highly correlated, the creditor need not monitor each asset separately. The information from any one asset would be a signal of the health of the entire business. Therefore, there is no benefit in partitioning the assets into separate corporate entities. Instead, if any one asset experiences financial distress, the creditor would prefer to take action (like requiring the management to do something, foreclosure etc.) against all the assets simultaneously.

Therefore, it makes sense to keep such correlated assets within the one company - integration.

In contrast, if the two assets are highly uncorrelated, a creditor has to monitor each asset separately. Moreover, a creditor which has expertise in the hotel industry may want to extend credit only to the hotel business and not to the oil refinery business. Such a creditor would therefore not want to be exposed to risks emanating from the oil refinery business. In such an event, the business would be better off putting these two assets in two different corporate entities. It could then raise debt against each of those assets separately from creditors who specialise in those specific types of assets. Such a structure would benefit the creditors too. Each of them would be exposed only to the asset which they can monitor effectively. As a result, they will be taking up lesser risk and would be able to extend credit to the business at a lower interest rate than if the assets were integrated. Overall, the business would be able to raise debt capital at the least cost by putting the assets into separate companies - partitioning.

In reality, however, business assets are unlikely to be either perfectly correlated or perfectly uncorrelated. Instead, they are likely to be partially correlated. In such cases, the risks facing the assets are correlated across some dimensions but not across others. If there is financial distress in any one asset across the correlated dimensions, the creditor should take action against both the assets simultaneously. However, if there is financial distress in one asset across an uncorrelated dimension, the creditor should act against only that asset but not the other. Therefore, in such cases, the creditor would benefit from both integration as well as partitioning - something which is seemingly impossible. It is this conundrum that tailored partitioning resolves.

Structure			
		<i>Integrated</i>	<i>Partitioned</i>
Assets	<i>Perfectly correlated</i>	Yes	No
	<i>Perfectly uncorrelated</i>	No	Yes
	<i>Partially correlated</i>	Yes	Yes

To understand the function of tailored partitioning, it would be useful to consider a simple hypothetical example. Imagine an entrepreneur E who owns two business assets - Asset 1 and Asset 2 - which are partially correlated. Bank B has expertise in monitoring both projects and is willing to extend credit to both. To keep the model simple, assume that monitoring by B could lead to any of the three signals from each project separately:¹³

Signal (1): This means there is no new information. The asset is performing fine and will generate 10% return.

Signal (2): This means that E is incompetent at managing that particular asset. Consequently, this asset will generate 5% return only. This signal by itself does not give any new information about the other asset. Therefore, B will want to exit only from this particular asset and re-invest the capital elsewhere at 8% return ('outside option').

Signal (3): This means that E is incompetent at managing both assets. The incompetence will spread from this asset to the other. Consequently, both assets will generate 5% return only. Therefore, B will exit from both the assets and re-invest the capital elsewhere at 8% return.

Table 1: Matrix – Tailored portioning

	Asset 2			
		Sg. 1 (10%)	Sg. 2 (5%)	Sg. 3 (5%)
Asset 1	Sg. 1 (10%)	(c,c)	(c,l)	(l,l)
	Sg. 2 (5%)	(l,c)	(l,l)	(l,l)
	Sg. 3 (5%)	(l,l)	(l,l)	(l,l)

The matrix in Table 1 captures the various potential future outcomes given the possible signals from each project. ‘c’ refers to the asset being continued, while ‘l’ refers to the asset being liquidated. Evidently, there are 9 potential future outcomes. In 6 of them, B will choose to liquidate both the assets and reinvest in the outside option. These include (Sg. 3, Sg.1) and (Sg.1, Sg.3). This is because although, at the moment, E has poorly managed that particular asset leading to 5% returns, it will affect the other asset too causing its returns to fall from 10% to 5%. In contrast, in the future outcome (Sg.1, Sg.1), B will choose to continue both the assets. Evidently, for 7 of these outcomes, the two assets will face the same action - (l, l) or (c, c) - simultaneously. Therefore, for these 7 outcomes, the two assets should be integrated into one corporate entity. However, for the 2 remaining outcomes (c, l) and (l, c) - B will have to liquidate one asset but continue the other. Therefore, for these two outcomes, the two assets have to be partitioned into two different corporate entities.

While entering into the credit contract, B and E have no way of knowing which of these outcomes will materialise in the future state of the world. Therefore, they will have to contractually agree *ex-ante* on a legal mechanism that would enable B the *ex-post* choice to invoke asset partitioning or to ignore it depending on the signals received in the future. One commonly used legal mechanism to achieve this result is tailored partitioning. The two assets are first partitioned and put into different corporate entities. Then cross-liability provisions are inserted in the credit agreement between each company and B.¹⁴ These clauses give B the option to rely on asset partitioning or to ignore it, depending on the signal received in the future. Overall, an *ex-ante* combination of asset partitioning and cross-liability provisions allows for precise *ex-post* balancing between integration and partitioning.

Shareholders’ perverse incentive

Tailored partitioning through intra-group guarantees serves a useful economic function when used across group companies with partially correlated assets. However, if the same arrangement is used

across group companies with highly correlated assets, it could be the result of perverse incentives of shareholders to engage in correlation seeking.

To put it in the context of our hypothetical example, partitioning is relevant only for the 2 outcomes (c, l) and (l, c) in Table 1. However, if the assets are highly correlated, these 2 outcomes would be highly unlikely. Consequently, there will be practically no need to partition the assets by putting them in different corporate structures. However, from the perspective of E, there may be a perverse incentive to use such tailored partitions even if the two assets are highly correlated. This is because, from E’s perspective, the cost of debt capital reduces if the loan taken by each group company is backed by guarantee from the other group company. When the borrower and guarantor companies are solvent, an inter-company guarantee by the guarantor company helps reduce the borrower company’s cost of debt capital. This in turn enhances the borrower company’s shareholder value, benefitting E. In contrast, when the borrower company becomes insolvent, the guarantor group company is already insolvent or is highly likely to go insolvent given the high degree of correlation between the assets of the two companies. Consequently, the value of E’s equity shares in both the companies would anyway be wiped out. Therefore, invocation of the inter-company guarantee by B in insolvency resolution would not have much material effect on the shareholder value of either company. Instead, when B invokes the guarantee to recover its dues from the assets of the insolvent guarantor company, it would essentially be reducing the available pool of assets for the unsecured (non-guaranteed) creditors of the guarantor company. Effectively, tailored partitioning in this case would ensure that E enjoys the upside when the group companies are solvent but the downside risks in insolvency are borne by the unsecured (non-guaranteed) creditors of the guarantor group company including suppliers and other vulnerable operational creditors.

Overall, shareholders have a perverse incentive to engage in correlation seeking when the underlying assets are highly correlated. They may be tempted to overuse tailored partitioning even when the assets are highly correlated. Instead of serving any useful economic purpose, in these cases tailored partitioning ends up complicating the group structure. Insolvency law should therefore be designed to minimise shareholders’ incentive to seek correlation seeking opportunities for highly correlated underlying assets through tailored partitioning and thereby help rationalise group structures.

POTENTIAL SOLUTION UNDER INSOLVENCY LAW

Under Indian law, a ‘corporate guarantor’ means a corporate person who is the surety in a contract of guarantee to a CD (that is, principal borrower).¹⁵ The liability of a corporate guarantor is co-extensive with that of the principal borrower.¹⁶ Upon default by the principal borrower, the principal borrower and the corporate guarantor are jointly and severally liable to the creditor.¹⁷ The creditor has the right to recover its dues from either of them or from both of them simultaneously.¹⁸ Therefore, the moment the principal borrower commits default in payment of debt which had become due and payable, the guarantee becomes a debt and the corporate guarantor itself becomes a CD.¹⁹

If the corporate guarantor defaults on this debt, the creditor can initiate corporate insolvency resolution process (CIRP) against the corporate guarantor under the IBC.²⁰ If the creditor is a financial creditor (FC) to the principal borrower, it can proceed against the corporate guarantor as a FC.²¹ Therefore, on default by the principal borrower, the debt due to the creditor from the corporate guarantor is a financial debt.²² However, since there is no security interest created in favour of the creditor against the corporate guarantor, the creditor would be an unsecured FC to the corporate guarantor.²³ Consequently, during the insolvency resolution of the corporate guarantor, the creditor would stand at par with other unsecured FCs of the corporate guarantor in the statutory waterfall.²⁴ Applying the conceptual framework discussed earlier, the shareholders of a group (comprising the principal borrower and the corporate guarantor) could engage in correlation seeking through intra-group guarantee to extract wealth away from the unsecured (non-guaranteed) FCs and other junior claimants of the corporate guarantor including the government and other operational creditors.

Insolvency law could potentially ameliorate this perverse incentive of shareholders through *ex-ante* priority rules.²⁵ During the insolvency proceeding of a corporate guarantor, the claim of a creditor arising out of a corporate guarantee issued by the corporate guarantor in favour of a group company, which is now insolvent, should rank below the claims of unsecured creditors of the corporate guarantor under section 53(1)(f). In other words, the statutory waterfall under section 53 of the IBC needs to be amended such that any debt arising out of a corporate guarantee issued in favour of a group company, which is now insolvent, is subordinated and ranks below all other unsecured debt of the corporate guarantor.

Such an explicit rule would change the *ex-ante* incentive of an external creditor, ameliorating the potential effect of the perverse incentive of the shareholders. While extending credit to a group company based on an intra-group guarantee, the creditor would take into account the correlation between the assets of the two companies - the CD and the corporate guarantor. If they have a low correlation, only then will such an intra-group guarantee be valuable for the creditor. During insolvency of the CD, the corporate guarantor is highly likely to be solvent. Consequently, the creditor can invoke the corporate guarantee and expect to get paid by the guarantor company. However, if their assets are highly correlated and the companies go insolvent at close proximity, such corporate guarantee would be of little value to the creditor. On insolvency of the CD, it is highly likely that the guarantor company would also be insolvent or on the verge of insolvency. Therefore, the creditor has to participate in the insolvency proceeding of the corporate guarantor. In that case, the guaranteed creditor's claim would be subordinated to other unsecured creditors of the insolvent corporate guarantor. Such guarantee is unlikely to be of much value to the creditor. Foreseeing these possibilities, there would not be much incentive to extend credit to a group company based on intra-group guarantees when the assets of the CD and the corporate guarantor are highly correlated. Overall, the proposed rule will help reduce overuse of intra-group guarantees and simplify inter-connectedness within group structures.

CONCLUSION

Complicated group structures make insolvency resolution of group companies challenging. A common source of such complexity in group structures is the frequent use of intra-group guarantees. These intra-group guarantees are quite commonly used by listed Indian companies, although their growth in volume terms has been falling since 2015-16. Yet, a conceptual understanding of why Indian business groups frequently employ intra-group guarantees has been largely elusive. In this context, this paper explored whether insolvency law could help simplify inter-connectedness within group structures by rationalising intra-group guarantees.

First, the paper reviewed the relevant law and economics literature on the potential reasons why a business group may structure itself into multiple limited liability companies with intra-group guarantees, complicating the overall group structure. Accordingly, it developed a specific research question: whether insolvency law could nudge a business group to simplify inter-connectedness within its structure by rationalising the use of intra-group guarantees? Second, the paper used the correlation seeking and tailored partitioning theories to develop a conceptual theoretical framework to understand the economic function of cross-liability provisions like intra-group guarantees in corporate groups. Third, the paper used this conceptual framework to identify the potential perverse incentive for shareholders to overuse intra-group guarantees, complicating group structures. Fourth, the paper argued that this incentive problem could be resolved by tweaking the statutory waterfall under insolvency law to reduce the incentive of an external creditor to extend credit to a group company based on intra-group guarantees when the assets of the CD and the corporate guarantor are highly correlated. This could be achieved by amending section 53 of the IBC to ensure that the claim of a creditor arising out of a corporate guarantee issued by the corporate guarantor in favour of its group company, which is now insolvent, should rank below the claims of unsecured creditors of the corporate guarantor under section 53(1)(f). The paper argued that such an explicit priority rule would reduce the *ex-ante* incentive of an external creditor to extend credit to a group company based on intra-group guarantees when the assets of the CD and the corporate guarantor are highly correlated. This would mitigate shareholders' perverse incentive to overuse intra-group guarantees, and help simplify inter-connectedness within group structures.

NOTES

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² Report of the Working Group on Group Insolvency, IBBI, September 23, 2019.

³ MA 1306/2018 & Ors., CP 543/2018 & Ors., August 08, 2019.

⁴ Total group guarantee by a company means the sum of guarantees for group companies and counter-guarantees for group companies given by such a company, as available from CMIE database.

⁵ The potential cause(s) of this trend reversal is beyond the scope of this paper.

⁶ The NCLT identified 14 different factors. These include ‘common liabilities’ and ‘common group of corporate debtors’. Both these factors are essentially based on intra-group guarantees, Refer n. 3, paras 78, 80.

⁷ The inception of this literature could be traced back to the famous Landers-Posner debate on the pages of the University of Chicago Law Review during the 1970s. Professor Jonathan Landers had argued that a group of affiliated corporations is in reality a single economic enterprise and should be treated as such. Landers concluded that creditors would be better off if bankruptcy courts relied more heavily on single enterprise doctrines like substantive consolidation. Professor Richard Posner countered by arguing that creditors adjust the interest rate on a proposed loan based on the debtor’s risk of default. After giving the loan, creditors might also monitor the debtor’s compliance to ensure that it is in compliance with the loan covenants that forbid any activity which increases the debtor’s default risk. Posner argued that if large firms were not sub-divided into subsidiaries, a creditor would have to appraise and monitor the entire enterprise, which would make it an expensive undertaking. The group structure enables a creditor to extend credit to any specific part of the group’s business that it understands the best. Thus, legally separate subsidiaries help reduce the creditor’s information and monitoring costs. This in turn enables the group to raise debt finance at a relatively lower interest rate. These commercial advantages of single entity approach would not be available under the single enterprise approach. Landers, J.(1975), “A unified approach to parent, subsidiary, and affiliate questions in bankruptcy”, The University of Chicago Law Review 42.4, pp. 589–652; Posner R. (1975), “The rights of creditors of affiliated corporations”, The University of Chicago Law Review 43, pp. 499–526.

⁸ Professor Richard Squire mounted a credible challenge to Posner’s theory. Squire highlighted that while big businesses do engage in asset partitioning by dividing their different businesses across subsidiaries, they also allow select creditors to ignore the separate legal identity of the subsidiaries through heavy use of intra-group guarantees. Posner’s theory fails to explain this apparent contradiction. To resolve this paradox, Squire proposed a new theory - correlation seeking. Squire R. (2011), “Strategic liability in corporate groups”, The University of Chicago Law Review 78, pp. 605–670; Squire R. (2010), “Shareholder opportunism in a world of risky debt”, Harvard Law Review 123, pp. 1151–1213.

⁹ Squire R. (2010), “Shareholder opportunism in a world of risky debt”, Harvard Law Review 123, pp. 1151–1213.

¹⁰ Squire R. (2011), “Strategic liability in corporate groups”, The University of Chicago Law Review 78, pp. 605–670.

¹¹ Casey A. (2015), “The new corporate web: Tailored entity partitions and creditors’ selective enforcement”, The Yale Law Journal 124, pp. 2680–2744.

¹² Khanna T. and Yafeh Y. (2007), “Business Groups in Emerging Markets: Paragons or Parasites?”, Journal of Economic Literature 45; Khosa A., Ahmed K. and Henry D. (2019), “Ownership structure, related-party transactions, and firm valuation”, Cambridge University Press.

¹³ In a realistic situation, these signals may be more complicated given potential external events beyond the control of E. However, for sake of simplicity, we are assuming a very simple model to understand the basic economic function of tailored partitioning.

¹⁴ Cross-liability provisions could include cross-guarantees, cross-defaults and holding- company guarantees. A cross guarantee is an agreement by one entity to be jointly liable for the debts of another. A cross-default provision is an agreement by which the default of one borrower on a loan or agreement will trigger the default of another borrower on a loan or agreement. A holding company guarantee is an agreement that provides for equity held by a holding company to serve as collateral for a loan that finances the operations of a subsidiary of the holding company. Overall, these cross-liability provisions help undo the economic impact of legal partitioning. Casey, see n. 11.

¹⁵ Section 5(5A), IBC.

¹⁶ Section 128, Indian Contract Act, 1872.

¹⁷ *Laxmi Pat Surana v. Union of India*, Civil Appeal No. 2734 of 2020.

¹⁸ Report of the Insolvency Law Committee, February 20, 2020; Supra Note 17.

¹⁹ *Ferro Alloys Corporation Ltd. v. Rural Electrification Corporation Ltd.*, CA (AT) (Insolvency) No. 92,93 & 148-2017, January 08, 2019, para 27. See also Supra Note 17, para 27.

²⁰ Supra Note 17, para 27

²¹ *Dr. Vishnu Kumar Agarwal v. M/s. Piramal Enterprises Ltd.*, CA(AT)346-2018, January 08, 2019, holding that ‘without initiating any corporate insolvency resolution process against the principal borrower, it is always open to the financial creditor to initiate corporate insolvency resolution process under section 7 against the corporate guarantors, as the creditor is also the financial creditor qua corporate guarantor.’, Para 25.

²² *Export Import Bank of India v. Resolution Professional JEKPL Pvt. Ltd.* 2018, EXIM Bank held to be an FC to JEKPL (the guarantor), after underlying loan to Jubilant Energy (the principal borrower) had become non-performing and the guarantee was invoked.

²³ Section 3(30), IBC defines ‘secured creditor’ as ‘a creditor in favour of whom security interest is created’. Section 3(31) defines ‘security interest’ to mean ‘right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person. Provided that security interest shall not include a performance guarantee’, refer n. 15.

²⁴ Section 53(1)(d), IBC, refer n. 15.

²⁵ Some scholars have argued that fraudulent transfer laws should be reformed to permit courts to subordinate a contingent debt if a high correlation between the contingent risk and the debtor’s insolvency risk was apparent at the time of contracting. However, such reforms provide only ex post remedies, whereas this paper is focussed on ex ante legislative tools to mitigate shareholders’ perverse incentive to engage in correlation seeking through intra-group guarantees. Squire R. (2010), “Shareholder opportunism in a world of risky debt”, refer n. 8.

THE CASE FOR A MUNICIPAL BANKRUPTCY LAW IN INDIA

Adam Feibelman and Bhargavi Zaveri-Shah¹

The pandemic years of 2020-2021 caused significant revenue losses to municipal bodies all over the world, raising concerns of financial distress for many cities², including in India. For example, in January, 2021 employees of all three municipal corporations of Delhi went on an indefinite strike for the non-payment of wages.³ In June, 2021, the sanitation workers of three municipal bodies in Punjab struck for over a month as they were underpaid.⁴ In 2020, the Municipal Corporation of Greater Mumbai (MCGM), often proclaimed as Asia's richest municipal corporation, offered to pay its vendors and contractors in credit notes or IOUs, an almost certain sign of impending financial distress.⁵ And this circumstance is not limited to the pandemic, municipal bodies in India face financial distress with some regularity.⁶

Indian cities' vulnerability to financial distress is increasing as they have a new and important source of indebtedness. To augment their financial resources, municipal bodies have been sporadically accessing the public debt markets, with nine municipal bodies having raised nearly ₹ 30 billion through bond issuances in the last five years. This is a positive development as, like firms that access the public markets, municipal bodies that subject themselves to market discipline are likely to improve the standards of local governance. A key missing element, however, is the clarity of creditors' rights and recoveries in the event of a default by a borrowing municipal body. The absence of a robust (or any) legal framework for debt recovery and the reorganisation of a defaulting borrower-municipal body is a limitation on municipal bodies' access to the public markets, and a source of vulnerability to their creditors, the cities' residents and other stakeholders such as their staff and vendors. In this article, the authors make a case for adopting such a framework and propose a formal bankruptcy regime as the model for such a framework.

CITIES' ACCESS TO FINANCE

Despite the members of the constituent assembly recognising the importance of decentralisation and local government in India, the Indian Constitution did not originally focus on local government as a self-sufficient unit. This position changed in 1993, when the 74th Constitutional Amendment conferred constitutional status on local government bodies in India.

Enacted in the context of the rapid urban development witnessed all over the country, the amendment mandated every state to constitute Nagar Panchayats (i.e., town councils) for areas in transition from rural to urban, municipal councils for smaller urban areas and municipal corporations for larger urban areas respectively (hereafter collectively, urban local bodies or ULBs). The amendment required states to devolve functions in relation to 18 areas of governance, such as land use regulation, urban planning, public health, sanitation and solid waste management, to the ULBs. It required states to devolve limited financial autonomy to ULBs by empowering them to levy and collect taxes and duties within state-defined limits, and mandated states to provide grants in aid to such bodies from the consolidated fund of the state. In the words of Ahluwalia et al (2019), the 74th Constitutional Amendment formally recognised urban local governments as the third tier of government.⁷

More than 10 years after this amendment, the state of finances of ULBs continue to remain weak. Three trends are apparent from a recent review of the state of municipal finances in India by Ahluwalia et al (2019).⁸ First, municipal revenues in India are, by and large, very low. For the decade 2007-08 to 2017-18, the aggregate municipal revenues accounted for a negligible share of GDP, stagnating at 1% or less of GDP. The corresponding ratios were 6% for South Africa, 7.4% for Brazil, and 13.9% for the United Kingdom. Second, ULBs under-invested in capital infrastructure, such as the creation of transport, water supply, sewerage, drainage and other critical infrastructure. Most of their revenues and other income were utilised in the payment of salaries, pension and other operational expenses. Third, ULBs are increasingly reliant on central and state government transfers to fund their activities. Despite their increasing importance, inter-governmental transfers to municipal bodies were estimated to be less than 1% of GDP. Again, the corresponding ratios are in the range of 7% in Norway and Italy and nearly 10% in the United Kingdom.

The debt market for municipal paper in India has historically been relatively small.⁹ There is no comprehensive database documenting all the bond issuances made by ULBs in India. The Municipal Corporation of Bengaluru made the first municipal bond issuance in India in 1997. But since 2017, there has been a remarkable increase in the volume and value of bond issuances made by ULBs. In the period from 2017 till August, 2021, nine municipal corporations have made bond issuances aggregating to ₹ 30 billion (Table 1), with an average issuance size of nearly ₹ 4 billion (approximately USD 5.5 million). In contrast, in the immediately preceding two decades, ten municipal bodies had issued bonds aggregating to less than half this amount.¹⁰

Table 1: List of public bond issuances by urban local bodies in India (2017-2021)

Municipal body	Year of issue	Issue size (in ₹)
Pune	2017	200
Surat	2018	200
Amravati	2018	2000
Indore	2018	140
Bhopal	2018	175
Vishakhapatnam	2019	80
Hyderabad	2019	395
Lucknow	2020	200
Ghaziabad	2021	150
Total		2942

Source: Data collated by the authors.

Most of the recent bond issuances have raised funds for capital works, such as water supply and road construction. These are good signs. Apart from financing much needed capital expenditure in urban and peri-urban areas, there are other advantages of municipal bodies accessing the public market for funds. For instance, such ULBs are required to obtain a credit rating at the time of listing, and at regular intervals, thereafter, disclose financial account statements in standardised formats and report events that may materially affect the price at which their securities are traded on the exchange.¹¹ This will likely help them and external stakeholders monitor project implementation, improve record keeping and better comply with transparency norms. Second, it has the same impact that fiscal discipline has on the borrowing costs of the Government of India. Defaults, late payments and breaches of covenants imply higher borrowing costs in the future, which in turn, acts as an effective feedback loop to effect municipal spending. Third, it will help the issuing ULBs build financial management capacity at the local level. For example, evidence from the early bond issuances by the Ahmedabad Municipal Corporation suggests that it enabled the corporation to develop capacity in its treasury management operations.¹²

CREDITOR RIGHTS AGAINST MUNICIPAL BORROWERS IN INDIA

State governments extensively regulate the market and institutional borrowing by ULBs. The Local Authorities Loans Act, 1914 empowers the state government to require municipal bodies to obtain their approval before borrowing. This is a requirement that has now been enacted by most states. It empowers the state government to make rules on the purpose of borrowing and the overall terms on which a municipal body may borrow, including the underlying security and the manner of its enforcement, the timing of the borrowing, the process for conducting inspection of works constructed using the borrowed funds, the format of accounts and the utilisation of unspent monies. These rules

govern the relationship between the state government and the local authority. Importantly, they do not secure the rights of ULB's creditors or their treatment in the case of default.

Other commentators have recognised the need to clarify and improve the rights of ULBs' creditors. For example, in 2011, a Steering Committee led by the Ministry of Urban Affairs made a detailed set of recommendations on the need to strengthen the regulatory framework governing municipal borrowing, such as easing the process for enforcing the security collateral in the event of a municipal default.¹³ Some of these have been implemented in the Securities and Exchange Board of India (Issue and Listing of Municipal Debt Securities) Regulations, 2015 (SEBI Municipal Debt Regulations), which is the regulatory framework enacted by the Securities and Exchange Board of India (SEBI) governing publicly issued or listed municipal debt securities.¹⁴ However, these norms are *ex-ante*. For example, they set out the eligibility criteria for ULBs desiring to make a public issuance, mandate creditor rating requirements and so on. They do not clarify or define the rights of creditors and bond holders in the event of default or imminent financial distress.

While some municipal bond issuances have in the past been guaranteed by the state government, many are not.¹⁵ The actual ability to enforce the state government guarantee and the costs associated with such enforcement, are unclear and are likely to be high, given that contract enforcement is particularly weak in India. The SEBI Municipal Debt Regulations require the creation of an escrow account in which all the revenues necessary to service the debt are to be deposited. In 2019, SEBI made a series of amendments to these regulations, which considerably relaxed the requirements in relation to the escrow account.¹⁶ The SEBI Municipal Debt Regulations also require the appointment of a debenture trustee who is a regulated intermediary acting for the benefit of the investors. However, upon default, the Debenture Trustee will likely use the same remedies for contract enforcement as any creditor would, namely, the filing of suit or arbitration proceedings in court. If bond holders believe that municipal bonds are a safer investment than those issued by corporates, this can only be justified by low historic default rates, not because of any features of the debt itself or the legal framework regulating default.

Towards a framework for dealing with municipal financial distress

The current legal regime in India provides neither opportunities for collective action against municipal debt default nor clarity on the treatment and rights of the ULB or the creditors (bond holders, banks and financial institutions, state lending agencies, employees and vendors) in the event of the ULB's insolvency. At one end of the spectrum, this creates the possibility of aggressive and the unforeseen sale of public assets owned and operated by the ULB for the benefit of the public by 'powerful' creditors of the ULB. On the other end of the spectrum, this deprives the system of the benefits of early recognition of financial distress in ULBs and minimises the possibility of salvaging a ULB's operations through a mutually negotiated and court-supervised reorganisation exercise. This is a recipe for disaster for the ULB, its creditors, its staff and the inhabitants of the city or town run by a financially distressed ULB. The growing levels of municipal borrowing from the public markets and the impact of the COVID-19 pandemic reinforce these concerns.

There are various institutional approaches for addressing this problem, and most combine two general features: control and support by higher levels of Government and bankruptcy-type procedures for restructuring claims and operations.¹⁷ Generally speaking, an effective municipal bankruptcy regime targets two outcomes: first, balance the claims and needs of different stakeholders of the debtor municipality; second, preserve the existing value of the municipality's assets, its tax base and its activities.¹⁸

More specifically, a municipal bankruptcy regime can *ex ante* clarify the rights of creditors (not just bond holders, but its vendors and current and former employees) in the event of acute financial distress; facilitate negotiation among a debtor and a diverse set of creditors; restore a municipality's fiscal sustainability, thereby preserving the provision of essential public services and benefiting creditors collectively.¹⁹ The threat of bankruptcy could also be an effective mechanism to address existing failures or weaknesses in municipal organisation and governance.²⁰

DESIGN OF A MUNICIPAL BANKRUPTCY LAW

As a municipal bond market begins to emerge in India, it is optimal, if not already belated, to consider the adoption of some form of a municipal bankruptcy regime in India that balances the rights of the creditors, the borrower-municipal bodies and cities' inhabitants. In this section, the authors describe some basic features of one such model, namely, the US regime for municipal bankruptcies.

By way of background, the US has a robust municipal bond market, with roughly \$4 trillion in bonds outstanding.²¹ That is roughly a quarter of the size of the US corporate bond market. Most, but not all, of municipal bonds are tax exempt for bondholders, which is a critical driver of demand for these securities. The market includes two distinct categories of bonds – those that are backed by the full faith and credit of the issuer (general obligation bonds) and those that are paid only from specific revenues sources, usually the projects they finance (revenue bonds). The amount of revenue bonds outstanding is somewhat larger than that of general obligation bonds. Many municipal bond issuances are insured against default by their issuers.

Since the depression of the 1930s, defaults of US municipal bonds have been relatively rare, with just over 100 defaults in the last century. The US first adopted its municipal bankruptcy regime, which is now Chapter 9 of the US Bankruptcy Code, in the 1930s amidst a wave of municipal financial crises. Since then, roughly 30 cities and counties have filed for bankruptcy, and nearly 100 other municipal entities have done so.²²

Eligibility and trigger

Chapter 9 is available to municipal entities, cities and any other 'subdivision or public agency or instrumentality of a State'.²³ To be eligible for Chapter 9, a municipal entity must be expressly authorised by state law or an authorised state official to file a bankruptcy petition²⁴, and it must

be deemed insolvent.²⁵ Notably, insolvency is not a defined term under the Code, and most large cases involve significant (and costly) disputes about whether the municipal entity is insolvent. Additionally, the municipal debtor must have either obtained the approval of a majority of creditors likely to be impaired in the process or ‘have negotiated in good faith’ with such creditors, unless such agreement or negotiation is deemed ‘impracticable’.²⁶ Only voluntary cases are allowed²⁷, i.e., only the municipal debtor is allowed to file a bankruptcy petition. But this should be understood in the context in which federal and state law generally allow state officials to effectively take control of the state’s municipalities.

Resolution process

The process of a Chapter 9 municipal bankruptcy is generally similar to that of Chapter 11 applicable to corporate debtors. Upon the filing of a petition with the US Bankruptcy Court, an automatic stay enjoins actions against the municipality and its property or to enforce a claim against the debtor, including any efforts to enforce a lien on taxes or assessments owed to the municipality.²⁸ The debtor generally has powers to pursue various causes of actions, including to recover preferential payments pre-petition.²⁹ The debtor municipality has the exclusive right to submit a ‘plan for the adjustment of the debtor’s debts’.³⁰ No time limitation for this is set by statute; any time limitations are to be set by the court.³¹ As in a Chapter 11 reorganisation³², a Chapter 9 plan creates classes of creditors with similar claims, which then vote as classes to accept or reject the plan.³³ At least one impaired class of creditors must vote to accept the plan.³⁴ If an impaired class of creditors rejects the plan, then the bankruptcy court must find that the plan ‘does not discriminate unfairly, and is fair and equitable, with respect to each [impaired] class...’.³⁵ Furthermore, the court must determine that the plan ‘is in the best interest of creditors’ and ‘feasible’.³⁶ Significantly, the bankruptcy court can confirm a debtor’s plan that includes certain policy components, but throughout the process, the court cannot direct or interfere with the debtor’s governmental power or its property or revenues.³⁷

These formal requirements for plans of adjustment are relatively vague and, as noted above, there have been few episodes through which a stable jurisprudence or a conventional practice may be developed. These requirements also underscore the prominent role played by the bankruptcy court in the bankruptcy proceedings of a municipal body. The contemporary understanding of the role of the bankruptcy court in a municipal bankruptcy has been greatly influenced and shaped by the recent bankruptcy proceeding of Detroit. That city was the largest municipal entity to file for bankruptcy in the US and its case involved the largest amount of debt (roughly \$20 billion) of any municipal bankruptcy under Chapter 9. Its bankruptcy is generally considered a successful and expedient resolution of its acute financial crises, although many of the details of the city’s plan of adjustment were, and remain, hotly debated.

Detroit filed for bankruptcy in July, 2013 following the declaration of a financial emergency and the appointment of an emergency manager for the city by the Governor of Michigan, both pursuant to state law. The city had faced intractable financial stress over decades, and its unsustainable debts included bonds and pension obligations to retired state employees. The bankruptcy judge appointed

a prominent federal judge as a special mediator. At the beginning of the case, after heated litigation, the bankruptcy judge determined that Detroit was in fact insolvent and had negotiated in good faith with its creditors and was therefore eligible for bankruptcy. The judge and the special mediator aggressively managed the case and the negotiations among the bondholders and employee claimants and were able to solicit major contributions by private foundations to fund what was called the ‘Grand Bargain’, which formed the core of Detroit’s plan of adjustment. With those contributions, losses to the retirees were limited to 5% and other creditors and debt insurers took losses ranging from 25% to 85%.³⁸ In total, the city shed roughly \$7 billion in obligations.³⁹ All but two classes of impaired creditors voted to approve the city’s plan, and the bankruptcy court issued a legal opinion deeming the plan to be feasible, in the best interests of all creditors, and to be fair and equitable and not to discriminate unfairly with respect to impaired classes.⁴⁰

Another key element in the Detroit bankruptcy proceedings was the opportunity provided for civic participation in the case. As Melissa Jacoby⁴¹ writes, the judge

‘allow[ed] participation by individual retirees as well as residents, the latter of whom lack creditor status. The court held a hearing for individual objectors to Detroit’s bankruptcy eligibility, [and] did the same for plan confirmation...’⁴² This engagement also provided informal opportunities for the judge to ‘weigh in on local policy and personnel matters,’ and to prod municipal officials to make changes that were not formally within the court’s powers.⁴³

The case did yield some meaningful reorganisation of municipal services and governance by, for example, facilitating the creation of a new regional sewage and water authority.

To be sure, Chapter 9 has its critics.⁴⁴ Some of this criticism is, for example, directed at the perceived inability of the regime to improve municipal operations going forward,⁴⁵ and for failing to provide sufficient debt relief to municipalities. Chapter 9 nevertheless has proven to be a viable municipal bankruptcy regime. It is a rule-bound process, but one that is flexible enough to be able to address the extremely complex problems of government financial distress, which inevitably combine important commercial concerns with essential necessities of social wellbeing. At the least, it helps frame a number of threshold and critical questions that should be part of any discussion or debate in this direction.

CONCLUSION

In this article, the authors make a case for essentially adopting a legal framework for addressing the financially distressed ULBs in India. Undoubtedly, the design of such a framework will raise several vexed questions of constitutional law that did not arise or were easier to resolve in the context of the insolvency and bankruptcy law of private corporations and individuals.

First, while bankruptcy and insolvency is in the concurrent list of the Constitution, municipal governance is an intrinsically state subject. A Union municipal bankruptcy legislation will raise complex questions of federalism. It will require that states retain their autonomy in applying a

Union legislated bankruptcy law to their ULBs. What might be the tools of such autonomy? We should anticipate, for example, that states will ask for the right to decide whether to authorise their ULBs to file under a municipal bankruptcy law, and that different states will apply the framework differently.

Second, as the Detroit bankruptcy demonstrated, a bankruptcy court will inevitably play a significant role in a municipal bankruptcy. Any framework in India will need to determine whether the court or Administrator heading the process will have the power to supervise the functioning of public services during the ULB's insolvency proceedings. If so, this would be a fundamental departure from the design of the Insolvency and Bankruptcy Code, 2016, which seeks to minimise court intervention in the insolvency proceedings and provides for the appointment of Insolvency Professionals for running the debtor's operations. Similarly, the scope of relief that the process can legitimately provide in a ULB's bankruptcy proceeding will need to be considered. Can a resolution plan for a ULB contemplate an increase in taxes? Can it provide for the sale of the ULB-owned public property? How can it do so without impinging upon decisions that are the prerogative of a city level legislature or the state's power?

Enacting a bankruptcy law will require the resolution of these questions and prolonged negotiations with states perhaps much alike the enactment of the Goods and Services Tax framework. However, this should not deter policymakers from beginning the process. The gains of a clear municipal bankruptcy framework, in the face of the severe impacts of the COVID-19 pandemic and the deteriorating state of India's cities, should provide motivation for doing so. The fact that municipal bonds are set to become an important asset held by Indian households adds an additional imperative and responsibility to ensure that there is a framework in place for addressing municipal financial distress in India.

NOTES

¹ The authors thank Margi Pandya and Aanchal Maheshwari for their research assistance on this article.

² Davidson M. and Ward K. (2020), "Next COVID casualty: Cities hit hard by the pandemic face bankruptcy", *The Conversation*, 30 July. They argue that the pandemic is likely to have pushed several municipal bodies in the United States to the brink of bankruptcy. D. Whitaker S. (2020), "Estimates of State and Local Government Revenue Losses from Pandemic Mitigation", Federal Reserve Bank of Cleveland.

³ HT correspondent (2021), "Municipal employees to go on indefinite strike from January 7, 2021 to demand pending wages", *Hindustan Times*, 7 January. It suggested that the municipal body had defaulted on the payment of their salaries for 4-6 months.

⁴ Tribune correspondent (2021), "25 Days of *Safai Sewak's* Protest", *The Tribune*, 07 June. HT Correspondent (2021), "Sanitation Workers Suspend Work in Patiala", *Hindustan Times*, 25 June.

⁵ Sharma, A. and Zaveri, B. (2020), "The payment woes of the Municipal Corporation of Greater Mumbai",

Business Standard, 23 November.

⁶ Ahluwalia et al. (2019), "State of Municipal Finances in India", ICRIER, in a historical review of the state of municipal finances finds that the financial health of a majority of municipal bodies in India is 'poor'. They also find that the aggregate municipal revenues in India were significantly lower than those in other countries and had stagnated at 1% of GDP in the decade of 2007-08 to 2017-18.

⁷ *Ibid.*

⁸ *Ibid.*

⁹ Viswanathan et al. (2015), "Municipal Bonds: Policy Brief", Janaagrah Center for Citizenship and Democracy.

¹⁰ As per the data collated by the authors, ten municipal bodies made bond issuances aggregating to ₹ 1364.5 crores in the two decades beginning 1997 until 2016. The WB steering committee records that after the initial few successful municipal bond issuances, there were some unsuccessful attempts at bond issuances. It cites the example of the bond issuance worth ₹ 1280 million made by Nagpur in 2007 which failed, and that of Indore which attempted a bond issuance in 2002-03 for ₹ 500 million, but due to weak government finances it could receive commitments only for ₹ 37 million.

¹¹ The Securities and Exchange Board of India (Issuance and Listing of Municipal Debt) Regulations, 2015.

¹² World Bank Report (2011), Developing a regulatory framework for municipal borrowing in India.

¹³ *Ibid.*

¹⁴ Before the enactment of these regulations, the municipal bonds issued to the public were governed by the SEBI (Issuance and Listing of Debt Securities) Regulations, 2008 which implied that they applied only to bond issuances made by agencies that were incorporated as limited liability companies of ULBs. The SEBI Municipal Debt Regulations takes into account the prevalent structures in urban local governance in India and are contextualised to apply to the debt securities issued by all types of ULBs.

¹⁵ Of 25 bond issuances made by ULBs from 1998-2017, only six were state guaranteed.

¹⁶ This includes doing away with the requirement to earmark municipal revenue that should be credited to this account, the requirement to appoint an agency to monitor this account and to have this account audited by a statutory auditor. Also, prior to 2019, ULBs could only issue revenue bonds, that is, bonds that could be repaid from the proceeds of a specific project undertaken by the ULB. The 2019 amendment dispensed with this requirement.

¹⁷ Liu L. and Waibel M. (2008), "Subnational Insolvency: Cross-Country Experiences and Lessons", World Bank, Working Paper 4496.

¹⁸ *Supra* Note 17. 'A well-designed workout procedure results in equitable debt collection for creditors, while lowering the costs of borrowing and creating fiscal space for infrastructure investment'.

¹⁹ *Supra* Note 17.

²⁰ Picker R. and McConnell M. (1993), "When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy", *University of Chicago Law Review*, Vol. 60, p. 425.

²¹ This amount includes bonds issued by state governments as well as their cities and instrumentalities.

²² Significant Chapter 9 bankruptcies in recent history include those by Orange County, California (1994); Vallejo, California (2008); Jefferson County, Alabama (2011); Stockton and San Bernadino, both in California (2018); and Detroit, Michigan (2013). The recent 'bankruptcy' involving Puerto Rico, though larger than these, was not pursuant to Chapter 9, because Puerto Rico is a US territory, not a state.

²³ Sections 109(c)(1), 101(40), 11 U.S.C.

²⁴ Chapman J. et al. (2020), "By the Numbers: A Look at Municipal Bankruptcies Over the Past 20 Years", Pewtrusts, 06 July. Only 27 states have existing rules authorising their subunits to file for bankruptcy.

²⁵ Section 109(c)(2), (3), 11 U.S.C.

²⁶ Section 109(c)(5), 11 U.S.C.

²⁷ Section 303(a), 11 U.S.C.

²⁸ Section 922, 11 U.S.C.; § 362, 11 U.S.C.

²⁹ But notably, pre-petition payments to bondholders are deemed not to be preferential payments. 11 U.S.C. Section 926.

³⁰ Section 941, 11 U.S.C.

³¹ *Ibid.*

³² Order Confirming Plan of Adjustment, In re Detroit, Bankr. E. D. Mich. Nov. 12, 2014, No. 13-53846.

³³ Section 901; Sections 1122, 1123, 1126, 11 U.S.C.

³⁴ Section 901; Section 1129(a)(10), 11 U.S.C.

³⁵ Section 901; Section 1129(b)(1), 11 U.S.C.

³⁶ Section 943, 11 U.S.C.

³⁷ Section 904, 11 U.S.C.

³⁸ Dolan M. (2014), “Judge Approves Bankruptcy Exit Plan”, *The Wall Street Journal*, 07 November.

³⁹ Jacoby M. (2016), “Federalism Form and Function in the Detroit Bankruptcy”, *Yale Journal on Regulation* Vol. 33, p. 57.

⁴⁰ *Ibid.*, Order Confirming Plan of Adjustment.

⁴¹ *Supra* Note 38, pp. 54-108.

⁴² *Ibid.*, p. 95.

⁴³ *Ibid.*, p. 96.

⁴⁴ For compelling recent critiques, refer Buccola V. (2019), “The Logic and Limits of Municipal Bankruptcy Law”, *University of Chicago Law Review*, Vol. 86, p. 817. Coordes L. (2016), “Restructuring Municipal Bankruptcy”, *Utah Law Review* 307. For a good summary of prior critiques, refer Buccola V. (2019).

⁴⁵ *Ibid.*, Buccola V. (2019), p. 830 (‘The most prominent critique of Chapter 9 is that it, unlike Chapter 11, lacks direct mechanisms by which the judge and creditors can correct dysfunctional governance ...’). Gillette C. and Skeel D. Jr (2016), “Governance Reform and the Judicial Role in Municipal Bankruptcy”, 125 *Yale L J*, pp. 1150- 1154. In the US, this also implicates important questions of federalism, as bankruptcy courts are federal courts, empowered to play this major role affecting local and state affairs. Jacoby M. (2016), “Federalism Form and Function in the Detroit Bankruptcy”, *Yale Journal on Regulation*, Vol. 33.

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NEXT GENERATION IBC: NEED OF THE HOUR

T. V. Mohandas Pai and Shankar Jaganathan

‘It is amazing how many drivers, including Formula One Level, think that the brakes are for slowing the car down’

- Mario Anretti, *Formula One driver*

The relationship between the insolvency and bankruptcy process (IB Process) and economic growth is not very dissimilar to the relationship between braking system efficiency and the speed of an automobile. The efficiency of the IB Process in an economy has a direct impact on its potential economic growth and the health of its banking system. Despite the significant progress made by India since 2016, with the introduction of the Insolvency and Bankruptcy Code, 2016 (Code/IBC), continuous improvements to efficiency and effectiveness of IB process are vital for accelerating India’s economic growth. This is especially so in the post pandemic era where many businesses—small, medium, and large, are reeling under enormous financial stress, despite their established track record of having been viable businesses.

INSOLVENCY LAW IMPLEMENTATION: RAPID PROGRESS MADE

Any student of Indian economy will find abundant evidence to show that India has made rapid strides in resolving insolvency. The World Bank, in its report on measuring the Ease of Doing Business, measures the efficiency and effectiveness of insolvency process by the time it takes, the cost that is incurred, the outcome, and recovery rate of the claims made by the creditors. After the introduction of the IBC, within a short period of four years, India has moved up 84 places in the

'resolving insolvency' parameter from 136th rank in 2017 to the 52nd rank in 2020. This impressive progress is second only to the ease with which construction permits are granted in India, which moved up by 156 places to the 27th rank.

The relative improvement in resolving insolvency compared to other economies is backed by remarkable numbers on the absolute front too. Since the new Code came into effect on December 1, 2016, as of March 31, 2021, a total of 4376 corporate insolvency resolution processes (CIRPs) have commenced, out of which more than 60% or 2653 cases are closed. Of the CIRPs closed, 617 (23%) have been closed on appeal or review or settled; 411 (15%) have been withdrawn due to arriving at settlement with the creditors; 1277 (48%) have ended in orders for liquidation and 348 (13%) have ended in approval of resolution plans.

On the realisation front too, the results are equally impressive. In the first three years of this novel Code, as on November 30, 2019, around 13,210 cases were disposed under the IBC. Around 190 cases involving claims around ₹ 3.67 lakh crore were resolved with a realisable amount of around ₹ 1.57 lakh crore. Around 11,366 cases involving claims around ₹ 4.74 lakh crore were disposed prior to admission. The Standing Committee on Finance estimates recovery from these cases to be around ₹ 2 lakh crore, which amounts to a total recovery of 43%, i.e. ₹ 3.57 lakh crores from the claims of around ₹ 8.4 lakh crore (₹ 4.74 lakh crore + ₹ 3.67 lakh crore). Further, the average time taken for resolution has reduced drastically to about 406 days, from 4.3 years or 1679 days under the previous regime.

Despite the impressive strides made on resolving insolvency in India, most of the results till date are the consequence of actions initiated by the financial creditors (FCs) or the operational creditors (OCs). Of the 4376 CIRPs, 51% were initiated by OCs, 43% by FCs and only 6% or 276 cases were initiated by the corporate debtor (CD), which is understandable, as the only condition under which the CD can initiate action is after default has occurred.

Given the extreme financial stress caused by the pandemic across a wide range of corporates, we believe that this is the right time to take the next bold step to enable corporates with viable business operations but facing financial pressures due to under-capitalisation and/or over-leverage the chance to rescue their business and place themselves on their path to prosperity and growth. This will protect the interest of all stakeholders in the distressed company, especially their employees and their eco-system of small suppliers, where creating fresh employment opportunities in the same geographies would be a challenge.

A CASE FOR DOING MORE

Resolving insolvency is not an easy task, given the conflicting interests of different stakeholders with fixed financial stakes like lenders, creditors, and employees on the one hand and the investors who take a higher risk for a variable and potentially large rewards on the other hand. Providing creditors, both financial and operational, who suffer at the hands of the delinquent borrowers or customers an

avenue to recover their contractual dues is only one of the twin objectives of resolving insolvency. The other and the more vital step from both economic and social perspective is to enable distressed debtors to initiate reconstruction of their business to prevent delinquencies and thereby preserve the employment opportunities and the commercial ecosystem they have built over the years.

Despite this daunting challenge of managing this conflict, second generation IBC needs to be introduced, as the benefits are significant, as seen in the top 20 performing economies that allow a viable business to continue operating as a going concern during their self-initiated insolvency proceedings. Keeping viable businesses afloat is one of the most important economic objectives of any insolvency and bankruptcy system. The highest recovery rates have been recorded in economies where reorganisation is the most common insolvency proceeding for viable businesses in financial distress.

Second generation insolvency regimes create an alternate path to restructuring businesses that are economically viable but face temporary financial distress by pre-empting them from slipping into the insolvency trap leading ultimately to their liquidation. Action here must start much before they default. Even as strengthening the path for allowing speedy liquidation for non-viable businesses continues, viable businesses must be provided with safety jackets to help them swim ashore. Commercial debt restructuring combined with stay of enforcement proceedings for debt recovery forms the core of this safety jacket.

WHAT COULD BE DONE?

Conceptually we need to create a clearly defined process for reorganisation of financially viable businesses that are going through financial distress, often as a result of external economic factors, well beyond the control of these businesses, like the current pandemic. The primary objective is to enable these businesses to continue their operations as a going concern, as they seek to reorganise their financial structure. Global practices in advanced economies point to the need for clear rules on the commencement of reorganisation. It includes an insolvency test, provision of defined mechanism to manage the debtor's property and minimum requirements for the content and adoption of the reorganisation plan. The reorganisation plan would contain elements of debt restructuring and provide a period when enforcement actions are legally kept in abeyance.

At an operating level, we will need new provisions that define the elements of a viable business, which could be operational profitability i.e. a positive returns at the level of Profit Before Interest and Tax, in the year or years prior to the pandemic i.e. financial year 2019-20 or 2018-19. For companies that meet this business viability criteria, all civil and tax recovery proceedings could be kept in abeyance for a period of three years and reorganisation of the capital structure could take any one or more of the following methods:

- (a) Moratorium on debt repayment for a defined period of say three years, or
- (b) Moratorium on debt repayments or conversion to equity, and/or

(c) Write down of debt for continuing debt in consideration of infusing fresh equity.

During the period of reorganisation, the existing shareholders through their elected board of directors will continue to run the operations subject to all reasonable restrictions on declaration of dividends and the participation of creditors' representative/s on the board of directors to protect their interest.

While this scheme proposed may go against the stated principle of 'creditors-in-possession' that is embedded in the current IBC, which is more suited for creditors' initiated insolvency process and which has recovery of their debt as their primary objective, the need of the hour is for 'debtors-in-possession' based insolvency process initiated proactively by CDs, without the pre-requisite of a default. This will prevent companies from going into liquidation and help them get back to the path of recovery.

India can learn from the successful practices in countries like the United States —their Chapter XI experiences and in the United Kingdom—their company voluntary arrangements, administration, and schemes of arrangement. Every challenge brings with it an opportunity. Bigger the challenge, bigger the opportunity. Can we grab it with both hands to usher in the second generation of IBC?

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VALUATION PROFESSION IN INDIA: ORGANISATIONAL EVOLUTION, INSTITUTIONAL IMPORTANCE AND WAY FORWARD

Navrang Saini

'Not everything that can be counted counts, and not everything that counts can be counted'

-William Bruce Cameron

INSTITUTIONS AND ECONOMIC GROWTH

The emergence of market society across the globe, increased trade of goods and services. It was accompanied by an exchange of ideas, movement of people that drove political, economic and social changes. Rapid increase in economic activity with market transitions, altered the mechanisms of existing institutions. The need for formalised and accountable institutions was created. Historical examination of the role of institutions in determining market outcomes highlights the pivotal role that institutions play in the larger economic growth trajectory of a country. European colonisation, division of Korea and evolution of these countries thereafter are evidence to the fact that 'institutions matter'. Colonies that were subject to extractive and exploitative institutions at the hands of their colonisers, still struggle to drive a progressive institutional change. Consider the case of Africa. Vested interests, high levels of corruption and exploitation which were passed down from their colonisers have defined the current political and economic outcomes to a large extent. The growth trajectories post division of Korea into North and South is a quintessential historical event

that provides evidence on role of institutions. The two parts have very different economic, political and social institutions. It reaffirms that less-restrictive, market oriented, and efficient institutions are foundations of nation growth and prosperity.¹

The study of role of institutions in economic growth has assumed greater significance owing to globalisation and increased interdependence between countries. Institutions that uphold property rights and ensure that contracts are enforced are pre-requisites to strong nation building. Studies² have arrived at a classification of institutions into four categories. The first is ‘market-creating’ institutions. These institutions allow for the development of a market economy, one that allows free trade and in absence of which markets cease to exist. The second is ‘market-regulating’ institutions. These institutions are concerned with externalities that arise from market failure. Excess market power, inefficient resource allocation typically accounts for market failure. Regulatory agencies in sectors such as telecommunications, transport and financial services form a part of market regulating institutions. Third category is ‘market-stabilising’ institutions. These comprise of institutions that reduce macroeconomic volatility and risks associated with financial crises- inflationary pressures, monitoring exchange rate fluctuations etc. The fourth category of ‘market-legitimising’ institutions are those that provide social protection and involve redistribution of resources. It includes social protection mechanisms such as pension schemes and unemployment insurance schemes³. By virtue of its inclusive nature, ‘market-legitimising’ institutions also manage to avert conflict.

Valuation Profession as an Institution

A market-oriented economy with increased firm activity engages a large number of stakeholders who may have conflicting interests. Competition is an essential characteristic of a free market economy, which at times can lead to abuse of market power and aggravation of conflicts.⁴ To balance individual interests, the law mandates a set of governance norms ensuring societal interests are best protected over individual benefit. This has given rise to the age of ‘professionals’.⁵ Professionals possess specialised knowledge and expertise in their area of operation. In the absence of formal institutions, the market forces of demand and supply acted as clearing agents and arrived at the equilibrium price of assets and commodities. However, while this may be the invisible hand that Adam Smith discussed in his *laissez-faire* economic policies, market prices in the current complicated political and economic structures may not serve as a useful metric to quantify the worth of assets and commodities. One such institutional framework where market price may not be a useful guide is the institution for Valuation Profession. A market-regulating, market-legitimising institution, it is fundamental in developing a sub-system of professionals. They act as economic agents that take several financial decisions on the basis of value of an asset.

Prior to developing a case for the need of an institution of Valuation Profession, it is imperative to understand the essence of this institution.

An institution for Valuation Profession as the name suggests is an entity that deals with business valuation. The entity consists of experts- Valuer or Valuation Professionals who carry out the task

of valuation and arrive at an estimate or worth of the asset which is called a value. This value is not the market price. It can be significantly different and in most cases is context specific.⁶ This value is determined after evaluating all aspects of the business and through use of other objective measures. The field of business valuation encompasses a wide array of variables that jointly and severally impact the value.⁷

Imperatives for Institutionalising Valuation Profession

The need for an institution of Valuation Profession stems from the wealth maximisation strategy. Business valuation process generally arises when an entity considers to sell all or a portion of its operations or even merge with / acquire another entity. Downside risks of incorrect valuation include deterioration in the value of assets or in the extreme case, complete loss of value.⁸ Financial risks are heightened in cases where values are not genuine. Both over and undervaluation of assets can leave either party worse-off and discourage a mutually beneficial exchange, stalling economic growth. Valuations are an essential part of business decisions. In order to facilitate smoother transactions in the market, a valuation of assets is required. An ever-growing market with expanding innovations and businesses are bound to render traditional methods, resources, technologies and entities redundant. This process of replacement of the old with new, coined as ‘creative destruction’ by the economist Joseph Schumpeter⁹ creates a need for an institution that achieves this with minimum erosion of value. Valuation services are used not only by corporate houses but also other financial institutions such as banks. Individual persons also seek valuation services. The values serve as a guide for evaluating alternatives and help arrive at an informed decision. The ultimate purpose of any firm is the creation of value for its stakeholders.

Focusing on the Indian context, post 1991, India has been on the path to become a market driven economy. The liberalisation, privatisation and globalisation (LPG) policies adopted in 1991, set India at the centre stage of international trade in goods and services. Early developments included diversification in manufacturing sector, emergence of a strong service sector and expansion of the financial sector. The role of institutions in further developing and sustaining economic growth cannot be negated.¹⁰ India continues to experience several political and economic changes. In this process, the resource stock of the country and its value also change. Thus, building a strong and efficient institution of Valuation Profession is of supreme significance. For long run growth of any profession, existence of institutions matters. The next section explores the evolution of the framework for institution of Valuation Profession in India.

ORGANISATIONAL EVOLUTION OF THE FRAMEWORK OF VALUATION PROFESSION

The valuation profession is a vital institution of the market economies, it directly or indirectly affects everyone. Valuation services are required in almost all parts of our globally financial system; it is needed for several market-based transactions such as mergers, acquisitions, take over, liquidation,

issue of securities etc. India in particular, being one of the fastest growing economies in the world, has a strong vested interest in high quality standards for valuation, both domestically and globally.¹¹

For long, in absence of any statutory provisions and rules in place, the valuation services have been delivered by the auditors, merchant bankers, company secretaries and chartered accountants. The services delivered were largely based on subjective opinions and not on any universal standard or established frameworks. Regulation of this profession is important to ascertain standardisation of practices and reduction in commercial uncertainties. However, the valuation profession and the services provided by it are not regulated, which creates a risky situation for the stakeholders.¹²

In 2005, the J.J. Irani Expert Committee report emphasised on recognition of the valuation profession and the necessity of regulating it. The Government of India, with the intention of regulating the valuation professionals and valuation professional organisations, introduced the concept of Registered Valuer (RV) under section 247 of the Companies Act, 2013 (Companies Act).¹³ Section 247 makes it mandatory to be a RV in order to carry out all valuations under the Companies Act. Even before this, the Government had been taking incremental steps for quite some time to bring the profession under some kind of structured framework. To overcome lacuna of absence of such a framework, following steps were taken by the Government in the recent past to establish an effective framework for promoting and recognising the valuation profession in India;

(a) The Companies Bill, 2008: The Companies Bill, 2008 (2008 Companies Bill) was a step forward towards the introduction of RVs to come into existence. The 2008 Companies Bill emphasised on the need to have a RV. Section 218 of the Bill provided that:¹⁴

where valuation is required to be made in respect of any property, stocks, shares, debentures, securities, goodwill or net worth of a company or its assets, it shall be valued by a RV appointed by the Audit Committee or in its absence by the Board of Directors of the company.

Subsequently, the Government also proposed a formal and regulatory framework for the valuation professionals by introducing a Valuation Professional Bill, 2008, *'which provided for the constitution of the Council of Valuation Professionals inter alia for development, regulation, certification of qualification and quality of the valuation professional engaged in providing valuation services.'* The Valuation Professional Bill, 2008, adopted a two-tier statutory self-regulated model where the Council of Valuation Professionals acted as the principal regulator and the recognised institutes as the frontline regulators.¹⁵

The 2008 Companies Bill further provided for the Government to maintain a record of RV to keep a track of all the active valuers. It laid the eligibility criteria for the professionals to become a RV, their roles and responsibilities etc. However, due to some technicalities, it was not introduced in the Indian parliament. Later, it was introduced as the Companies Bill, 2009 with further recommendations from the Standing Committee on Finance which increased the extent of the RV.¹⁶

(b) The Companies Act, 2013: The Ministry of Corporate Affairs (MCA) vide its notification dated

October 18, 2017, introduced RV as a new profession under section 247 of the Companies Act which states that the valuation, where required, in respect of any property, stocks, shares, debentures, securities or goodwill or any other asset or net worth of a company or its liabilities, is to be valued by *'a person having such qualifications and experience and registered as a valuer in such manner, on such terms and conditions as may be prescribed.'*¹⁷ Prior to this notification, this profession was not regulated by any regulatory body. Perhaps this is the reason as to why the valuation profession has not achieved the heights which it deserves, in parallel to other existing professions such as Chartered Accountants, Company Secretaries, Cost Accountants. Subsequently, vide notification dated 23rd October, 2017, the Central Government delegated its powers and functions vested in it under section 247 of the Companies Act, 2013 to the Insolvency and Bankruptcy Board of India.

In pursuance of provisions of section 247 of the Companies Act, the MCA placed the Draft Companies Rules, 2017 and invited comments/ suggestions from the general public in order to understand the requirements and concerns of various stakeholders. After considering the comments/ suggestions, the Companies (Registered Valuers & Valuation) Rules, 2017 (Valuation Rules) were notified under the Companies Act by the MCA on October 18, 2017 as a response to the arising needs of the market of valuation services. These rules laid down various valuation standards and policies to be followed by the companies and the RVs.¹⁸ It also laid down the eligibility criteria for an organisation to be registered as a Registered Valuers Organisation (RVO), thus, sealing the existence and functioning of the RVOs.

(c) The Companies (Removal of Difficulties) Second Order, 2017: After section 247 of the Companies Act came into existence, a difficulty was observed when various different organisations dealing with various distinct group of assets such as land and building, machinery and equipment, and having different set of valuers for valuation were functioning without being recognised. It was imperative to recognise these organisations by registering them in order to ensure the required level of regulation on the RVs as well as on these organisations. Further, it was essential to recognise the internal procedures and conducts of these organisations to improve the standards in valuations and workings of the valuers. This order, as notified by MCA, highlighted;

And, whereas, although the said section provides for valuation to be made by a person having such qualifications and experience and registered as a valuer in such manner, on such terms and conditions as may be prescribed, there is a need to provide clarity and remove the difficulty of having no reference to an organisation to which the valuer may belong...¹⁹

Thus, this order amended the definition of RV specified under section 247 of the Companies Act and bestowed identity to various valuation organisation and recognised their existence.²⁰

The first RVO, namely, RVO Estate Manager and Appraisers Foundations, was registered in 2018. At present, there are more than 4300 RVs and 16 RVOs registered with IBBI. RVs are permitted to form an entity i.e., Registered Valuer Entity (RVE) (Partnership / Company) for rendering valuation services. There are currently 43 RVEs registered as RVs as of June 30, 2021.²¹

As per Valuation Rules, societies and trusts were also allowed to be registered as RVOs, however, for societies and trusts to be registered as RVOs, it was mandatory for them to be converted into or register themselves as a company under section 8 of the Companies Act²² within one year of the date of commencement of valuation rules.

VALUATION AND THE CODE

Valuation plays a critical role in the corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016 (Code). Throughout the entire corporate insolvency resolution process (CIRP), the practical and strategic implications of valuation play key roles. Each player in the process makes decisions based on the value of the corporate debtor (CD) and its assets. Some of the most important areas in which valuation plays an important role during insolvency resolution process are adequate protection of value of the CD; determination of claims; call for resolution plans by resolution applicants, approval of resolution plan by committee of creditors (CoC) and realisations by creditors. Role of valuation ranges from asset collateral valuation matters, to disputes as to the value of the CD as a whole, to fairness and equity issues related to the valuation of securities and distribution of proceeds to settle the claims of various stakeholders.

Framework established under the Code

Transparent and credible value of the assets of a CD is an important parameter for commercial decisions in a CIRP. It determines the entitlement of some stakeholders under the resolution plan. The Code read with regulations assign the task of such valuation to RVs.

The Valuation Rules provide a comprehensive unified framework for development and regulation of the profession of valuers, though its remit is limited to valuations required under the Code and the Companies Act. This framework, however, does not affect the conduct of valuations under any law other than the Companies Act and the Code. With effect from February 01, 2019, only a RV will be appointed by an IP to conduct any valuation under the Code or any of the regulations made thereunder.

The approach followed for regulation and development of the valuation profession is quite distinct as compared to other professions in the country. Only fit and proper persons are eligible for registration as RVs, given the responsibilities they discharge. For determining if a person is fit and proper, the IBBI considers various aspects, including (i) integrity, reputation and character, (ii) absence of convictions and restraint orders, and (iii) competence and financial solvency.

The Valuation Rules broadly follow the model of insolvency profession for regulation of RVs. Valuers are subject to a two-tier, regulated self-regulation where they are enrolled with an RVO as a member, and thereafter registered with the IBBI as a valuer. This combines the benefits of statutory regulation and self-regulation and promotes competition among the RVOs. Similar to the role played by IPAs for IPs, Registered Valuer Organisations act as frontline regulators for RVs.

They provide an institutional arrangement for the oversight, development, and regulation of RVs. They grant membership to valuers who comply with the eligibility norms provided in the Valuation Rules, conduct educational courses in valuation and provide training for the individual members before a CoP is issued. They also lay down standards of professional conduct and monitor their members for adherence to standards. They may take appropriate action to ensure that compliance with the Valuation Rules is strictly adhered to by their members.

The Valuation Rules envisage a competitive industry of RVOs, where they compete with one another to provide better valuation services through their professional members, in the interest of the users, and other stakeholders of valuation services. These also envisage that a member may shift membership from one RVO to another, subject to prior permission of the Authority for the same. The Valuation Rules require an RVO to employ fair, reasonable, just and non-discriminatory practices for enrolment and regulation of its members. It was, however, observed that a few RVOs were restricting transfer of membership by using dilatory tactics, charging unreasonable transfer fee, etc.

Role of Valuers under the Code

As opposed to other professions in India like Chartered Accountants, Company Secretaries, Cost Accountants, Advocates and medical professionals, there is no legislation as such which provides for the development and regulation of the profession of valuers exclusively. Over time, several laws or subordinate legislation framed thereunder recognised and demanded valuation services provided by valuers. For example, under the SARFAESI Act, 2002 in case of sale of immovable assets, before effecting the sale of immovable property, the authorised officer is required to obtain valuation of the property from an approved valuer, the latter being a person registered as a valuer under section 34AB of the Wealth Tax Act, 1957 and approved by the Board of Directors or Board of Trustees of the secured creditor. Similarly, the Foreign Exchange Management (Transfer of Issue of Security by a Person Resident Outside India) Regulations, 2017 provides for the valuation of capital instruments. Further, under Schedule 6 of these Regulations, the investment in a Limited Liability Partnership either through capital contribution or acquisition/ transfer of profit shares, cannot be less than fair price worked out as per any valuation norm which is internationally accepted/adopted as per market practice. There are other statutes such as the Banking Regulations Act, 1949; Income Tax Act, 1961 etc. that also have provisions that require valuations to be done for various purposes.

The role of a valuer under the Code transcends across different processes. For instance, in case of voluntary liquidation of corporate persons the declaration from the majority of the directors of the company regarding its solvency is required to be accompanied by a report of the valuation of the assets of the company, if any, prepared by a RV. Further, while considering an application for avoiding a transaction as undervalue, the Adjudicating Authority may require an independent expert to assess the evidence relating to the value of the transaction. Additionally, regulations framed under the Insolvency and Bankruptcy Code, 2016 also provide for RVs for various services such as determination of fair value and liquidation value at the stage of CIRP of a CD and during Fast

Track Insolvency Resolution Process for corporate persons and valuation of assets intended to be sold during the liquidation process.

The valuation profession under the Companies Act, 2013 and the IBC, in its present form is a regulated profession. This is a good start for creating a credible base of valuers for purposes of these two legislations. The RVs are bound by the Valuation Rules and Code of Conduct contained therein. They are answerable for their actions and misconduct, if any. On the other, valuers operating under other legislations, as discussed above, are not bound by a regulatory framework and are thus not accountable for their actions in case of misconduct. Thus, the current framework under Companies Act, 2013 and the IBC has laid the foundation of institutionalising the profession of valuers. The concept of two-tier regulation, RVOs being frontline regulator and IBBI being the principal regulator, has set the tone for designing a common regulatory framework for all valuers.

WAY FORWARD

There are a large number of individuals and entities practising the valuation profession. At present, there are more than 4300 valuers and 16 RVOs, registered with IBBI under the Valuation Rules. There are also valuers who have registered themselves with other agencies. The market size of this profession is large and the case for an integrated comprehensive institutional framework to regulate the same is thus strong.

To take this profession to the next level and to lay down a roadmap for the future of the profession in India, the Government had constituted a Committee of Experts (CoE) to examine the need for an institutional framework for regulation and development of valuation professionals. The CoE during its deliberations took note of attempts made in the past to provide an institutional framework for the valuation profession, particularly the draft Valuation Professionals Bill, 2008. It studied the progress in implementation and experience with the implementation of the Valuation Rules. It perused the institutional framework for other professions in the country and of the valuation profession in other jurisdictions. It also considered the contemporary thought on regulatory architecture and design and had extensive consultation with stakeholders.

The CoE in its report has, *inter alia*, recommended an institutional framework for valuation profession that envisages an exclusive statute to provide for the establishment of the National Institute of Valuers to protect the interests of users of valuation services in India and to promote the development of, and to regulate the profession of valuers and market for valuation services, with a view to ensure that valuers enjoy an enviable reputation of the stakeholders, while being accountable for their services. The CoE has proposed an institutional framework that is least disruptive and builds on the existing resources to ensure that the transition to a new framework is seamless. It has indicated the three objectives that institutional framework should strive for namely, (i) development and regulation of the valuation profession; (ii) development and regulation of market for valuation services; and (iii) protection of interest of the users of valuation services.

The CoE has designed an ecosystem having four elements: (i) National Institute of Valuers, which would be a statutory body primarily responsible for the development and the regulation of the valuation profession in India and registration and regulation of Valuers, Valuer Institutes and VPOs; (ii) Valuers, who would render valuation services, after registration with the Institute; (iii) Valuer Institutes, who would provide educational courses, after registration with the Institute; and (iv) valuation professional organisations (VPOs), who would be front-line regulators primarily responsible for development of the valuation profession, after registration with the Institute. To bring the proposed institutional framework into effect, a statute would need to be enacted that would lay down the basic structure of the institutional framework.

At present, in the absence of any statutory mandate and local valuation standard issued by any regulatory authority, the valuers generally have been following the International Valuation Standards (IVS) General Standards with or without minor modifications or the RICS Red Book. However, despite the existence of these Standards there is considerable variation in how local standards engage and comply with the accepted principles laid out in the IVS. Recognising the need to have consistent, uniform and transparent valuation policies and harmonise the diverse practices in use in India, uniform valuation standards having international recognition are required. Simultaneously, the valuation standards should be consistent with the Indian institutional framework for valuation profession.

Given the importance of valuation across sectors and different statutes, it is time to bring the valuation profession under a single umbrella framework and valuation standards. This is essential to ensure uniformity and consistency in valuations done by valuers, thereby imparting legitimacy to the valuation profession. Further, continuous professional development of valuers will play a key role in keeping the profession relevant and up-to date. At the same time the valuers will have to abide by a common code of conduct that lends utmost integrity and professionalism to the profession.

Any attempt to regulate a set of economic agents in a free-market economy set-up is often opposed by many, especially those who will be brought under the umbrella of regulation. A divide is created between those who support the idea of a regulatory regime and those who oppose it. This is the organic process of ushering in a change in an established system. It would not be wrong to say that almost all professions, be it Chartered Accountants, Company Secretary, Cost Accountants etc., have benefitted from a regulatory framework, lending the professions credibility, competence and a space among global professionals. To provide the same legitimacy to the valuation profession, an integrated institutional framework for the valuation profession is the need of the hour.

NOTES

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⁵ Report of the Committee of Experts to Examine the Need for An Institutional Framework for Regulation and Development of Valuation Professionals, April 2020, Vol 1, Ministry of Corporate Affairs.

⁶ *Ibid.*

⁷ Valuation: Professionals’ Insight, July 2018, Valuation Standards Board, ICAI.

⁸ Supra Note 5

⁹ Pfarrer M. and Smith K. (2015), “Creative Destruction”, *Wiley Encyclopaedia of Management*.

¹⁰ Supra Note 4

¹¹ Talbot N. (2018), “It’s time to get serious about valuation”, *The Hindu BusinessLine*, 18 July.

¹² Supra Note 5.

¹³ Navrang S. (2019), “Need for Uniform Valuation Standards”, *A Miscellany of Perspectives*, IBBI Annual Publication, p. 172.

¹⁴ Section 218 of the Companies Bill 2008 makes it mandatory for the valuers to be registered under Chapter XVII of this Bill in order to conduct valuation of any property, stocks, shares, debentures, securities or goodwill or net worth of a company or its assets.

¹⁵ *Ibid.*

¹⁶ 21st Report of the Standing Committee of Finance on the Companies Bill, 2009, August, 2010.

¹⁷ Section 247 of the Companies Act, 2013 as notified on October 18, 2017.

¹⁸ Supra Note 4

¹⁹ The Companies (Removal of Difficulties) Second Order, 2017, MCA, October 23, 2017.

²⁰ The Companies (Removal of Difficulties) Second Order, 2017 substituted section 247 (1) of Companies Act, 2013 with ‘a person having such qualifications and experience, registered as a valuer and being a member of an organization recognized, in such manner, on such terms and conditions as may be prescribed’.

²¹ IBBI Quarterly Newsletter, April-June, 2021.

²² Rule 12(3) of the Companies (Registered Valuers & Valuation) Rules, 2017.

ABOUT THE CONTRIBUTORS

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Dr. M. S. Sahoo serves as Chairperson of the IBBI. He has served as a Member of the Competition Commission of India, Secretary of the Institute of Company Secretaries of India, Whole Time Member of SEBI, Economic Adviser with the National Stock Exchange of India and held senior positions in Government of India as a Member of Indian Economic Service. He also had a brief, but eventful legal practice. Dr. Sahoo has been a Member / Chairman of several committees set up by Government of India and Regulators.

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Mr. Saurav Sinha joined the Reserve Bank of India in Kolkata in 1988. Since then, he has held multiple positions in the banking space. Thereafter he was posted in Central Office, Mumbai as a portfolio manager. On transfer to Bhopal, he was posted to the Department of Banking Supervision, which assignment continued on transfer to Chennai. He then took over as In-Charge of Reserve Bank Office at Ranchi before being transferred back to Central Office as head of the newly set-up Corporate Strategy & Budget Department. Thereafter, he was in-charge of Department of Regulation before being promoted as Executive Director and is currently working in the area of Regulation of Commercial banks, Urban Cooperative banks and NBFCs.

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Former Chairman and MD of the National Housing Bank of India, Mr. Verma has an experience of nearly 36 years in the financial and housing sector. He was CMD of NHB, first MD & CEO and Central Registrar, CERSAI, Officiating Chairman and Whole Time Member at the PFRDA and Chairman at the Asia-Pacific Union for Housing Finance.

Mr. Verma is currently Consultant to the World Bank Group and is serving as the IFC's nominee Director on the Board of India Mortgage Guarantee Corporation. He was also a Member of the IBBI's Advisory Committee on Individual Insolvency and Bankruptcy and is currently serving as Part-time Chairman of AU Small Finance Bank.

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She was awarded the Woman Lawyer of the Year Award 2017-18, conferred by Legal Era at Mumbai, March 2018. She was also awarded Woman Lawyer of the Year 2019 by Business Legal World.

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She has previously advised the MCA and the Insolvency Law Committee on the design and drafting of amendments to the Code. She also advised the MCA and the IBBI on the design and drafting of rules and regulations relating to the corporate insolvency and liquidation processes, insolvency professionals and information utilities. She further advised the Expert Committee set up by the IBBI on the introduction of a Group Insolvency regime.

Mr. Debanshu Mukherjee

Mr. Debanshu Mukherjee is one of the Co-founders of the Vidhi Centre for Legal Policy, New Delhi. He led the Vidhi team that advised the Government on the design and drafting of the IBC and its subsequent implementation. He is an alumnus of Harvard University, the University of Oxford, and Hidayatullah National Law University. He attended Harvard as a Fulbright Scholar. Before co-founding Vidhi in 2013, he practised as an M&A lawyer with AZB & Partners.

Mr. Aditya Ayachit

Mr. Aditya Ayachit is a Senior Project Fellow at the Vidhi Centre for Legal Policy, New Delhi. He works on law and policy issues pertaining to financial regulation, commercial law and technology. He is a graduate of the National University of Juridical Sciences, Kolkata and has previously worked in areas of technology and commercial laws at two prestigious Indian law firms.

Mr. M. V. Nair

Mr. M. V. Nair is the Chairman of TransUnion CIBIL. He is also advisor to reputed private equity firms. He has been one of the longest serving Chairman and MD in the Indian public sector banking industry and served as Chairman of the Indian Banks Association.

He was the Chairman of SWIFT India Domestic Services (The Society of Worldwide Interbank Financial Telecommunication India Limited) and Chairman of the RBI's Committee set up to assess the Priority Sector Lending norms in the country. He is member of the IBBI's Advisory Committee on Corporate Insolvency and Liquidation.

Mr. Vinod Kothari

Mr. Vinod Kothari is a Fellow member of the Institute of Company Secretaries of India and an Associate member of the Institute of Chartered Accountants of India. With an experience of over 30 years in field on corporate laws, Mr. Kothari was one of the earliest Insolvency Professionals in India. Mr. Kothari is the author of 'Law relating to Insolvency and Bankruptcy 2016', co-authored with Ms. Sikha Bansal. Mr. Kothari has conducted seminars on various subjects in financial services in over 25 jurisdictions all over the world.

Ms. Sikha Bansal

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. 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 Insolvency Code. She has also been a speaker at the professional institutes.

Ms. Prachi Apte

Ms. Prachi Apte is working as a Research Associate (Law) with Individual Insolvency division of IBBI. She looks after the personal insolvency matters and developments happening therein. She has

completed her Master's degree in Law from Karnataka State Law University. She has practiced as an Advocate in Supreme Court of India as well as Gulbarga District Court in Karnataka. She has also worked as a Research Assistant in High Court of Karnataka, Bengaluru and National Law School of India University, Bengaluru.

Mr. Sushanta Kumar Das

Mr. Sushanta Kumar Das is working as Deputy General Manager in the IBBI. He is an MBA with specialisation in Finance and a certified associate of Indian Institute of Bankers. He has more than 15 years of experience in banking sector and has served in diverse capacities in multiple banking and financial institutions in India and abroad.

Mr. Das is a professional Grade-B Commercial Mediator, certified by MCA, Government of India. His area of expertise includes analysing banking practice and procedures and is actively involved in spreading awareness about the provisions of the IBC through his constant research and publications.

Mr. B. Sriram

Mr. B. Sriram is a Part-time Member of the Governing Board of IBBI. He was MD of SBI and subsequently MD & CEO of IDBI Bank Ltd, before his retirement in 2018. Mr. Sriram is currently an Independent Director at ICICI Bank Ltd, TVS Credit Services Ltd, Nippon Life India Asset Management Ltd, IndiaIdeas.com Ltd and is the Non-Executive Chairman of National Highways Infra Investment Managers Private Limited.

Mr. Sriram has been a member of several Committees constituted by Government of India and RBI, including the Insolvency Law Committee and Committee of Experts to examine the need for an Institutional framework for regulation and development of Valuation Professionals.

Mr. Debajyoti Ray Chaudhuri

Mr. Debajyoti Ray Chaudhuri is the MD and CEO of National E-Governance Services Ltd. Prior to this he was working as Chief General Manager in IBBI, on deputation from the SBI. He holds an MBA from the FMS (University of Delhi) and is a certified associate of Indian Institute of Bankers.

Mr. Ray Chaudhuri is a career banker with over 30 years of experience in SBI in managing assignments of a diverse nature in commercial and retail banking, and international banking. Before taking up the assignment in IBBI in January, 2018, he was at the corporate office of SBI where he was responsible for compliance and risk and implementation of the IBC, at the Corporate Accounts Group business vertical.

Ms. Radhika Agarwal

Ms. Radhika Agarwal is working as a Research Associate (Law) with the Registered Valuers Organisation Division, IBBI. She is a legal professional, having completed her Masters in Law (LL.M.) from National Law Institute University, Bhopal. She has qualified National Eligibility Test conducted by University Grants Commission and has also authored several articles in journals of repute.

Mr. Ashwin Bishnoi

Mr. Ashwin Bishnoi is a Partner with Khaitan & Co LLP. He is a leading lawyer in the field of corporate restructuring and distressed investing and focusses on the most complex and unique corporate rescues. He assisted the Bankruptcy Law Reforms Committee in peer reviewing the Insolvency and Bankruptcy Bill, 2015 which became the IBC.

He is recognised as one of the Top 20 Emerging Leaders (2019) by the international renowned RSG Consulting. Legal 500 recommends him as a practitioner in the field of corporate restructuring (2021) and is one of the select eight nominated by IFLR 1000 for the restructuring lawyer of 2021.

Mr. Unnikrishnan A.

Mr. Unnikrishnan A., Legal Adviser, Reserve Bank of India, is an ex-officio member of the Governing Board of IBBI. In the year 1995, he joined the RBI as Legal Officer. Later he was promoted to Legal Adviser. 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. Some of his articles were published in the RBI Legal News & Views.

Dr. Shashank Saksena

Dr. Shashank Saksena, Senior Economic Adviser, Department of Economic Affairs, Ministry of Finance, is an ex-officio member of the Governing Board of IBBI. He is an Indian Economic Service officer from the 1987 batch and has served the Government in various capacities. In his present position, he is involved with the formulation of policy reforms including legislative reforms for the financial sector, financial stability and cyber security for financial sector and currency and coins sector. He has been a Member of several Expert Committees in the financial sector. He has been involved with the formulation and enactment of several financial sector legislations with respect to the securities market, banking sector, payment system, financial markets and pension sector and the

delegated legislations made thereunder. He has also published several technical papers in the edited books and news magazines.

Dr. Ashok Haldia

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 and independent director on the board of RVO 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.

Mr. Vellayan Subbiah

Mr. Vellayan Subbiah is currently the MD of Tube Investments of India, one of the Group's leading manufacturing companies in business segments including bicycles, metal formed products, tubular components. He was the MD of Cholamandalam Investment & Finance Co. Ltd., a leading NBFC in India.

He has worked with McKinsey & Company, USA for six years. He is on the Board of Shanthi Gears Ltd., SRF Ltd., Cholamandalam Investment & Finance Co. Ltd., and CG Power and Industrial Solutions Ltd. He is also a member of the IBBI's Advisory Committee on Service Providers. He was a recipient of the Extraordinary Entrepreneur of the year – TiECON 2014 Award.

Mr. Pranay Mehrotra

Mr. Pranay Mehrotra is a Senior Partner and MD at The Boston Consulting Group. He is a leader in the firm's Financial Institutions practice based in Mumbai.

Pranay has around 25 years of experience of working with banks and financial institutions on large scale transformation, go-to-market programs, sales excellence, operational and organizational transformation, risk management, new business build, M&As and digital business models. His recent areas of focus with banks and non-banking financial companies include transformation of MSME and corporate lending models, systems and processes. He is also a frequent participant in industry-level forums.

Dr. Jose M. Garrido

Dr. Jose M. Garrido is the Supervisor of the Insolvency Working Group at the Legal Department of the IMF, and a Senior Counsel at the Financial and Fiscal Law Unit. He is an internationally recognized specialist in insolvency and creditor rights and in financial and company law, experienced in legal analysis and design of law reforms in Europe, Asia, Africa, and America. Dr. Garrido is a professor of commercial, corporate and insolvency law in Spain. He also served in the European Commission's Group of high-level company law experts, in areas such as the Takeover Directive and the future of company law in Europe.

Mr. Sunil Mehta

Mr. Sunil Mehta is the Chief Executive of Indian Banks' Association which acts as a representative of over 248 member banks and associate members operating in India. Prior to this, he served as the MD & CEO of Punjab National Bank. He is a seasoned banker with over 37 years of rich experience.

During the course of his career, he has held various important positions in view of his expertise in agriculture, retail, credit and planning & development. He is a part of various Committees of the Government/Regulators, representing IBA. He served as a member of the Insolvency Law Committee and IBBI's Advisory Committee on Corporate Insolvency and Liquidation.

Mr. Vijaykumar Iyer

Mr. Vijaykumar Iyer is a registered Insolvency Professional and has been appointed as the resolution professional on various projects including Bhushan Steel Limited, Binani Cement Limited and the Aircel group of companies. He is currently a partner in Deloitte India Insolvency Professionals LLP.

Mr. Kumar, with over 20 years' experience as M&A specialist and industry expert has worked on over 400 domestic and cross border M&A transactions. He is also an esteemed member of the Academic Council for the Graduate Insolvency Programme.

Mr. Sanjeev Marwah

Mr. Sanjeev Marwah is an Associate Director, Deloitte Touche Tohmatsu India LLP. He is part of the corporate finance and restructuring practice and has experience in executing several restructuring and insolvency engagements across industries, including, Murli Industries, Aircel group of companies, Reliance Communication group of companies and Lavasa. He is a computer science engineer and also holds a masters' degree in business administration.

Mr. Sanjeev Sanyal

Mr. Sanjeev Sanyal is the Principal Economic Advisor to the Government of India. As the Co-Chair of the G-20 Framework Working Group, he has been one of the main architects of the G20's Global Action Plan used to coordinate the global response to the COVID-19 pandemic.

He has spent over two decades in the financial sector and was Global Strategist & MD at Deutsche Bank. He was named Young Global Leader by the World Economic Forum in 2010. He has been a Visiting Scholar at Oxford University, a Fellow of the Royal Geographical Society, London, and an Honorary Professor of Jawaharlal Nehru University, Delhi.

Ms. Aakanksha Arora

Ms. Aakanksha Arora is an Indian Economic Service Officer of 2013 batch, currently posted as Deputy Director of Department of Economic Affairs, Ministry of Finance. She has been working closely with Chief Economic Advisor and Principal Economic Advisor on Economic Surveys 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 for Budget Responsibility of UK. She has represented India in OECD meetings in Paris on various occasions.

Mr. Challa Sreenivasulu Setty

Mr. C. S. Setty, MD, SBI is currently in charge of retail banking, digital initiatives, MSME, agriculture and financial inclusion activities of the Bank. He is a Certified Associate of Indian Institute of Bankers. Across a career spanning over three decades, he has worked in corporate credit, retail banking and stressed asset management.

Previously, Mr. Setty was heading the Stressed Asset Resolution Group of the Bank, where he represented SBI in various fora related to IBC and has led the teams that worked on a number of high profile, large resolutions under CIRP.

Mr. Mahesh Vyas

Mr. Mahesh Vyas is MD and CEO of Centre for Monitoring Indian Economy Pvt. Ltd. (CMIE). He is the chief architect of CMIE's databases which include– Prowess, CapEx and the Consumer Pyramids Household Survey database. Prowess is India's largest database on the performance of Indian companies, CapEx is India's largest database on the implementation of investment projects to create new capacities in India and, Consumer Pyramids Household Survey is India's largest panel household survey.

He writes regularly on the Indian economy for CMIE's Economic Outlook service. He also writes a

weekly column for Business Standard. His writings focus on labour markets, consumer sentiments, performance of enterprises and investment cycles.

Mr. Amarjit Singh Chandhiok

Mr. A. S. Chandhiok is a distinguished Indian Senior Advocate practising in the Supreme Court and High Courts in India. He was the president of Delhi High Court Bar Association for six terms, which is a record. He is also President of Maadhyam, Council for Conflict Resolution. He is an expert in commercial, company, and insolvency laws and is a member of London Court of International Arbitration. He was also the Chairman of IBBI's Working Group on Individual Insolvency.

He is the recipient of 'Legal Excellence Award as a Visionary Leader for Outstanding Contribution & Excellence in the Field of Mediation', by Legal Era, in June 2021, the National Law Day Award, from the Prime Minister of India in 2006 and other prestigious awards.

Mr. Dwijaraj Bhattacharya

Mr. Dwijaraj Bhattacharya is a Senior Research Associate with the Financial Systems Design Initiative of Dvara Research. His research focuses on the various aspects of households' access to credit and impediments therein. He has studied India's personal insolvency regime, aspects of consumer protection across several financial products, and the phenomenon of over indebtedness in India.

He has worked with several committees and working groups formed by the Government of India and financial sector regulators. He has also worked with the government advisory vertical of Deloitte's consulting arm and other institutions where he had advised several central and state authorities in India.

Ms. Bindu Ananth

Ms. Bindu Ananth is the co-founder and Chair of Dvara Trust. She was Board Chair of Northern Arc Capital from 2009 – 2018.

Ms. Ananth has publications in leading journals and paper series. She has co-edited 'Financial Engineering for Low-Income Households', a SAGE publication. She was a member of three RBI Committees on financial inclusion, SME finance and housing securitisation. She was a member of the Government of India's High-Level Committee on Women. She was a member of IBBI's Working Group on Individual Insolvency. In 2017, Ms. Ananth was featured by Forbes as one of India's leading women leaders.

Dr. H. S. Shylendra

Dr. H. S. Shylendra holds a Ph.D in Economics and is a Professor in the Social Science area. He is a member of the Centre for Sustainable Livelihood at Institute of Rural Management Anand, Gujarat. Dr. Shylendra was Chairman of the Standing working group on local institutions of the Chhattisgarh Planning Commission; a member of the Expert Committee of RBI on Credit Cooperatives; and member of the IBBI's Working Group on individual insolvency. He was awarded the Dr. S. R. Sen Prize by Indian Society of Agricultural Economics for Best Book for his work 'Diversification and Sustainable Rural Livelihood' in 2012.

Mr. Bahram N. Vakil

Mr. Bahram N. Vakil, Co-Founder of AZB & Partners is amongst India's foremost restructuring, bankruptcy, infrastructure and project finance attorneys. He was appointed as a key member of the Dr. T. K. Viswanathan Committee on Bankruptcy Law Reforms, to draft the IBC. He is also a member of the Insolvency Law Committee and is the first Indian lawyer to be invited to serve as a member of the International Insolvency Institute .

He has also served as a member of the Task Force on the Development of Secondary Market for Corporate Loans set up by the RBI and the Financial Sector Legislative Reforms Committee – SEBI Advisory Group, among others.

Mr. Suharsh Sinha

Mr. Suharsh Sinha is a partner in finance practice at AZB & Partners, specialising in restructuring and insolvency. Mr. Sinha was a researcher with the Bankruptcy Law Reform Committee which was instrumental in drafting the IBC and has been actively involved in advising the Insolvency Law Committee. He has advised a wide range of clients including resolution professionals, foreign portfolio investors, hedge funds, banks and resolution professionals in marquee insolvency matters such as Essar Steel, Bhushan Steel, DHFL, Alok Industries and Jet Airways.

Ms. Amrita Sinha

Ms. Amrita Sinha is a senior associate in the banking & finance and insolvency & restructuring practice of AZB & Partners. She has advised various stakeholders, including domestic and international banks and financial institutions, funds, distressed companies and industry professionals on insolvency resolution processes and related laws and regulations. She continues to advise on some of the most complicated restructuring and insolvency matters. She has also advised on various financing transactions, including secured lending, trade finance, issuance of debt instruments

and cross-border financing. Amrita has completed her LLB from National Law School of India University, Bangalore and is qualified to practise law in India.

Mr. Sanjeev Krishan

Mr. Sanjeev Krishan is the Chairman of PwC, India, leading the firm's Transactions, Private Equity and Deals businesses.

He has domestic and international experience in Deals, working across a range of sectors, such as technology, consumer and industrial products. He is passionate about playing a part in building a sustainable future for the society we live in, and actively advocates the causes of conservation, socio-economic inclusion and diversity. He has been specifically focused on the sponsorship and retention of women employees.

He is a certified Chartered Accountant and an Associate Member of the Institute of Chartered Accountants of India.

Ms. Rabitah Khara

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 for the firm. She has worked with clients from various industries including manufacturing, enterprise services, technology and consumer. Ms. Khara has also worked on numerous corporate insolvency resolution processes from both sides, supporting the committee of creditors and the insolvency professional or supporting the resolution applicant in achieving a successful resolution of the corporate debtor.

Mr. Pratik Datta

Mr. Pratik Datta is a Senior Research Fellow at Shardul Amarchand Mangaldas & Co. After serving as a Law Clerk to a sitting judge of the Supreme Court of India, Mr. Datta became one of the first lawyers to join the National Institute of Public Finance and Policy. He has worked closely with the Government of India, financial regulators, and expert committees, giving legal shape to the most momentous financial reforms in India. These include drafting the IBC; setting up the Monetary Policy Committee; and merger of the Indian commodities and securities regulators.

Mr. Datta regularly publishes research papers and articles primarily related to law and finance.

Dr. Adam Feibelman

Mr. Adam Feibelman is the Sumter Davis Marks Professor of Law and Director of the Center on Law and the Economy at Tulane Law School. His teaching and research focus on bankruptcy law, regulation of financial institutions, legal issues related to sovereign debt and international monetary law. He joined the Tulane faculty in 2009. Prior to that, he was a faculty member at the University of North Carolina School of Law and University of Cincinnati School of Law and a Bigelow Fellow at the University of Chicago Law School.

Ms. Bhargavi Zaveri-Shah

Ms. Bhargavi Zaveri-Shah is a doctoral candidate at the Faculty of Law, NUS, Singapore. Her core research interests are financial regulation, bankruptcy law and land and access to finance in India. She was part of the Working Group to set up the IBBI, the research team for the Cross-border Insolvency Rules and Regulations Committee. She was recently appointed as a member of the expert committee on variable capital companies, constituted by the International Financial Services Centres Authority. She has previously worked with the NIPFP and led legal research at a Mumbai-based interdisciplinary think tank prior to her doctoral candidature.

Mr. T. V. Mohandas Pai

Mr. T. V. Mohandas Pai is currently the Chairman of Aarin Capital and Chairman of Manipal Global Education. He is also the Chairman of the Regulatory and Financial Technology Committee of SEBI, Chairman of the SEBI Primary Markets Advisory Committee, and Investment Committee Member of 3one4 Capital. He also chairs the IBBI's Advisory Committee on Service Providers.

Over a career spanning 37 years, Mr. Pai has served in the areas of finance, information technology, education, corporate governance, social impact innovation, environmental conservation, policy formulation, heritage preservation, philanthropy, and the startup ecosystem.

He was awarded the Padma Shri in 2015 and the Karnataka Rajyotsava Award in 2008.

Mr. Shankar Jaganathan

Mr. Shankar Jaganathan, is, presently, the Founder & Chief Executive of CimplifyFive, a company that is a pioneer in developing automation and compliance management solutions for corporate law compliances. He is a Chartered Accountant by profession and a law graduate by qualification, with varied experience in corporate, academic and social sectors in a career spanning 35 years.

He is the author of 'Corporate Disclosures: 1553-2007, The Origin of Financial and Business Reports' which established his name, in 2013 and 2015, in the list of top 50 Management Thinkers in India by Thinkers50, a London based consulting firm.

Dr. Navrang Saini

Dr. Navrang Saini took charge as Whole-time Member of IBBI on March 31, 2017. He holds a Ph.D. in Corporate Law and professional qualification as a Company Secretary. Dr. Saini has served the MCA in various capacities. His last assignment was as Director General at the Ministry. He also served as a Commissioned Officer in Territorial Army from July, 1985 to March, 2011 and superannuated as Lt. Colonel.

He is presently looking after Registration & Monitoring Wing comprising Insolvency Professionals, Insolvency Professional Entities, Information Utilities, Insolvency Professional Agencies, Registered Valuers, Registered Valuers Organisations, Inspection, Investigation, Surveillance and Grievance Redressal. In addition, he is in-charge of the Legal Affairs Division and Establishment Division in the IBBI.



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Insolvency and Bankruptcy Board of India

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