आज़ादी का
अमृत महोत्सव

INSOLVENCY: NOW & BEYOND

A THOUGHT LEADERSHIP DOCUMENT ON INSOLVENCY REGIME

Joint publication by:
Insolvency and Bankruptcy Board of India
&
Foreign Commonwealth Development Office, UK

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

UK Government

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Foreword

Any economic law has to keep on experimenting with evolving market conditions, to continue to remain relevant. The Indian Insolvency law is no different and as a key economic reform, has established itself, in very short span of time, as credible instrument which has brought about perceptible transformation in the prevailing credit culture in the country. The legislative interventions and evolving jurisprudence, on continuous basis, is imparting further depth and maturity to the law in the context of the evolving market economy.

The Insolvency and Bankruptcy Code, 2016 (**Code**) was enacted in 2016 as a time-bound mechanism for the insolvency resolution of stressed debtors, for maximizing the value of their assets. The four pillars of the insolvency ecosystem, namely the Insolvency and Bankruptcy Board of India (**IBBI**), insolvency professionals, insolvency professional agencies, and information utilities, have all worked in tandem, matured and graduated to the next level, during the last over five years.

The key objective of the Code is to rescue firms in financial distress and promote entrepreneurship while balancing the interests of all the stakeholders. Since the inception of the Code, the Legislature has intervened six times, to amend the Code, to incorporate key learnings, for reinforcing the processes and advancing its core objectives. A plethora of landmark judgments have been delivered in the past few years, clarifying on several conceptual issues and settling the position of the Code over other existing laws, in case of any inconsistency between them.

The role of knowledge products is of paramount importance in, not only, evaluating the efficacy of the IBC ecosystem and outcomes, but more importantly, they are serving as key source in chartering the path for future reforms in furtherance of objectives as enunciated in the preamble of the Code. The knowledge products delivered so far, both inhouse and by other stakeholders with or without collaboration with IBBI have immensely contributed to the rich material and resources available on the subject. A wide range of such products, i.e Quarterly Newsletters, Annual Reports, Annual Publications and plethora of other research papers are available on IBBI Website.

In this context, the present Thought Leadership Booklet *"Insolvency- Now & Beyond"* a joint initiative of the Foreign Commonwealth Development Office (FCDO) and IBBI, will surely aid the stakeholders in further improving their understanding of the emerging issues of the insolvency and bankruptcy regime, prevalent in India. Apart from India, this book presents various procedural issues of insolvency laws prevailing in certain other key jurisdictions.

The book also captures multifarious aspects of conceptual and procedural matters and intricacies of the various issues such as role of directors during the insolvency process and avoidable transactions, ipso facto clauses in insolvency law, actionable claims, ADR techniques in resolution process, going Concern sales and schemes of arrangement in restructuring. The book attempts to capture the evolving insolvency law with all its nuances and is intended to serve as a useful guide for stakeholders, who may wish to study more and delve into this emerging area of law and practice.

I would like to compliment the FCDO, UK; EY (delivery partner of FCDO programme) and all the authors who have contributed to preparation of this book. I sincerely believe that stakeholders of the insolvency and bankruptcy ecosystem, including policy makers, insolvency professionals, creditors, academia, researchers, and students would find this book useful.

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Role of Directors during the Insolvency Process and Avoidable Transactions

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Abstract

Drawing primarily from the Singapore insolvency regime (both statutes and case law) while also mentioning developments and practices in Australia and the United Kingdom, this paper begins with an overview of the relevant Singapore law before moving on to discuss three main issues relating to the role of directors during the insolvency process and avoidable transactions, namely (1) the appropriate latitude to be given to directors to exercise commercial judgment when making decisions for the company, (2) the right balance under the wrongful trading regime to both promote a rescue culture and protect creditors' interest, and (3) the importance of building an effective enforcement framework. Two areas are discussed under the third topic, litigation funding for insolvency avoidance actions and the recognition and enforcement of cross-border insolvency-related judgments.

Where relevant, this paper refers to pertinent provisions under the Insolvency and Bankruptcy Code 2016 and the reports of the Insolvency and Bankruptcy Board of India to provide a clearer context and a better comparison.

When one imagines the hypothetical director that insolvency law tries to regulate, three archetypes come to mind: the Founder, the Independent Director and the Crook.

[1] The author would like to thank Smitha Menon, Partner and Deputy Head of Restructuring & Insolvency Practice of WongPartnership LLP, and Catherine Shen Haoyu, Project Manager of the Asian Business Law Institute, for reading an earlier draft of this paper and providing feedback.

The Founder built the business from the ground up and holds a major stake in the company. When the company is approaching insolvency, the Founder is driven to save the business at all costs, not only to preserve his personal wealth but also to salvage the pride and legacy of his life's work.

The Independent Director performs his role in a professional capacity. He is primarily motivated to act in an accountable manner and to act within the confines of the law. Nevertheless, he may be driven by personal reasons to save the company – for example, to preserve his directorship fees as a source of his income or to maintain his professional reputation – but he does not act at the cost of exposing himself to criminal and civil liability.

The Crook, on the other hand, may have very little interest in whether a business survives or dies. He is purely self-interested and is willing to bend or break the law to benefit himself at the expense of other stakeholders.

Certainly, reality is more complex than these three archetypes suggest. But they provide a useful framework to envisage how the law should regulate the conduct of directors when a company is approaching insolvency.

There can be no question that the law should keep a leash on the Crook and impose heavy sanctions to deter his worst impulses. But the challenge is in making sure that the leash on the Crook does not end up being a noose around the neck of the entrepreneurial Founder or the diligent Independent Director. Yet, the Founder is no saint either and must be restrained from taking gambles to revive the business, especially if it comes at the expense of creditors. Finally, the law cannot be so strict that it pushes the Independent Director to act defensively and refuse to undertake ventures that can benefit creditors and other stakeholders.

A balance and compromise must therefore be struck. There is no perfect answer or ideal solution for every country, because the balance and compromise requires a negotiation of a country's social contract. The political, economic, social and cultural values of a country shape what is a fair and just way for formulating the rules that govern how directors and companies should behave. This cuts across issues that are fundamental to the organisation of a state – corporate responsibility to the community, the efficient functioning of trade and commerce in the economy, creation and preservation of jobs, and the allocation of costs and benefits of entrepreneurial risk-taking.

It is for this reason that the present paper does not overreach to propose solutions as there is no "one-size fits all" regime for every country, let alone every industry. Some industries require more risk-taking to fuel entrepreneurship and others require more regulation where vulnerable sectors of the society are stakeholders. Rather, we describe the challenges and successes of the Singapore insolvency regime, with the aim of providing insights and ideas to inform India's own further insolvency law reforms. We draw from the developments and innovations of other jurisdictions to highlight how we foresee the Singapore regime advancing in the future. It is our hope that by sharing approaches that have been taken we can also help to cultivate the harmonisation and convergence of Asian insolvency laws.

I. Overview of Singapore law

Before we discuss the Singapore regime, it is helpful to start with an overview of Singapore's laws on directors' duties in insolvency and avoidable transactions. In the summary that follows, it will be apparent that the laws of India and Singapore share many similarities, which bodes well for both regimes evolving and developing in a harmonised fashion.

Directors' general duty to take into account creditors' interests in insolvency situations

Under Singapore law, when a company is insolvent or in a parlous financial situation, its directors are required to take into account the creditors' interests as part of their duty to act in the company's best interests.[2] This duty requires directors to ensure that the company's assets are not dissipated or exploited for their own benefit to the prejudice of the creditors.[3] The greater the concern over the company's financial health, the more weight the directors must accord to the creditors' interests over those of the shareholders.[4] The rationale for prioritising the creditors' interests is that the company is effectively trading and running its business with creditors' money.[5] This duty is not owed by the directors to the creditors, but to the company directly.

[2] *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] 4 SLR 1089 (Singapore) at [48].
[3] *Prima Bulkship Pte Ltd v Lim Say Wan* [2017] 3 SLR 839 (Singapore) at [62].
[4] *Dynasty Line Ltd v Sukamto Sia* [2014] 3 SLR 277 (Singapore) at [34].
[5] *ECRC Land Pte Ltd v Ho Wing On Christopher* [2004] 1 SLR(R) 105 (Singapore) at [49].

Wrongful trading and fraudulent trading

Directors and officers of a company may face criminal sanctions and personal liability if the company engages in wrongful trading and fraudulent trading. A company engages in wrongful trading if it incurs debts without reasonable prospect of meeting them in full when it is insolvent or becomes insolvent as a result of incurring these debts.[6] If a director knew or ought to have known that the company was trading wrongfully, the court may declare such a director personally responsible for all or any of the company's debts.[7]

A company engages in fraudulent trading if it carries on its business with an intent to defraud its creditors or creditors of any other person or for any fraudulent purpose.[8] If a director was knowingly a party to the carrying on of the company's business in such manner, the court may declare such a director personally responsible for all or any of the company's debts.[9]

Avoidable transactions

Singapore insolvency law provides for the avoidance of certain transactions entered into by the debtor before the commencement of insolvency proceedings (i.e., judicial management and liquidation). The categories of avoidable transactions include:

(a) undervalue transactions;[10]
(b) unfair preferences;[11]
(c) extortionate credit transactions;[12]
(d) transactions which create floating charges for past value;[13] and
(e) transactions defrauding creditors.[14]

Undervalue transactions

Undervalue transactions are those in which the company received either no consideration from the counterparty or significantly less value than what the company provided to the counterparty.[15] A director that procures an

[6] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 239(12).
[7] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 239(1).
[8] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 238(1).
[9] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 238(4).
[10] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 224.
[11] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 225.
[12] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 228.
[13] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 229.
[14] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 438.
[15] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 224(3).

undervalue transaction to be entered into is likely to also be found to have breached his fiduciary duties.[16]

Undervalue transactions can be avoided if they were entered into at a time when the company was insolvent or if the company became insolvent as a result of the transaction.[17] If the transaction was made with a person connected with the company,[18] it will be presumed that the company was insolvent at the time or became insolvent in consequence of the transaction.[19] The "look back" period in which such transactions are liable to be avoided is a period of three years before the commencement of the company's winding-up or judicial management.[20]

It is a defence if it can be shown that the transaction was entered into in good faith, for the purpose of carrying on the business of the company, and that there were reasonable grounds for believing that the transaction would benefit the company.[21] Further, a third party in receipt of property which is the subject of an undervalue transaction is statutorily protected if such third party receives the property in good faith, for value and without notice of the relevant facts.[22] Any interest derived from such property is also protected.[23]

Once it is established that a transaction was entered into at an undervalue, the court has broad powers to restore the affected company to the position it would have been in if the transaction had not been entered into. Among other things, the court may require any property transferred under such a transaction to be transferred back to the affected company, order the release of a security, and order a person whose has received benefits from the company to pay such sums to the company.[24]

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[16] *Living the Link Pte Ltd (in creditors' voluntary liquidation) and others v Tan Lay Tin Tina and others* [2016] 3 SLR 621 (Singapore)

[17] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) ss 224 and 226.

[18] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 217. There are detailed and complex rules that cover a wide variety of situations in which an individual or company will be deemed to be a connected person. Some examples include a director's spouse and relatives, and companies under the common control of a director.

[19] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 226(3).

[20] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 226(1)(a).

[21] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 224(4).

[22] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 227(3).

[23] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 227(3).

[24] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 227(1).

Unfair preferences

A company is regarded as having given an unfair preference if it does anything or suffers anything to be done which puts a creditor in a better position than it would have been on a hypothetical liquidation of the company. A director that procures an unfair preference is likely to also be found to have breached his fiduciary duties.[25]

Unfair preferences can be avoided if they were entered into at a time when the company was insolvent or if the company became insolvent as a result of the transaction.[26] The "look back" period in which unfair preferences are liable to be avoided is a period of one year before the commencement of the company's winding-up or judicial management,[27] and a longer period of two years before the commencement of the company's winding-up or judicial management if the unfair preference was given to a person connected with the company.[28]

A crucial requirement for an unfair preference to be avoidable is that the company must be shown to have been influenced by a desire to prefer the creditor.[29] In other words, the fact that a company gives a creditor preferential treatment does not automatically constitute an unfair preference - it is the *subjective* desire to give preferential treatment to a creditor that makes a preference "unfair". Where a company's intention in giving preferential treatment to a creditor is purely actuated by proper commercial considerations, such actions do not constitute an unfair preference.[30]

If the transaction was entered into with a person connected with the company,[31] it will be presumed that the company was influenced by a desire to prefer the connected person. To rebut this presumption, it must be shown that the transaction was not influenced by *any* desire of the insolvent company to place the connected person in a preferential position.[32]

As with undervalue transactions, once it is established that a transaction is an unfair preference, the court has a broad remedial discretion to restore the

[25] *Living the Link Pte Ltd (in creditors' voluntary liquidation) and others v Tan Lay Tin Tina and others* [2016] 3 SLR 621 (Singapore)
[26] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) ss 224 and 226.
[27] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 226(1)(c).
[28] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 226(1)(b).
[29] *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] 4 SLR 1089 (Singapore).
[30] *Coöperatieve Centrale Raiffeisen-Boerenleenbank BA v Jurong Technologies Industrial Corp Ltd* [2011] 4 SLR 977 (Singapore) at [24]
[31] See footnote 18.
[32] *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] 4 SLR 1089 (Singapore) at [36].

affected company to the position it would have been in if the transaction had not been entered into. To this end, the court has the same powers mentioned above in relation to undervalue transactions.

Extortionate credit transactions

Extortionate credit transactions are also avoidable. A transaction is presumed to be extortionate if, having regard to the risk accepted by the person providing the credit, the terms of such credit required grossly exorbitant payments to be made (whether unconditionally or in certain contingencies), or are harsh and unconscionable or substantially unfair.[33] The "look back" period in which extortionate credit transactions are liable to be avoided is a period of three years before the commencement of the company's winding-up or judicial management.

Once it is established that a transaction is an extortionate credit transaction, the court may, among other orders, set aside or vary the transaction or require the counterparty to surrender any sums paid to him. Any sums or property so required to be paid or surrendered will form part of the insolvent company's estate.[34]

Floating charges for past value

A floating charge is avoidable if it is provided by the company to a counterparty to secure past value provided by the counterparty. A floating charge created during the "look back" period is valid only to the extent of the aggregate of the value of the consideration for the creation of charge (consisting of money paid, goods or services supplied, the discharge or reduction of debt, and any interest payable on any of such amounts) provided to the company at the same time or after the creation of the floating charge.[35]

Where a floating charge is created in favour of a person not connected with the company, the floating charge is only liable to be avoided if the company was insolvent at the time of the creation of the charge or if the company became insolvent as a result of the transaction under which the charge was

[33] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 228.
[34] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 228.
[35] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 229.

created;[36] the "look back" period in this case is a period of one year before the commencement of the company's winding-up or judicial management.[37] Where a floating charge is created in favour of a person connected with the company,[38] the "look back" period is a period of two years before the commencement of the company's winding-up or judicial management,[39] and there is no requirement to show that the company was insolvent or became insolvent as a result of the transaction under which the charge was created.

Transaction defrauding creditors

Where a transaction is entered into at an undervalue for the purpose of either (i) putting assets beyond the reach of a person who is making, or may at some time make, a claim against the debtor, or (ii) otherwise prejudicing the interests of any person in relation to a claim which the person is making or may make against the debtor, any person who is, or is capable of being, prejudiced by the transaction (referred to in the statutory provisions as a "victim of the transaction") can apply to have the transaction avoided.[40] The victim of the transaction may make such an application whether or not the company has entered insolvency proceedings.[41] Additionally, in a case where the debtor company is being wound up or is in judicial management, the Official Receiver, or the liquidator or judicial manager (whichever is applicable), may also make an application to avoid such a transaction.[42]

Breach of fiduciary duties for procuring avoidable transactions

A director that procures the company to enter into avoidable transactions would likely be found to be in breach of his fiduciary duties. In *Living the Link Pte Ltd (in creditors' voluntary liquidation) v Tan Lay Tin Tina* [2016] 3 SLR 621, the Singapore High Court found a director liable for breaching her fiduciary duties by giving unfair preferences to a related company under her control. The court referred to the established principle that, when a company was insolvent or nearing insolvency, a director had a fiduciary duty to ensure that the company's assets were not misapplied to the prejudice of creditors' interests. The purpose of this duty is to preserve the company's assets for

[36] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 229(3).
[37] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 229(2)(b).
[38] See footnote 18.
[39] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 229(2)(a).
[40] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) ss 438–439.
[41] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 438(5)(d).
[42] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 438(5)(c).

distribution to the company's creditors through the mechanism of insolvency.[43] Because the director's fiduciary duty mirrored the statutory avoidance provisions, the court opined that it was "practically inevitable" in every case that a director who procures an unfair preference would be found to be in breach of his fiduciary duties.[44]

Furthermore, a company in winding-up can make concurrent and separate claims for both unfair preference and breach of fiduciary duties. This allows a liquidator to pursue claims against the recipient of the preference and the errant director, which may help to maximise recovery for the estate. It is also crucial where the clawback period for an unfair preference has expired, as the company can at least pursue a separate claim against the director for breach of his fiduciary duties (which has a longer limitation period).[45]

II. Latitude for commercial judgment – how wide or narrow should it be?

The first issue we discuss in this paper relates to the degree of latitude that should be given to directors to exercise commercial judgment when making decisions for the company.

Under Singapore insolvency law, there are various areas in which such latitude is given to directors. For example, under the law relating to undervalue transactions, it is a defence if the company entered into the transaction in good faith and for the purpose of carrying on its business, and at the time the company entered into the transaction, there were reasonable grounds for believing that the transaction would benefit the company.[46] In a similar vein, under the law relating to unfair preferences, if the company's intention in giving preferential treatment to a creditor was purely actuated by proper commercial considerations, such actions do not constitute an unfair preference.[47]

These exceptions are not dissimilar to those found in India's Insolvency and Bankruptcy Code 2016 ("**IBC**"). The IBC provides that transfers made in the

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[43] *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] 4 SLR 1089 (Singapore) at [48]

[44] *Living the Link Pte Ltd (in creditors' voluntary liquidation) and others v Tan Lay Tin Tina and others* [2016] 3 SLR 621 (Singapore) at [78]

[45] *Parakou Investment Holdings Pte Ltd and another v Parakou Shipping Pte Ltd (in liquidation) and other appeals* [2018] 1 SLR 271 (Singapore) at [109] to [110].

[46] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 224(4).

[47] *Coöperatieve Centrale Raiffeisen-Boerenleenbank BA v Jurong Technologies Industrial Corp Ltd* [2011] 4 SLR 977 (Singapore) at [24]

ordinary course of the business or financial affairs of the corporate debtor or the transferee do not constitute avoidable preferences.[48] Likewise, under the law relating to undervalue transactions, the IBC stipulates that in order for a transaction to be considered undervalued, it must have taken place outside the ordinary course of business of the corporate debtor.[49]

There is a recognition in both jurisdictions that some degree of latitude for commercial judgment is desirable,[50] but this sparks the more difficult question of how wide (or narrow) that latitude should be. Using the framework introduced at the introduction to this paper, how is the degree of latitude to be calibrated such that it reins in the Founder from acting imprudently, gives certainty to the Independent Director, and averts abuse by the Crook?

There is an interesting contrast in the legislative approaches in India and Singapore. As a broad generalisation, the Indian approach relies primarily on an objective test (whether a transaction was in the ordinary course of business) while the Singaporean approach incorporates subjective elements (whether a transaction was in good faith or actuated by proper commercial considerations).

Cases in both jurisdictions exemplify this distinction. In *Anuj Jain Interim Resolution Professional for Jaypee Infratech Limited v Axis Bank Limited*, Civil Appeal Nos. 8512-8527 of 2019, the Supreme Court of India, after undertaking a comprehensive analysis of the theory relating to avoidance of transactions in insolvency, gave guidance on the scope of the "ordinary course of business" defence under section 43(3)(a) of the IBC. The court held that for a transaction to constitute a part of "ordinary course of business" of a corporate debtor, it had to be part of "the undistinguished common flow of business done" and must not arise out of "any special or particular situation".51 The inquiry is an objective one that focuses on the past practices of the debtor company's business.

In contrast, in *Coöperatieve Centrale Raiffeisen-Boerenleenbank BA (trading as Rabobank International, Singapore Branch) v Jurong Technologies Industrial Corp Ltd* (under judicial management) [2011] 4 SLR 977, the

[48] Insolvency and Bankruptcy Code 2016 (India), s 43(3)(a).
[49] Insolvency and Bankruptcy Code 2016 (India), s 45(2).
[50] In *Anuj Jain Interim Resolution Professional for Jaypee Infratech Limited v Axis Bank Limited*, Civil Appeal Nos. 8512-8527 of 2019 (India), the Supreme Court of India cited at paragraph 17.5 the UNCITRAL Legislative Guide on Insolvency Law in its examination of the theory and principles governing the provisions relating to avoidance of preferential transactions. The UNCITRAL Legislative Guide on Insolvency Law at paragraph 179 explains that the "ordinary course of business" defence "encourages suppliers of goods and services to continue to do business with a debtor that may be having financial problems, but which is still potentially viable".
[51] *Anuj Jain Interim Resolution Professional for Jaypee Infratech Limited v Axis Bank Limited*, Civil Appeal Nos. 8512-8527 of 2019 (India) at paragraph 25.6.2.

Singapore Court of Appeal endorsed the predominantly subjective nature of the inquiry as to whether a transaction constituted an unfair preference. The court held that the assessment is whether the debtor had the desire (a subjective state of mind) to improve the creditor's position. A transaction which is actuated by proper commercial considerations may not constitute a voidable preference. A noteworthy point is that the court even clarified that a genuine belief in the existence of a proper commercial consideration may be sufficient even if, objectively, such a belief might not be sustainable.[52]

There are advantages and disadvantages under these different approaches. The objective approach in India has the advantage of delineating a clearer boundary as to what transactions are permissible when a company is in insolvency. In doing so, it gives the Independent Director greater certainty as to the confines within which he is permitted to act. It also makes it easier and clearer for a resolution professional or liquidator investigating the company's transactions to objectively assess whether a transaction may be avoided or not. Whether a transaction was carried out in the "ordinary course of business" can be determined by examining the company's established practices and is likely to be discernible from the company's accounting records.

The subjective approach in Singapore, which examines the intent of the parties to the transaction, suffers from the disadvantage of being difficult to prove and may make avoidance proceedings complex, unpredictable and lengthy (as noted in the UNCITRAL Legislative Guide on Insolvency Law at paragraph 179).

The Singapore regime accepts these disadvantages of the subjective approach in order to promote and foster a rescue culture. This underlying philosophy can be gleaned from the Singapore Court of Appeal decision of *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] 4 SLR 1089 ("***Progen***"), in which the court opined that commercially sensible transactions made with the objective of creating or extending a lifeline to a company suffering financial difficulty should not be questioned, and a court ought not to be too astute in taking directors to task when they appear to have been attempting in good faith to facilitate the preservation or rehabilitation of

[52] *Coöperatieve Centrale Raiffeisen-Boerenleenbank BA (trading as Rabobank International, Singapore Branch) v Jurong Technologies Industrial Corp Ltd* (under judicial management) [2011] 4 SLR 977 (Singapore) at [24].

a company, and where they had reasonable commercial grounds for believing that the transaction would benefit the company. [53]

This approach allows more freedom for the Founder and the Independent Director to undertake restructuring options and transactions that are outside the ordinary course of business in order to benefit the company when it is nearing or in insolvency. (The directors must, of course, take into account the interests of creditors when making such decisions in the twilight of insolvency.) After all, for most companies, entering insolvency is anything but ordinary, and a company may have to step outside of its normal business practices to enable a successful rehabilitation. In the next section, we continue the discussion of how the regulation of directors' conduct in connection with the wrongful trading regime in Singapore intersects with the broader policy objective of promoting a rescue culture.

As a parting thought on this section, it is worth highlighting that the subjective approach in Singapore does not entail a more liberal or lax approach towards avoiding unfair preferences. There may be cases where a preferential payment which is protected under an "ordinary course of business" defence would be avoidable under the subjective approach. In *Progen*, the recipient of preferential payments (which was a related company of the debtor company) argued that the payments were made pursuant to an established practice, but the Court of Appeal held that the mere existence of an established past practice of a particular type of transaction is not a defence. It is still necessary to analyse the intention behind the transaction to determine if the transaction was carried out with the desire to prefer the creditor in question.[54] This means that a debtor company cannot hide behind the fact that a transaction was in its ordinary course of business, and it is necessary that the transaction was carried out with the right motives (taking into account the interests of creditors). Seen from this light, the subjective approach may give less cover to the Crook to act opportunistically by hiding behind the letter of law.

[53] *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] 4 SLR 1089 at [3]
[54] *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] 4 SLR 1089 at [57]

III. Walking a tightrope under the wrongful trading regime – how to promote a rescue culture while protecting creditors' interests?

As alluded to briefly in the section above, the framework of law that regulates directors' conduct in insolvency intersects with a state's broader policy objectives. In the Singapore context, the drive to promote a rescue culture is balanced against the need to provide adequate protection to the interests of creditors. In this section, we discuss the challenges in striking this balance in the context of the wrongful trading regime in Singapore.

At first blush, it might appear that this difficulty is not as pronounced under India's existing legal framework, given that the corporate insolvency resolution process ("CIRP") under the IBC is primarily a "creditor in control" (as opposed to "debtor in possession") model.[55] Directors currently do not have much role to play under the IBC's current CIRP structure. However, under the pre-packaged insolvency resolution process ("PIRP") for micro, small and medium enterprises which came into effect in April 2021,[56] which involves a revolutionary hybrid model involving "debtor in possession" and "creditor in control" elements. [57] Under the hybrid approach, it is envisaged that the affairs of the corporate debtor shall be managed by its board of directors[58] subject to the control of the committee of creditors and other safeguarding measures.[59]

With these developments, the restructuring community in India may also have to contend with the difficulty in calibrating the wrongful trading regime under the IBC to suit the desired policy objectives.

To recap the position under Singapore law, directors and officers of a company may face criminal sanctions and personal liability if the company engages in wrongful trading. A company engages in wrongful trading if it incurs debts without reasonable prospect of meeting them in full when it is

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[55] Asian Business Law Institute's Corporate Restructuring and Insolvency in Asia 2020, Jurisdiction Report: India, paragraph 4.
[56] Insolvency and Bankruptcy Code 2016, at Chapter III-A. See also the Report of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process (Insolvency and Bankruptcy Board of India), at Chapter 5.
[57] Chapter 5.
[58] Insolvency and Bankruptcy Code 2016, at Section 54H.
[59] Insolvency and Bankruptcy Code 2016, at Section 54F and 54J. For example, under Section 54J of the Insolvency and Bankruptcy Code 2016, the committee of creditors, may at any time during the pre-packaged insolvency resolution process period, by a vote of not less than sixty-six per cent. of the voting shares, resolve to vest the management of the corporate debtor with the resolution professional, in which case the resolution professional shall make an application for this purpose to the Adjudicating Authority. If the Adjudicating Authority is of the opinion that during the pre-packaged insolvency resolution process: (a) the affairs of the corporate debtor have been conducted in a fraudulent manner; or (b) there has been gross mismanagement of the affairs of the corporate debtor, it shall pass an order vesting the management of the corporate debtor with the resolution professional. See also Report of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process (Insolvency and Bankruptcy Board of India), at paragraph 5.16.

insolvent or becomes insolvent as a result of incurring these debts.[60] If a director knew or ought to have known that the company was trading wrongfully, the court may declare such a director personally responsible for all or any of the company's debts. [61]

The wrongful trading prohibition continues to apply even when the company is undertaking efforts to restructure (whether by way of a consensual out-of-court workout or a scheme of arrangement).[62] This poses a challenge to any Founder or Independent Director seeking to restructure a company. A successful restructuring often depends on the continuation of the company's business, so it is unavoidable that the company would have to continue incurring debts, yet the directors run the risk of attracting personal liability. They are forced to "walk a tightrope" and tread carefully when trying to restructure the company.

There are carve-outs available under the wrongful trading regime in Singapore. A director may be relieved from personal liability if he satisfies the court that he acted honestly, and, having regard to all the circumstances of the case, he ought fairly to be relieved from personal liability.[63] An alternative is that the company can seek an advance ruling from the court as to whether a proposed course of conduct or transaction would constitute wrongful trading.[64] These carve-outs, while attractive in theory, do not appear to have been tested in practice yet as they were introduced only in 2020.

The wrongful trading regime in Singapore was adopted from draft legislative provisions suggested by the United Kingdom's ("**UK**") Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558 (more commonly referred to as the "**Cork Report**"). It is noteworthy that these provisions did not find their way into UK legislation. The UK Insolvency Act of 1986 imposes an arguably stricter standard than that under Singapore law. Under UK law, a director may be liable for wrongful trading if he knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation and failed to take every step with a view to minimising potential loss to the company's creditors.[65]

[60] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 239(12).
[61] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 239(1).
[62] For more details on the avenues for a company to restructure in Singapore, refer to the Singapore chapter of the Asian Business Law Institute's Corporate Restructuring and Insolvency in Asia 2020.
[63] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 239(2).
[64] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) (Singapore) s 239(10).
[65] Insolvency Act 1986 (UK), s 214.

The Singapore Insolvency Law Review Committee, in its 2013 report, recommended adopting the Cork Report's wrongful trading framework as it was viewed as striking the best balance between promoting responsible entrepreneurship and preventing abuse of the corporate form by those who manage companies.[66] The framework in the Cork Report was preferred over the UK and Australian legislative frameworks as the committee considered the former lacking in concrete meaning or positive guidance,[67] and the latter being too strict as it effectively prohibited trading once there are "reasonable grounds for suspecting" that a company is insolvent.[68] The committee observed that a wide notional cessation of trading even prior to the commencement of insolvency proceedings may further endanger a financially-troubled company's ability to trade through a period of crisis, and thus worsen the company's financial difficulties. It does not strike the best balance between the interest in protecting creditors against the reckless or unreasonable incurring of debts by an insolvent company, and the interest in allowing the directors of a distressed company a fair opportunity to take reasonable steps to avoid the company's financial ruin.

Since the Singapore Insolvency Law Review Committee's report in 2013, there have been further developments in other jurisdictions in this area. The most prominent of these developments is the introduction of a "safe harbour" under the Australian insolvency regime, in part to discourage companies from entering into administration or liquidation prematurely to avoid personal liability.[69] Under the Australian safe harbour provisions, directors will not be personally liable for debts incurred while the company was insolvent where it can be shown that they were developing or taking a course of action that at the time was reasonably likely to lead to a better outcome for the company than immediately proceeding to administration or liquidation.[70] The provisions were designed to be flexible as to what constitutes a course of action that attracts the protection of the safe harbour, as there was an acknowledgement that what is reasonably likely to lead to a better outcome varies in each case.[71] A number of factors are considered in this assessment, including whether the company's directors obtained advice from an appropriately

[66] Report of the Insolvency Law Review Committee (2013) (Singapore), Chapter 9 paragraph 21.
[67] Report of the Insolvency Law Review Committee (2013) (Singapore), Chapter 9 paragraph 12.
[68] Report of the Insolvency Law Review Committee (2013) (Singapore), Chapter 9 paragraph 18.
[69] Consultation on the review of the insolvent trading safe harbour (Australia), https://treasury.gov.au/sites/default/files/2021-09/205011-safeharbourreviewconsultationpaper.pdf
[70] Corporations Act 2001 (Australia), s 588GA.
[71] Consultation on the review of the insolvent trading safe harbour (Australia), https://treasury.gov.au/sites/default/files/2021-09/205011-safeharbourreviewconsultationpaper.pdf

qualified adviser, and had been taking appropriate steps to develop or implement a plan to restructure the company.[72]

The discussion above shows a great diversity in the approaches across different jurisdictions and exemplifies how the legal framework needs to be tailored to the needs and objectives of each country. In Singapore, a substantial number of companies (including listed companies) are family-owned or family-run.[73] Where such companies are concerned, it is arguably more important for the law to rein in the fervour of the Founder (as he would already be financially and emotionally motivated to save the company) than it is to spur the Independent Director to be less conservative or defensive.

Tailoring the legal framework for wrongful trading in India is also likely to bring its own unique challenges. While there may have been a historical distrust of debtor in possession regimes,[74] the institutional framework and insolvency ecosystem in India has made great strides in recent years.[75] This makes the country much more well positioned to have a system of effective checks and balances to safeguard against abuses of a debtor in possession regime, while exploiting its benefits.

IV. Building an effective framework for enforcement

Building an effective framework for enforcement is as important as designing a legal framework that best fits the country's needs and objectives. Otherwise, the law is nothing but a paper tiger – it appears threatening but has no real bite.

In this section, we touch on two areas that can be refined and improved upon in building an effective enforcement framework. The first topic relates to litigation funding for insolvency avoidance actions and the second relates to the recognition and enforcement of cross-border insolvency-related judgments.

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[72] Corporations Act 2001 (Australia), s 588GA.

[73] Marleen Dieleman et al., *Success and Succession: A Study of SGX-Listed Family Firms, NUS* Centre for Governance, Institution & Organisations (2013), https://bschool.nus.edu.sg/cgs/wp-content/uploads/sites/7/2018/10/Success-and-Succession-2013.pdf

[74] The IBBI noted in its Report of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process (at paragraph 5.12), that the requirement of displacing management under the CIRP was introduced due to the negative past experiences of the debtor-in-possession regime under the Sick Industrial Companies (Special Provisions) Act 1985. It was observed in the Notes on Clauses to the Bill of the Insolvency and Bankruptcy Code, 2015 that past experience indicated that giving control to the existing management incentivised management to propose and implement risky rescue measures and increased the danger of management siphoning off assets.

[75] Report of the Insolvency Law Committee on Pre-packaged Insolvency Resolution Process (India), at paragraph 5.13.

Litigation funding for insolvency avoidance actions

There is perhaps nothing more perverse in the practice of insolvency than seeing the wrongdoers drain the assets of the company, leaving the company without the financial resources to pursue claims to recover the misappropriated assets. Creditors are often hesitant to fund litigation actions as they have likely already suffered significant losses and are afraid of throwing good money after bad. Litigation funding helps to address this problem. A clear and predictable litigation funding framework is necessary to encourage the pursuit of legitimate and viable claims against wrongdoers that have depleted the company of its assets.

There have been calls among restructuring and insolvency practitioners in India to establish a litigation funding framework. In the IBBI's 2021 report, Quinquennial of Insolvency and Bankruptcy Code, 2016, two papers were devoted to the topic of litigation funding, both of which highlighted the desirability of establishing a statutory and regulatory framework for litigation funding in India. Similarly, the IBBI's Discussion Paper on Corporate Liquidation Process (26 August 2020) suggested that further consideration be given to whether liquidators should be empowered to assign certain statutory rights of action (such as avoidance transactions actions, contingent claims etc.) to third parties in cases where the liquidation estate is insufficient to fund recovery actions.[76]

In Singapore, a statutory framework for litigation funding of avoidance actions was introduced in July 2020 through the enactment of the Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020.

As a quick aside, prior to the introduction of these regulations, the core principles and structure of the litigation funding framework were shaped incrementally through case law. *Re Vanguard Energy Pte Ltd* [2015] 4 SLR 597 was the seminal case in which the Singapore High Court held that a liquidator had the power to sell a cause of action of a company (as well as the proceeds from such an action). The court's reasoning was that a cause of action was property of the company which, like any property of the

[76] At paragraph 10.

company, could be sold by the liquidator under his statutory powers.[77] The funding arrangement was structured as a sale of the cause of action to the funders, but the company had a contractual entitlement to receive any surplus recovery remaining after the funders were repaid the amounts that they had funded,[78] thereby allowing the company to reap the benefits in the event of a successful claim.

In *Solvadis Commodity Chemicals Gmbh v Affert Resources Pte Ltd* [2018] 5 SLR 1337, the Singapore High Court provided further helpful guidance and held that the court would not readily interfere with a liquidator's discretion in entering into a litigation funding agreement unless what he was doing was utterly unreasonable or lacking in *bona fides*.[79] The court enumerated a list of non-exhaustive factors that can be considered in ascertaining whether a liquidator has acted *bona fide*, including the extent to which the liquidators have sought other funding options and consulted with the creditors of the company, the effect that the funding agreement may have on the company's creditors, and the extent to which the liquidators maintain control over the proceedings.[80]

Finally, in *Re Fan Kow Hin* [2019] 3 SLR 861, the Singapore High Court held that avoidance claims could also be sold by a liquidator (the previous cases had only dealt with the sale of more straightforward monetary claims). The funding arrangement involved the assignment of a portion of the proceeds of the avoidance claims,[81] thereby saving the company a share of the fruits of the litigation if it succeeded. These cases all recognised that, provided certain safeguards are satisfied, litigation funding in the insolvency context helps to serve the ends of justice and public interest.[82]

With the introduction of the new regulations, litigation funding of avoidance actions has now been placed on statutory footing. Under the regulations, a liquidator or judicial manager of a company is authorised to solicit an offer from one or more creditors or members of the company, or one or more third-party funders, to fund all or part of the costs of a relevant action, in return

[77] *Re Vanguard Energy Pte Ltd* [2015] 4 SLR 597 (Singapore) at [23] to [24].
[78] *Re Vanguard Energy Pte Ltd* [2015] 4 SLR 597 (Singapore) at [7].
[79] *Solvadis Commodity Chemicals Gmbh v Affert Resources Pte Ltd* [2018] 5 SLR 1337 (Singapore) at [34] and [35].
[80] *Solvadis Commodity Chemicals Gmbh v Affert Resources Pte Ltd* [2018] 5 SLR 1337 (Singapore) at [38].
[81] *Re Fan Kow Hin* [2019] 3 SLR 861 (Singapore) at [2].
[82] *Re Vanguard Energy Pte Ltd* [2015] 4 SLR 597 (Singapore) at [43] to [49]; *Solvadis Commodity Chemicals Gmbh v Affert Resources Pte Ltd* [2018] 5 SLR 1337 (Singapore) at [60]; *Re Fan Kow Hin* [2019] 3 SLR 861 (Singapore) at [22].

for the assignment of a share or other interest in the proceeds or potential proceeds of the relevant action to which the company may become entitled.[83] When soliciting such an offer, the liquidator or judicial manager must provide a written notice containing all material information necessary, including but not limited to:[84]

(a) the nature of the relevant action or contemplated relevant action;
(b) the parties or potential parties involved;
(c) the estimated potential proceeds of the relevant action or contemplated relevant action;
(d) the estimated amount of funding sought; and
(e) the date by which an offer of funding is to be received by the relevant insolvency practitioner.

There are safeguards in place to prevent conflicts of interest. The potential funder, when making an offer, must provide written confirmation that there is no actual or potential conflict of interest between the potential funder and the parties to the action or the lawyers acting for the parties.[85] The potential funder must also either confirm that there is no actual or potential conflict of interest between the potential funder and the liquidator or judicial manager, or declare the actual or potential conflict of interest if it exists.[86] The liquidator or judicial manager has a duty not to seek approval of a funding agreement if he is aware of an actual or potential conflict of interest.[87]

Before a funding agreement is reached with the potential funder, the liquidator or judicial manager must seek approval from the relevant approving body (e.g. the committee of inspection or the court) which varies depending on the nature of the insolvency proceedings.[88] When seeking approval of the funding agreement, the liquidator or judicial manager must provide the material information relating to the offer, including the efforts he has taken to solicit offers, the identity of the potential funder, and a summary of the

[83] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 4(1).
[84] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 4(3).
[85] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 4(4)(c).
[86] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 4(4)(d).
[87] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 4(7).
[88] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 4(6).

material terms of the offer (including the amount of funding, the order of priority or structure of the transaction, and the share of the potential proceeds to be assigned).

A creditor or member of the company who is a defendant in the contemplated action or who has made an offer to fund the action is barred from attending or voting at such a meeting to approve the funding agreement.[89]

There are also various duties imposed on liquidators or judicial managers under the litigation funding framework. A liquidator or judicial manager must not solicit offers from a third-party funder in which he directly or indirectly holds any share or other ownership interest.[90] He must also not receive any commission, fee or share of proceeds from a third-party funder which has a funding agreement with the company.[91]

The liquidator or judicial manager must retain control and oversight over the conduct of the relevant action in relation to which a funding agreement was entered into and he must not take instructions from the funder on the conduct of the relevant action.[92]

As an overarching safeguard, the regulations provide the members and creditors of a company with the right to apply for relief from the Court where there has been a breach of the regulations which has resulted in prejudice to the company or the members or creditors of the company. The court has the power to make an order declaring that the funding agreement is void and make such consequential orders or directions as it thinks fit, taking into account the identity of the person whose fault resulted in the breach concerned.[93]

Enforcement of cross-border insolvency-related judgments

In the realm of cross-border insolvency, no man is an island (although, unhelpfully for this metaphor, Singapore *is* an island). For a country to carry out an effective restructuring or insolvency proceeding under its laws, it

[89] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 4(10).
[90] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 5(1).
[91] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 5(3).
[92] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 5(4) and (5).
[93] Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 (Singapore), reg 6(2) and (3).

depends on other countries to recognise and give effect to it. Practitioners in India too have raised the need for the enactment of cross-border insolvency legislation, despite ground-breaking developments on this front such as the cross-border cooperation protocol established in the Jet Airways insolvency.[94]

In relation to avoidance actions, one can easily see why a robust framework for cross-border enforcement is necessary. Imagine a scenario where a wrongdoer siphons off assets from a company and stashes them away in a foreign jurisdiction. The wrongdoer then disappears and the liquidator seeks a default judgment against the wrongdoer to clawback the misappropriated assets. The liquidator then takes the judgment to the foreign courts in the jurisdiction where the assets are located and seeks the courts' assistance to recognise and enforce the judgment. Will such a judgment be recognised and enforced?

This was, in a nutshell, the situation that confronted the UK Supreme Court in *Rubin v Eurofinance SA* [2013] 1 AC 236 ("***Rubin***"). The UK Supreme Court, applying well-entrenched English private international law rules governing the enforcement of *in personam* judgments, held that the default judgment against the wrongdoer could not be enforced. This was because at common law, a foreign judgment *in personam* could be enforced only if the judgment debtors had been present or resident in the foreign jurisdiction or if they had submitted to its jurisdiction, but neither requirement was satisfied on the facts of the case.[95] The court also held that the UNCITRAL Model Law on Cross-Border Insolvency ("**MLCBI**") (adopted under the UK Cross-Border Insolvency Regulations 2006) offered no panacea either, as the MLCBI says nothing about enforcement of judgments against third parties.[96]

It is not certain how the Singapore courts would rule on a case which involves the same facts. The common law rules for enforcement of *in personam* judgments in Singapore remain fundamentally the same as the traditional English position,[97] and that appears to be the case in India as well.[98] That

[94] IBBI's 2021 report, Quinquennial of Insolvency and Bankruptcy Code, 2016, Chapter 43.
[95] *Rubin v Eurofinance SA* [2013] 1 AC 236 (United Kingdom) at [6]
[96] *Rubin v Eurofinance SA* [2013] 1 AC 236 (United Kingdom) at [142]
[97] *Humpuss Sea Transport Pte Ltd (in compulsory liquidation) v PT Humpuss Intermoda Transportasi TBK* [2016] 5 SLR 1322 (Singapore) at [67] to [85].
[98] Saloni Khanderia (2021): The prevalence of 'jurisdiction' in the recognition and enforcement of foreign civil and commercial judgments in India and South Africa: a comparative analysis, Oxford University Commonwealth Law Journal, DOI: 10.1080/14729342.2021.1934298, at section 2.2.1.2.

said, the Singapore courts have not shied away from departing from English law (most notably in the reformulation of the *Gibbs* principle in *Re Pacific Andes Resources Development Ltd* [2018] 5 SLR 125).

However, legislation offers the clearest path forward. In a very timely development, India's Ministry of Corporate Affairs issued a notice on 24 November 2021 inviting public comments on a proposed cross-border insolvency legislation. The notice highlighted the difficulties engendered by *Rubin*, and noted that the "*interpretation adopted in Rubin has been criticised by many practitioners since mere recognition of proceedings without enforcement of judgments may render the [MLCBI] toothless*".[99] To address this problem, the notice proposes that India's cross-border insolvency legislation should clarify that the Adjudicating Authority may order the enforcement of a judgment arising out of a foreign proceeding that has been recognised in India.

The UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments ("**MLREIJ**") (not to be confused with the MLCBI) is also another potential solution to the problem. The MLREIJ was formulated, in part, as a response to the uncertainty engendered by *Rubin.*[100] The MLREIJ is intended to complement the MLCBI to further assist the conduct of cross-border insolvency proceedings.[101]

Under the MLREIJ, avoidance judgments are among the various insolvency-related judgments that may be recognised and enforced.[102] The MLREIJ provides more expansive grounds on which a foreign *in personam* judgment can be recognised and enforced compared to the traditional English law rules. Like English law, under the MLREIJ, a foreign judgment can be recognised if the judgment debtor explicitly consented or submitted to the jurisdiction of the court. However, the MLREIJ provides that it suffices if the foreign court either exercised jurisdiction on a basis on which the recognising court could have exercised jurisdiction or on a basis that was not incompatible with the law of the recognising state.[103]

[99] Government of India, Ministry of Corporate Affairs, Notice – Invitation of comments from public on Cross-Border Insolvency under Insolvency and Bankruptcy Code, 2016 File No. 30/27/2018 (24 November 2021).
[100] UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments with Guide to Enactment, part two, chapter 1, paragraph 2.
[101] UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments with Guide to Enactment, part two, chapter 1, paragraph 1.
[102] UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments with Guide to Enactment, part two, chapter 5, paragraph 60(b).
[103] UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments, Article 14(g). UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments with Guide to Enactment, part two, chapter 5, paragraphs 110 to 115.

The MLREIJ provides various safeguards to protect the interests of the recognising state. This includes a public policy exception under which the recognising court may refuse to take action if doing so would be manifestly contrary to the public policy of the state,[104] and the discretion to refuse recognition and enforcement if the judgment is inconsistent with a judgment of the recognising state in a dispute involving the same parties.[105]

The MLREIJ is likely to represent the next step in the evolution of cross-border insolvency and will help to establish an effective international regime for the enforcement of avoidance judgments.

V. Conclusion

We conclude by borrowing a quote used in Dr. Sahoo's introductory message in the IBBI's 2021 report, Quinquennial of Insolvency and Bankruptcy Code, 2016: "It does not matter how slowly you go as long as you do not stop." This message rings equally true in Singapore. Despite substantial reforms having been made, there are areas for refinement and improvement.

The first two issues discussed – the appropriate latitude for commercial judgment and the right balance under the wrongful trading regime – exemplify the difficulty in calibrating the legal framework to suit each country's policy objectives. There is also a need for a clear cross-border enforcement framework despite the adoption of the MLCBI.

Both jurisdictions have embarked on parallel paths in recent years to revamp and revitalise their restructuring and insolvency regimes. In time, those paths may intersect as laws in the region harmonise and converge.[106] We hope that this paper has given useful insights into the Singapore insolvency regime that can assist India's efforts in refining its own.

[104] UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments, Article 7.
[105] UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments, Article 14(c).
[106] Regional initiatives to promote the convergence of corporate insolvency laws and practices in Asia include the Asian Principles of Business Restructuring project jointly undertaken by the Asian Business Law Institute and the International Insolvency Institute where multiple best practice guides are being drafted in relation to corporate restructuring matters in Asia.

Ipso Facto Clauses in Insolvency Law – a Singapore Perspective

Sim Kwan Kiat and Catherine Shen

Ipso Facto Clauses in Insolvency Law – a Singapore Perspective

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Abstract

The operation of *ipso facto* clauses in the context of insolvency and restructuring often causes tension between the freedom to utilise the protections offered by such clauses and the adverse impact such clauses have on debt restructuring and the debtor's survival. Primarily focusing on the restrictions on *ipso facto* clauses introduced by Singapore under its restructuring and insolvency regime, this article explores the background to the imposition of these restrictions, the scope of the restrictions, and the applicable exceptions, with reference to practices in Australia, Canada and the United States where relevant.

The article also discusses the issues arising from these restrictions and how the law seeks to resolve these conflicts, as well as the uncertainties and outstanding questions regarding the operation of the provisions. The treatment of *ipso facto* clauses under India's insolvency regime is mentioned where relevant for a more comprehensive comparative assessment.

Introduction

Ipso facto clauses are contractual clauses that allow a party to a contract to terminate or modify the contract, or to accelerate certain obligations, upon the occurrence of prescribed events of default. It is common for such events of default to include the insolvency of the counterparty, or the commencement of restructuring or liquidation proceedings.

The phrase *ipso facto* means "by the fact itself", and an *ipso facto* clause generally does not require anything beyond the occurrence of the prescribed event to trigger the clause. Such clauses are not uncommon in the commercial world, and may serve as vital protective measures for the party in whose favour the clauses are drafted. Where the event of default is the insolvency of the counterparty, an appropriately-worded *ipso facto* clause would allow the protected party to terminate the contract or otherwise modify its rights rather than continue to be bound to the original agreement. A protected party may be concerned that the insolvent counterparty may not be able to make payment or otherwise fulfil its performance obligations. *Ipso facto* clauses are useful because they allow the protected party to rely on the insolvency alone, instead of having to show an actual breach of contract.

On the other hand, *ipso facto* clauses may not sit well with the objective of debt restructuring and debtor rehabilitation. The unilateral termination of key contracts pursuant to *ipso facto* clauses is likely to hinder a company's restructuring efforts, especially when such contracts may be vital to the company's survival.

Singapore law seeks to address this tension by imposing statutory restrictions on the operation of *ipso facto* clauses. The provisions, taking effect in legislation in July 2020, essentially restrict the operation of certain *ipso facto* clauses when a debtor company is undergoing restructuring proceedings.

In this article, we explore the restrictions on *ipso facto* clauses in the context of the restructuring and insolvency regime in Singapore, including the background to the provisions, the scope of the restrictions, and the applicable exceptions. We also discuss the issues arising from these restrictions and how the law seeks to resolve these conflicts, as well as the uncertainties and outstanding questions regarding the operation of the provisions.

Overview of the *Ipso Facto* Framework in Singapore

There is a tension between the freedom to utilise the protections offered by *ipso facto* clauses and the adverse impact of such clauses on debt restructuring and the debtor's survival. In Singapore, the then Senior Minister of State for Law, in the Second Reading of the Insolvency, Restructuring and Dissolution Bill in Parliament in 2018, referred to the case of Hyflux Ltd, a company listed on the Singapore stock exchange.[107] Upon encountering financial difficulties, Hyflux sought to restructure its debts so as to continue as a going concern. Upon its application for moratorium, its creditors exercised their rights under *ipso facto* clauses to accelerate repayment terms, thus restricting Hyflux's already strained cash flow and further exacerbating its financial situation.

The issue of whether to restrict the operation of *ipso facto* clauses has been much debated. Notably, in 2013, the Insolvency Law Review Committee considered arguments for and against restrictions on *ipso facto* clauses, but ultimately declined to recommend doing so.[108]

This issue was ultimately addressed in the Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**"), which came into effect on 30 July 2020. The IRDA consolidated the Singapore corporate and personal insolvency regimes and updated the restructuring and insolvency framework. Specifically, it introduced restrictions on the operation of certain *ipso facto* clauses when the company is undergoing restructuring proceedings.

As stated by the then Senior Minister of State for Law in the Parliamentary Debates on the IRDA, the introduction of these restrictions was in response to the potential roadblock that exists in a company's bid to restructure and revive its business.[109] In so doing, the amendments also enhance Singapore's position and capabilities as a restructuring and insolvency hub.

[107] *Parliamentary Debates, Official Report* (1 October 2018), vol 94 (Mr Edwin Tong Chun Fai, Senior Minister of State for Health and Law).
[108] Insolvency Law Review Committee, *Report of the Insolvency Law Review Committee*: Final Report (2013) at ch 6, paras 84-90.
[109] *Parliamentary Debates, Official Report* (1 October 2018), vol 94 (Mr Edwin Tong Chun Fai, Senior Minister of State for Health and Law).

The restriction on *ipso facto* clauses is provided in section 440 of the IRDA:

440.(1) No person may, at any time after the commencement, and before the conclusion, of any proceedings by a company —

(a) terminate or amend, or claim an accelerated payment or forfeiture of the term under, any agreement (including a security agreement) with the company; or

(b) terminate or modify any right or obligation under any agreement (including a security agreement) with the company,

by reason only that the proceedings are commenced or that the company is insolvent.

(2) Nothing in this section is to be construed as —

(a) prohibiting a person from requiring payments to be made in cash for goods, services, use of leased property or other valuable consideration provided after the commencement of the proceedings; or

(b) requiring the further advance of money or credit.

(3) Any provision in an agreement that has the effect of providing for, or permitting, anything that, in substance, is contrary to this section is of no force or effect.

(4) On an application by a party to an agreement, the Court may declare that this section does not apply, or applies only to the extent declared by the Court, if the applicant satisfies the Court that the operation of this section would likely cause the applicant significant financial hardship.

(5) Subsection (1) does not apply in respect of any legal right under —

(a) any eligible financial contract as may be prescribed;

(b) any contract that is a licence, permit or approval issued by the Government or a statutory body;

(c) any contract that is likely to affect the national interest, or economic interest, of Singapore, as may be prescribed;

(d) any commercial charter of a ship;

(e) any agreement within the meaning of the Convention as defined in section 2(1) of the International Interests in Aircraft Equipment Act (Cap. 144B); or

(f) any agreement that is the subject of a treaty to which Singapore is party, as may be prescribed.

(6) In this section —

a. "Company" means any corporation liable to be wound up under this Act, but excludes such company or class of companies as the Minister may by order in the *Gazette* prescribe.
b. "Essential Service" has the meaning given by section 2(1) of the Cybersecurity Act 2018 (Act 9 of 2018).
c. "National Interest" includes national defence, national security, public security and the maintenance of any essential service.
d. "Proceedings" means any proceedings arising from —
   (a) any application under section 210(1) of the Companies Act for the approval of the Court in relation to any compromise or arrangement between a company and its creditors or any class of those creditors.
   (b) any application under section 71 for the approval of the Court in relation to any compromise or arrangement.
   (c) any application for an order under section 64 or 65.
   (d) any application for a judicial management order under section 91; or
   (e) the lodgement of a written notice of the appointment of an interim judicial manager under section 94(5)(*a*).

Section 440 has been developed against the backdrop of existing restrictions on *ipso facto* clauses in other restructuring and insolvency regimes. The section itself is largely modelled on section 34 of the Canadian Companies' Creditors Arrangement Act[110] ("**Canadian CCAA**"). Further, the introduction of the *ipso facto* regime in Singapore brings its position in line with that of other major jurisdictions, including the United States, Canada and Australia.

As section 440 is still relatively new in Singapore, there is limited case law expounding on the operation of its provisions. As we examine the elements of the section, we will look to case law from the relevant jurisdictions.

Scope of Section 440

The restriction on *ipso facto* clauses, despite its practical utility, represents an incursion into the freedom to contract, and curtails a party's ability to protect its interests. The scope of application of section 440 is thus important

[110] R.S.C., 1985, c. C-36.

in how it balances between the competing interests, while limiting the boundaries of its operation to the areas necessary to fulfil its statutory purpose.

We first look at when and how the restrictions in section 440 are triggered, and what types of *ipso facto* clauses are covered.

When is section 440 triggered?

Section 440 only applies in the context of prescribed insolvency and restructuring proceedings. Section 440(1) states that the provision is triggered "at any time after the commencement, and before the conclusion, of any proceedings" by the company in question. "Proceedings" are defined[111] to include applications to place the company into judicial management or to appoint an interim judicial manager, as well as applications to hold a creditors' meeting to propose a scheme of arrangement or for moratorium orders for a company intending to propose a scheme of arrangement.

The prescribed categories of "proceedings" relate to judicial management and schemes of arrangement, and not other insolvency processes such as winding up or receivership. This is because judicial management and schemes of arrangement are restructuring processes aimed at the rehabilitation of companies in financial distress, and it is in this context that the unfettered operation of *ipso facto* clauses would hinder the objective of the debt restructuring.

What types of *ipso facto* clauses are restricted?

Section 440 does not restrict the operation of all *ipso facto* clauses; it only restricts the operation of *ipso facto* clauses which are triggered by reason only of the insolvency of a contracting party or the commencement of corporate rescue proceedings – namely, proceedings for judicial management and schemes of arrangement.

[111] Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) s 440(6).

Therefore, section 440 does not prevent parties from exercising their right to terminate or amend contracts based on other events. Such events can include a breach of contract, failure to comply with certain covenants or obligations, the debtor's failure to pay outstanding sums, or other specified defaults such as the appointment of receivers or the passing of resolutions to wind up the debtor. Parties are free to agree on events, not based on insolvency or the commencement of debt restructuring proceedings, which allow termination of the contract or modification of contractual rights.

What is the scope of the restriction on *ipso facto* clauses?

Section 440(1) restricts parties from relying on the relevant *ipso facto* clauses to:

(a) terminate or amend, or claim an accelerated payment or forfeiture of the term under, any agreement (including a security agreement) with the company; or

(b) terminate or modify any right or obligation under any agreement (including a security agreement) with the company.

These restrictions are specific and targeted. They aim to provide some form of stability to the company as it undergoes restructuring.

The scope of restrictions appears to be adopted from existing equivalent legislation from other major jurisdictions, namely the United States and Canada. The restriction in section 440(1)(a) mirrors the wording of section 34(1) of the Canadian CCAA, while section 440(1)(b) mirrors the wording of section 365(e)(1) of the US Bankruptcy Code. Case law relating to the equivalent provisions in the Canadian CCAA and the US Bankruptcy Code may be relevant in interpreting section 440(1)(a) and (b).

While the wording of section 440(1) is generally fairly straightforward, one area of uncertainty is the meaning of amending an agreement or modifying any right or obligation. US case law provides some guidance on the "modification" of rights and obligations.

In *Lehman Brothers Special Financing Inc v Bank of America National Association* 553 BR 476, the United States Bankruptcy Court for the Southern District of New York was asked to decide if certain "flip clauses" were *ipso facto* clauses which were unenforceable in bankruptcy. The case involved swap agreements in which the parties would be paid from the proceeds of the liquidation of certain collateral. The parties, including Lehman Brothers

Special Financing ("**LBSF**") and the Lehman Brothers noteholders ("**Noteholders**"), would be paid in accordance with the priority of payments or waterfall provisions in the agreements. The flip clauses served to change the priority of the parties in the payment waterfall.

The court in this case identified two distinct waterfall provisions in the agreements:

(a) Type 1 transactions – LBSF initially had priority in payment over the Noteholders. However, upon LBSF's default under the swaps, the flip clause was activated such that the Noteholders then held payment priority over LBSF. The court found that these were unenforceable *ipso facto* clauses as they served to modify LBSF's rights, divesting LBSF of its existing payment priority. (However, the distributions were eventually found to be protected under the US Bankruptcy Code's safe harbour provisions.)

(b) Type 2 transactions – In these transactions, neither LBSF nor the Noteholders held payment priority at the outset. The order of priority would only be established after a termination event occurred. Pursuant to this "toggle", the Noteholders would have priority if the early termination was the result of LBSF's default under the swaps. The court found that these did not constitute a modification of LBSF's rights as LBSF did not initially have an existing right to payment priority, and only held a contingent right to priority depending on the circumstances. As such, these were restricted under the *ipso facto* provisions.

The court's holding in this decision suggests that the "modification" of a right under the *ipso facto* regime involves the variation of an existing right upon an event of insolvency or restructuring. The existing right should be defined and crystallised before the occurrence of the triggering event, as opposed to the contingent right in the Type 2 transactions described above.

Further, it may be observed that "modification" does not require the *ipso facto* clause to expressly provide that the party's rights are altered in a certain manner upon the occurrence of a triggering event. A contract which sets out the relative position of the parties at the outset (when the parties are solvent) and prescribes a different position upon a party's insolvency proceedings may be regarded as an *ipso facto* clause which is subject to restriction if that party finds itself in a less advantageous position following the triggering event.

Does section 440 cover *ipso facto* clauses triggered by insolvency of related companies?

There is a question whether section 440 covers *ipso facto* clauses which take effect on the insolvency of a company related to a party to the contract, rather than the contractual party itself. In the context of corporate groups, it is common for *ipso facto* clauses to be triggered by a cross-default.

On a plain reading of section 440, the restriction on *ipso facto* clauses only applies as between the parties to the contract, and not to related companies such as subsidiaries, parent companies or companies under the same parent company. However, if this were the case, it would raise the concern that parties may be able to avoid the section 440 restriction by implementing *ipso facto* clauses that take effect on the insolvency of a related company that is not a party to the contract, especially where the financial operations of the related companies are closely tied.

Whether section 440 covers *ipso facto* clauses involving the insolvency of a related company is thus a matter that would benefit from greater clarity, either by legislative clarification or by judicial pronouncement.

Does section 440 cover anticipatory breach?

Another issue is that of anticipatory breach. Under the doctrine of anticipatory breach, a party to a contract may indicate its intention not to perform its obligations, thus repudiating the contract before performance is due. The counterparty can accept the repudiation and choose not to be bound by the contract.

In a hypothetical scenario, two companies enter into a contract which contains an *ipso facto* clause allowing for the termination of the contract upon the insolvency of a contractual party. The *ipso facto* clause is restricted under section 440 cannot be relied on only for companies undergoes restructuring or insolvency. The counterparty regards that as an indication of the first company's inability to perform its obligations under the contract. The counterparty alleges anticipatory breach and terminates the contract, effectively achieving the same outcome as the *ipso facto* clause.

Section 440 does not preclude the termination of a contract on the ground of actual breach, and it is unlikely to preclude the termination of a contract on the ground of anticipatory breach. Would anticipatory breach then serve as a side door which allows the termination of a contract based on a party's insolvency?

Much of this would depend on the facts. A company's insolvency does not necessarily evince its intention not to perform its contractual obligations; its financial distress may not preclude it from making contractual payments or otherwise fulfilling its obligations. In particular, restructuring arrangements pursuant to judicial management or schemes of arrangement may allow a company to re-adjust the schedule of repayments so as to allow for sufficient cash flow for continued operations, and companies in such circumstances may also be able to obtain rescue financing.

In short, insolvency does not necessarily and by itself constitute an anticipatory breach. However, where counterparties are able to establish an anticipatory breach in the context of a company undergoing insolvency proceedings, without having to rely on an *ipso facto* clause, they should be entitled to rely on such a breach. This is, of course, subject to the counterparty being able to satisfy the legal and evidential requirements of proving anticipatory breach.

Exemptions to Section 440

The restriction on *ipso facto* clauses in section 440 generally applies to most commercial contracts. However, the provisions have been drafted with the awareness that the restriction may not be appropriate in the case of certain industries or types of contract. This is addressed in the exemptions to section 440, which are set out in section 440(4) and section 440(5). Section 440(4) provides a mechanism for a party seeking to rely on an *ipso facto* clause to apply for exemption on the ground of "significant financial hardship", and section 440(5) prescribes a list of agreements to which the restriction in section 440(1) does not apply.

These exemptions recognise, as a policy matter, that the restriction on *ipso facto* clauses should not apply in the context of the identified industries and agreements.

Significant financial hardship

One may feel aggrieved that it is unable to rely on a contractual bargain struck specifically for the contingency of insolvency of the counterparty. There may also be instances where the restriction on *ipso facto* clauses causes prejudice or hardship to the party seeking to rely on the clause.

Section 440(4) provides that a party to the relevant agreement may apply to court for a declaration that the restriction on *ipso facto* clauses does not apply, or applies only to a limited extent as may be decided by the court. The applicant must first satisfy the court that the operation of section 440 would likely cause the applicant significant financial hardship.

What amounts to "significant financial hardship"? While the IRDA does not define the elements of significant financial hardship, Canadian case law provides some guidance. The Canadian CCAA contains a similar provision allowing exemptions for significant financial hardship, and the Canadian courts have had occasion to consider what significant financial hardship entails.

In general, it seems that the Canadian courts have adopted a high threshold of proof for significant financial hardship. It is understandable why a high threshold is required. Any party prevented from relying on an *ipso facto* clause against an insolvent counterparty is likely to face some form of financial hardship. An unduly low threshold would defeat the purpose of the restriction in the first place.

In the case of *Toronto Dominion Bank v TY (Canada) Inc* 42 CBR (4th) 142, 2003 CanL II 43355 ("**Toronto Dominion Bank**"), the Ontario Superior Court considered what constitutes significant financial hardship. The decision sheds light on the applicable test for significant financial hardship and the stakeholder interests that should be taken into account.

The applicant in this case had entered into distributorship and licensing agreements with the counterparty. Following disputes between the parties, the applicant sought to terminate the agreements between them. However, the counterparty was in financial difficulties and had filed a notice of intention to file a proposal pursuant to the Bankruptcy and Insolvency Act. The applicant sought a stay of proceedings from the court and for permission to terminate the agreements on the basis, among others, that the applicant would suffer significant financial hardship if it were not allowed to do so and sell its new inventory directly in the Canadian market.

The court declined to grant the stay. The court held that the applicant "must be able to show quantitatively the prejudice that it will suffer if the stay is not removed". On the facts, the court found that the applicant had not demonstrated quantitatively any material prejudice it would suffer if it were not allowed to terminate the agreements, other than a delay in pursuing its strategy of direct selling to Canadian customers.

The decision in *Toronto Dominion Bank* suggests that an applicant alleging significant financial hardship is unlikely to be able to utilise the exemption by bare allegations of the prejudice it would suffer. Rather, there should be some form of quantitative analysis to materially demonstrate the extent of the resultant prejudice.

The court's decision in *Toronto Dominion Bank* raises two other points. First, the court decided that the prejudice to be considered "is objective prejudice, not subjective prejudice". In the Second Reading of the Insolvency, Restructuring and Dissolution Bill, it was stated in Parliament that section 440(4) of the IRDA was intended to introduce a degree of flexibility, and that its application would depend on the impact which the restriction would have on the particular creditor or in the particular situation.[112] If the Singapore courts adopt the Canadian approach, it appears that the impact on the particular creditor may be assessed objectively.

Second, the court in *Toronto Dominion Bank* stated that it should also "consider a balancing of the interests of all affected parties" and that it should "take into account the effect of the lifting of the stay on the administration of the estate and the prejudice to other stakeholders". This implies that, in considering significant financial hardship, even if the applicant demonstrates

[112] *Parliamentary Debates, Official Report* (1 October 2018), vol 94 (Mr Edwin Tong Chun Fai, Senior Minister of State for Health and Law).

that it would suffer prejudice because of its inability to enforce the *ipso facto* clause, the court may balance such prejudice against the interests of other interested stakeholders. Whether this position will be adopted in Singapore is uncertain as, on a plain reading, the wording of section 440(4) does not mention the interests of any party other than the applicant, and the scope of the court's consideration in this regard does not appear to be as wide as implied in this decision.

Prescribed Exemptions

Section 440(5) provides that the following categories of agreements are not subject to the restriction in section 440(1)

(a) Eligible financial contracts.
(b) A licence, permit or approval issued by the Government or a statutory body.
(c) Any contract that is likely to affect the national or economic interest of Singapore.
(d) A commercial charter of a ship.
(e) Agreements under the International Interests in Aircraft Equipment Act; and
(f) Agreement that are the subject of a treaty to which Singapore is party.

The Insolvency, Restructuring and Dissolution (Prescribed Contracts under section 440) Regulations 2020 ("**Prescribed Contracts Regulations**") serves to prescribe "eligible financial contracts" under paragraph (a) above, which include:

(a) Any derivatives contract, margin lending agreement or securities contract.
(b) Any master netting agreement, securities/commodities lending or repurchase agreement, or spot contract, that contains a netting arrangement or set-off arrangement.
(c) A covered bond or connected agreements.
(d) A debenture or connected agreements.
(e) Any agreement to clear or settle transactions relating to a derivatives contract; and
(f) The business rules of an approved exchange, a licensed trade repository, an approved or recognised clearing house or a recognised market operator.

As stated by the then Senior Minister of State for Law in the Parliamentary Debates on the IRDA, these exemptions recognise that restricting the application of *ipso facto* clauses in certain categories of transactions or contracts would have a disproportionately adverse impact on certain markets, while also balancing the efficacy of the restriction.[113]

Of the exempted categories, the most significant category would be that of "eligible financial contracts". The Prescribed Contracts Regulations contains an extensive list of prescribed financial contracts, and it remains open for further types of financial contracts to be added to the list. The intention is to minimise any potential negative impact on the industries that rely on such contracts, where *ipso facto* clauses may be well established and regarded as industry norms.

The list of eligible financial contracts in the Prescribed Contracts Regulations was arrived at after a public consultation by the Singapore Ministry of Law ("**MinLaw**"). MinLaw published a proposed list of eligible financial contracts and invited comments and feedback. MinLaw then responded to the feedback by amending certain categories of exempted contracts and adding new categories into the eventual Prescribed Contracts Regulations. However, there were also certain categories of exemptions proposed for inclusion in the Prescribed Contracts Regulations by industry parties in the public consultation that were rejected by MinLaw. This includes:[114]

(a) Any contract or agreement that is directly connected with a commodity – This proposed category was rejected for being too broad and not justifiable. Further, a narrower category of "commodities lending or repurchase contract" is already excluded.

(b) Loan contracts – This proposed category was rejected for being too broad and not justifiable. Further, there are already various safeguards in place for financial institutions.

(c) Outsourcing contracts – This proposed category was rejected for being too broad and not justifiable. The types of contracts falling within the scope of this category are not generally of a nature of financial contracts which may be prescribed as exempted.

[113] *Parliamentary Debates, Official Report* (1 October 2018), vol 94 (Mr Edwin Tong Chun Fai, Senior Minister of State for Health and Law).
[114] Ministry of Law, *Ministry's Response to Feedback Received from Public Consultation on the Exclusions under Sections 440(5)(5) of the Insolvency, Retructuring and Dissolution Act 2018* (23 July 2020).

(d) Cash pooling – Cash pooling is a manner of structuring financing for a group of companies and does not appear to be a type/category of financial contract *per se*.

(e) An entity-level exclusion for banks and insurers – It was submitted in feedback that the resolution regime is the more appropriate form of restructuring for banks and insurers as it is specifically tailored to take into account the considerations that arise in respect of the insolvency of banks and insurers. However, MinLaw stated that section 440 neither prejudices nor adversely constrains the possibility of a bank or insurer being placed into the resolution regime. Also, in the event the bank or insurer is not placed into the resolution regime, that particular bank or insurer may attempt to restructure by way of a scheme of arrangement.

Comparative Assessment

The categories of agreements exempted from section 440 may be seen to be fairly standard. In Australia, a wider range of contracts has been included in the list of exempted agreements under the Australian Corporations Act and the Corporations Regulations 2001 (Cth). This includes (i) any contract, arrangement or agreement relating to Australia's national security, border protection or defence capability; and (ii) any agreement for the supply of goods and services to a public hospital or a public health service.[115]

This approach has raised questions about whether *the* scope of exemptions may be too wide, leading to uncertainty and reducing the effectiveness of the *ipso facto* regime. In contrast, Singapore's position seems geared towards greater specificity in the prescribed categories of exemptions, taking into account industry feedback.

It is noteworthy that India's Insolvency and Bankruptcy Code 2016 ("**IBC**") was recently amended pursuant to the Insolvency and Bankruptcy (Amendment) Act 2020 to introduce certain potential restrictions on contractual rights of termination or suspension on the ground of insolvency.[116] Specifically, the potential restrictions apply to certain categories of contracts, namely, licenses, permits and registrations, etc. granted by a government or state authority, and contracts for critical supplies. In addition, once an

[115] Corporations Regulations 2001 (Cth) Reg 5.3A.50.
[116] Section 14(1) of the Insolvency and Bankruptcy Code 2016.

insolvency practitioner is appointed, any other supply of goods or services which he or she deems "*critical to protect and preserve the value of the corporate debtor…as a going concern*" would also be protected.[117] This approach is similar to that in section 233 to 233B of the UK Insolvency Act 1986, which focuses on the protection of supplies of essential goods and services, rather than a general restriction on the exercise of *ipso facto* clauses.

In the decision of *Gujarat Urja Vikas Nigam Limited v Amit Gupta and others* (Civil Appeal No. 9241/2019) ("***Amit Gupta***"), the Supreme Court of India, after carefully reviewing the regimes relating to *ipso facto* clauses in different jurisdictions, was of the view that the resolution of issues on the validity of *ipso facto* clauses would require the balancing of a myriad of complex questions. As such, it was best left to the legislature to decide on the scope and ambit of any restriction on the exercise of *ipso facto* clauses.

Conclusion

The introduction of the restrictions on *ipso facto* clauses under section 440 of the IRDA has garnered much attention from the legal and business communities in Singapore. Moving forward, such restrictions are also likely to impact the drafting of contracts, as parties try to address the impact of section 440, and find ways to re-allocate risks between the contractual parties.

The statutory establishment of the *ipso facto* framework represents a significant development in restructuring and insolvency law in Singapore. The Singapore government is keenly aware of the unique challenges to restructuring efforts brought about by *ipso facto* clauses, and has set about to prescribe the limits of the application of *ipso facto* clauses in certain circumstances. As the Supreme Court of India correctly observed in the *Amit Gupta* case, there are different and sometimes conflicting considerations on whether and how contractual rights should be restricted in the insolvency context, and it may ultimately be up to the legislature to attempt to strike a balance.

The *ipso facto* regime in Singapore is still relatively new. It is expected that existing issues and uncertainties would be addressed in future case law, which will serve to further develop the law on *ipso facto* clauses in Singapore.

[117] Section 14(2A) of the Insolvency and Bankruptcy Code 2016.

Building an Insolvency Framework for technology service suppliers: Experience from India and UK

Neeti Shikha and Rebecca Parry

Building an Insolvency Framework for technology service suppliers: Experience from India and UK

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Introduction

Modern society, particularly in the Covid-19 era, is becoming increasingly dependent on digital technologies and lives are being transformed, for example through greater social inclusion, improved business opportunities, medical enhancements, and wider educational opportunities. India stands at the forefront of these developments and attention has righty been focused on considerable achievements and great potential. Yet behind the services that businesses and individuals rely on are companies and problems are inevitable in cases where they become insolvent. Insolvencies in this area are likely to present complex challenges and disruption to vital services. Yet little thought has been directed to how law can support sustainability, as well as how insolvency laws can operate in the public interest to minimise the impact of insolvencies. Lying at the intersection of law and technology, the proposed interdisciplinary and comparative project will consider the rise of technology in India, as well as overlooked aspects of the role of law in supporting it, particularly in insolvency, gaining insights from the UK's approach to sustainable public services.

Rise of Technology Services

The twenty-first century's world is expected to be dominated by Information Technology, with India at the centre of world attention and it is already being regarded as a knowledge powerhouse. IT services, IT-enabled services, e-commerce, software, and hardware items are all part of the IT sector and there are underlying technologies whose existence is not widely appreciated. Not only has information technology contributed to the country's economic success, but it has also made governance more competent and approachable. It has simplified and reduced the cost of obtaining government services and information. It is the backbone of our economy, allowing it to grow enormously and provide millions of employments. The market size of the IT industry in India has grown from approx. 67 billion US dollars in 2008-09 to 191 billion US dollars in 2019-20.[118]

The National Association of Software and Services Companies (Nasscom) and McKinsey anticipated in 2015 that the Indian technology services industry might be worth $300-350 billion.[119] The report titled 'Future of Technological Services Winning in this decade' highlights that if India can win in the Cloud, Cybersecurity, AI and other emerging technologies, the country's IT services industry may grow by 2-4 % over the next five years. The IT industry has also contributed around 8% in 2017-18 to the total GDP of India and has a contribution of 7.7% in 2019-20.[120]

The technology was used by the government to make the public services available to citizens electronically by improved online infrastructure and by increasing Internet connectivity and by making the country digitally empowered in the field of technology. India's upcoming policy design rests upon its technological backbone. India has developed the world's largest digital ID programme, Aadhaar, which has enrolled over 1.2 billion people. This remarkable example of e-governance development has been identified as offering enhanced prospects for the delivery of government services[121] and, as well as enabling greater information about the Indian economy and society to be obtained and the tax base to be widened.[122] This has fostered social inclusiveness, reaching persons who did not previously have access to bank accounts.[123] Electronic transactions are also safer in terms of public health and have increasingly been used in place of existing formalities in

[118] https://diplomatist.com/2020/08/29/it-industry-boosting-indias-growth/

[119] https://www.business-standard.com/article/companies/indian-tech-services-can-touch-revenues-of-300-350-bn-in-next-5-years-121033101271_1.html

[120] IBEF, Ministry of Commerce and Industry, Government of India, https://diplomatist.com/2020/08/29/it-industry-boosting-indias-growth/

[121] Fang Zhao, Joseph Wallis, and Mohini Singh, 'E-Government Development and the Digital Economy: A Reciprocal Relationship', *Internet Research*, 25.5 (2015), 734–66 <https://doi.org/10.1108/IntR-02-2014-0055>.

[122] B. Ramija, 'Indian Digital Economy: Opportunities and Challenges' (2018) 10 International Journal of Current Research 74338, available at https://www.journalcra.com/article/indian-digital-economy-%E2%80%93-opportunities-and-challenges.

[123] K.R. Babu, A.B. Sagar, P. Kothari (2020) Social Inclusion and e-Governance: A Case Study in Alirajpur District. In: S. Rautaray, G. Eichler, C. Erfurth, G. Fahrnberger (eds) Innovations for Community Services. I4CS 2020. Communications in Computer and Information Science, vol 1139. Springer, Cham. https://doi.org/10.1007/978-3-030-37484-6_16. For a study identifying gaps see Anusha Goel, An Empirical Study of Jan Dhan - Aadhaar - Mobile Trinity and Financial Inclusion. (2020) 8 International Journal of Banking, Risk and Insurance 62-79, Available at SSRN: https://ssrn.com/abstract=3603272

response to the COVID-19 pandemic, since for example electronic signatures are valid under Indian law[124] and any formalities that require writing can be validly complied with electronically.[125]

This penetration of technology has raised the importance of technology companies and their ease of doing business. The economy has benefited from opportunities for business growth and the export provision of services. The benefits of digitisation are compelling from a business perspective as they enable access to finance to be improved and costs of transactions to be lowered.[126] There have already been successes and the digital economy is contributing to rising prosperity in India. Entrepreneurs have gained record amounts of funding for start-up projects, more than United States and Chinese businesses in the equivalent period.[127] The development emphasises the need for easy entry and exit of IT companies that can foster its growth and harness the natural creative destruction processes of competitive markets. Businesses work within a larger framework of law and the technology sector arguably presents new challenges for existing laws and presents a case for updating some, while developing new hard and soft law approaches. Particularly neglected has been the need for law to support the sustainability of businesses and protect customers in the event of a service supplier experiencing financial distress.

The rule of law is important for economic development. A modernizing nation's economic prosperity will start with a modest legal infrastructure centred on the protection of property and contract rights.[128] The essential legal reform required to create that infrastructure may be the adoption of a system of relatively precise legal rules, as distinct from more open-ended standards or a heavy investment in upgrading the nation's judiciary.[129] While India has a developed legal system, judicial infrastructure is still poor. Further, though insolvency laws in India are considered sector agnostic, there are inherent challenge in the existing insolvency framework that is not suited for handling technology insolvency. Against this backdrop, this paper focuses on another possible need for further development, namely the legal framework needed to support modern, digital-service focused trends in a sustainable way. But before that, let us consider how the sector has evolved post-pandemic altering the way that business is done and thereby creating newer opportunities for both UK and India.

[124] Information Technology Act 2000, s 3, as amended by the Information Technology Amendment Act 2008.
[125] Information Technology Act 2000, ss 4-10.
[126] Leora Klapper, “How Digital Payments Can Benefit Entrepreneurs” IZA World of Labor 2017:396 https://wol.iza.org/uploads/articles/396/pdfs/how-digital-payments-can-benefit-entrepreneurs.pdf?v=1.
[127] Benjamin Parkin and Mercedes Reuhl, “Chinese investors miss out on record year for Indian tech fundraising” Financial Times 12 July 2021, https://www.ft.com/content/94ad2e3e-e2f0-4333-b105-c980cddb212b
[128] Richard Posner Creating A Legal Framework For Economic Development https://elibrary.worldbank.org/doi/pdf/10.1093/wbro/13.1.1. Last accessed on 30 November 2021.
[129] ibid

Potential for India and UK

The pandemic has altered the way we do business; governments and industry around the world have collaborated in sharing covid-19-related data to address the wide-ranging challenges in health and the economy; as a result, it is critical to include the lessons learned and benefits derived from data access and sharing in such bilateral discussions.

Cross-border data transfer enables innovation and job growth across all sectors. Security of the services that enable this helps businesses to be resilient and productive while working remotely and improves access to global R&D and clinical testing data. Cross border data transfer also holds potential for supply chain management by enabling access to innovative technologies and participation in global supply chains, as well as moving data in real time on inventories, sales, demand forecasts, order status, production schedules, and so on, across different entities.

The UK and India recently committed to an enhanced trade partnership as part of a 10-year roadmap to double trade by 2030 and state their intention to negotiate a UK-India free trade agreement (FTA). This would also enhance digital trade between UK and India.[130] This India-UK technology trade will complement each other's strengths. With its tech talent, India can meet the UK's Post-EU departure strengths on AI, clean growth, and future mobility in the middle, thanks to technology diplomacy.[131] India can play to its strength by linking Modi's flagship Ayushman Bharat scheme to the UK's healthcare AI companies, leveraging India's competitive federalism with the UK's rapid devolution of tech, economic, and job creation to regions like the Northern Powerhouse and Midlands Engine.

As the trade, or more specifically, digital trade is growing across the two countries, it has opened a lot of new opportunity for both the countries. The relationship will make the economy and people stronger and safer. With the Tech investment deals between 2009 and 2019, Indian investments into London were worth over 523 million pounds, which involved 36 projects by 22 Indian companies, creating a rise in jobs, economy, travel, health, technology.[132] Tech Companies like Infosys, HCL Technologies, Mphasis, Wipro created more than 3000 jobs in UK.[133]

[130]https://www.financialexpress.com/opinion/india-uk-fta-talks-should-champion-digital-trade/2362151/
[131] https://www.ukibc.com/blog-digital-trade-an-important-element-of-uk-india-fta/
[132]https://economictimes.indiatimes.com/tech/ites/india-among-top-destinations-for-london-tech-firms-report/articleshow/69726058.cms?from=mdr
[133] https://www.uktech.news/news/uk-india-trade-deal-20210505

Likewise, India is the among the top 5 destination for London tech companies who are looking to expand outside UK. It is the 4th biggest market for Technology and the 3rd largest start-up economy globally.[134] Investments from all over the work, especially UK has been flowing in Indian tech start-ups and companies. Recently, Entrepreneur First (EF), which is a UK-based global talent investor, has announced an investment in 6 tech start-ups from India.[135]

HMG's India network, which is the world's largest and commercially skilled has guaranteed that household names such as Ola, OYO rooms, Tech Mahindra, and First Source have selected the UK as their home-from-home, resulting in the creation of many thousands of employments in recent years. They chose the UK because, simply put, it is the best place in the world to create a digital business, with unparalleled access to talent, innovation, R&D, and risk capital.[136]

The two governments should work together through the FTA to establish a consistent approach to ethical values, based on the creation of internationally agreed-upon principles like Fairness, Accountability, Sustainability and Transparency. It is proposed that law must focus on aspect of sustainability and particularly the role of corporate governance in failure prevention, as well as the role of insolvency law in enabling financial distress to be resolved. Digital service insolvencies present difficult challenges, given the dependency of customers and need for continuity of service and the paper will consider how these aspects can be addressed.

Impact on Economy – Insolvency of Tech Companies

Given the rapid rise of the digital economy around the world, and the fact that the majority of Indian business is focused on technology support, it is critical to discuss the impact that insolvent tech companies and tech service providers might have. This part will highlight the key features of digital services before examining why specific attention needs to be focused on insolvency law.

- Easy accessibility: Technology serves as a vehicle for making existing services more helpful. For example, customers benefit from the convenience of using an internet-based bill payment service. Map and

[134] https://inc42.com/resources/the-uk-will-be-a-co-star-in-indias-tech-blockbuster/
[135] https://www.outlookindia.com/website/amp/entrepreneur-first-announces-investment-in-six-indian-tech-start-ups/396147
[136]https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/india-the-uk-its-a-lot-more-than-cricket/articleshow/69986624.cms?from=mdr

routing software is installed in cars, which directs drivers. On one click, groceries are delivered at our doorsteps.

- Global reach of data/services: Internet is one big service which has no boundaries. Information, services, transactions can reach across countries. Technology-based service can be extended to the customers living around the globe.
- Employment generation: As the IT industry is rapidly growing, it is creating more and more employment.
- Close link with customers: Customers and staff can both benefit from technology in terms of getting and providing service. Customer relationship management and sales support software aid frontline employees in providing better service.

The above facts demonstrate the importance of the technology industry. IT Service companies provide o- demand services to other businesses. Many of the businesses instead of having their own IT department, outsource to these companies as it helps in cost efficiency. Cybersecurity is a major concern for all businesses. So evaluating and responding to potential threats is a popular service for a lot of IT businesses. A database is the system that a business uses to monitor and access its data throughout the lifecycle.[137] The impact of the tech companies providing IT services to different companies will have a significant influence on the economy and many other businesses connected to it. The services and working of many companies would come to a standstill in the event of disruption to services.

The IT industry is governed through various laws and thus faces a lot of legal challenges, which ranges from data transfers, Intellectual Property issues, tax implications, data protection, cloud computing, etc.

Economic Challenges in Tech Services

As tech services are gaining in popularity, such as start-ups working in data analytics, artificial intelligence and block-chain, there have been notable successes. Some have made headlines for obtaining funding as well as being acquired by the global tech platforms such as Facebook, Apple and Google. Serving the technological needs of Indian small and medium firms, which

[137] https://smallbiztrends.com/2018/08/types-of-it-services.html#comments

have been pushed to adapt to online, always-connected ways of conducting business as a result of the twin shocks of demonetization and GST implementation, there is even bigger growth potential. As these companies become more comfortable with incorporating technology into their daily operations, a huge opportunity for Indian tech firms will open up.

Although, the market environment appears to be favourable for Indian tech companies, there often remains immense difficulties hidden behind the spotlight. As the world has faced a pandemic, there has been a widespread concern and economic hardships. The tech industry has seen a boost, as all the operations have turned online, but simultaneously faced some issues.

A tech service provider company can face issues due to hacking, mismanagement, data protection and privacy issues, economic hardships, as well as natural disasters which would lead to financial difficulties as well as insolvency.

Cybersecurity has become increasingly crucial in recent years. Data has become the most precious commodity for many firms, and criminal activities, such as malware, are on the rise. Data breach incidents are becoming more common. To maintain business continuity and supply chain security, IT businesses are stepping up their cybersecurity efforts. There was a rise in cybersecurity risks as more people are working remotely.

Technology helps to achieve our goals efficiently, convenience of doing business, boost productivity, but it’s only as good as those who can manage to use it. According to a research, 93 percent of businesses report a skills gap[138] in their IT employees, indicating a mismatch between required and existent skill sets. Before they can use innovation and new technologies, IT executives, starting with the CIO, must engage the necessary talent for the IT team to maximise the tools. As IT strategy becomes more integrated into overall business strategy, investing in tech talent is an investment in your company's long-term goals.

Every year, approximately $300 billion in software development productivity is lost due to a lack of access to senior people and complicated software systems.[139] This has a significant impact on technical executives and their businesses, as the marginal cost of software delivery rises. Understanding how automation may help their teams deliver better software at scale is a key problem for tech leaders.

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[138] https://www.comptia.org/content/research/state-of-the-it-skills-gap?utm_source=blog&utm_medium=incopy&utm_campaign=Top_IT_Issues
[139] https://www.forbes.com/sites/forbestechcouncil/2020/09/03/12-tech-leaders-on-the-biggest-challenges-facing-their-industry/?sh=6cd918de1bce

Due to the lockdown, IT companies in India struggled to transition their personnel to a remote-work environment. Companies hurried to give computers to hundreds of thousands of workers, overcome low Internet bandwidth, and gain customer authorization to allow working from home, which had previously been prohibited owing to security concerns.[140]

According to survey results from 3,450 executives in 20 countries across 22 industries, corporate priorities are much more focused on crisis management, workplace safety and security than they were two years ago. Cybersecurity concerns have skyrocketed, too, with some industries showing an increased commitment of more than 90%. Overall, 76 % of executives plan to prioritize cybersecurity over the next two years, with 46 % planning to use AI to enhance cybersecurity in the same timeframe. That is twice as many as deploy the technology today.[141]

Insolvency Framework for Tech Companies

Due to the ongoing pandemic, market conditions and other risks, these tech service supplier companies face the risk of business failure. When the tech company / service provider gets into financial difficulties, and is not able to pay its debts, it can either be liquidated or be revived (reorganised).

Exit processes are just as important as start-up procedures for businesses. Insolvency proceedings are used all over the world to assist entrepreneurs in closing down unprofitable enterprises and launching new ones. The insolvency legislation is transforming the way society perceives company failures as it becomes a reform by, for, and of the stakeholders, fuelled by a tremendous discontent hunger for freedom of exit.

There are various facets to a technology company, they may be involved in providing service to other companies, or marrying out marketing related activities etc. Providing cloud services is yet another activity that they may be involved in. The provision of protections for users of cloud services is something that can potentially be better addressed by different jurisdictions. Digital economies can offer significant benefits and many countries, including developing countries, are building on this. A legislative framework that can provide security of data and continuity of service in the event of insolvency

[140] https://www.shrm.org/resourcesandtools/hr-topics/global-hr/pages/coronavirus-india-it-challenges.aspx
[141] https://www.ibm.com/thought-leadership/institute-business-value/report/covid-19-future-business

can support the development of such economies, as it can attract cloud service providers which can then offer confidence to customers that there will not be a sudden and catastrophic loss of services and content. A special procedure for cloud service providers, enabling a managed closedown, would be one possibility.

An example of existing provision for cloud computing insolvencies is Art 567 of the Luxembourg Code de Commerce. As originally enacted this law enabled the recovery of goods entrusted to debtors upon the debtor's insolvency and in 2012 it was extended to include intangible property such as software in recognition of the growing importance of cloud computing. Such a law would not suffice in itself, since having an entitlement to recover content in the event of the insolvency of a cloud service provider is only one problem and temporary continuity of service to enable recovery of the content is also needed.

In the absence of specific provisions, cloud computing insolvencies could be difficult to resolve. What happens to the data when the cloud provider becomes subject to bankruptcy proceedings? Does the automatic stay imposed at the beginning of the bankruptcy case prevent customers of cloud providers that host data from accessing or retrieving their data? This is not an academic question – there are several recent examples of cloud providers at or near failure.

In most of the jurisdiction, filing of a petition for bankruptcy invokes the automatic stay which prohibits all adverse actions taken against the debtor. Under US Laws, under Section 362(a) of the Bankruptcy Code provides for this. Indian Insolvency code section 14 provides for similar relief. When a company files for bankruptcy under Chapter 7, all management of the business shifts from the shareholders or board (with a corporation) or its members and managers (with a limited liability company or partnership) to the appointed Chapter 7 trustee, who takes control over the debtor's assets.

In a Chapter 11 case, the debtor generally remains in control of its own assets. The question then, is whether the data is the "property of the estate" under Section 541 of the Bankruptcy Code, or whether data belong to the users or customers? If the data is property of the estate, the automatic stay prohibits any attempt to regain control over the data without first seeking relief from the automatic stay. With a cloud provider, customers are going to want to continue to have access to their data. However, if the debtor "owns" the data or information, what happens to the data in the event of a bankruptcy?

Even if ownership is established, how can the cloud service be kept running while customers recover data and make alternative arrangements? Keeping the business running temporarily presents a tension with the interests of creditors, who will wish for the case to be resolved quickly and without ongoing expense. Thus, there are several challenges that arise in case a technology company goes into insolvency. These challenges are not only limited to process that insolvency law adopts but also the laws that come into play outside the purview of insolvency laws.

It might be expected that digital service users will make provisions in their contracts to address insolvency aspects. Performing thorough financial diligence, including assessing the risk to the provider from a concentration of customers and its ability to access capital could be one such way. Contract terms can provide that the delivery of data to the host does not transfer any element of ownership; and, as between the customer and data host, the customer retains all right, title and interest in the data. It should clarify that the provider's role with respect to the data is limited to a storage function to fulfil its obligation to provide hosting services, and the provider will not interfere with the customer's access. In true sense, the provider is a "bailee for hire" with respect to the data (that is, a person compensated for holding the property as bailee).

A greater challenge is to ensure that contracts address foreseeable issues that may arise during insolvency. The contract might address the potential loss or interruption in access to data from a provider's bankruptcy or failure in the disaster recovery plan, to the same extent as a natural disaster. However, any damages awarded would be on an unsecured basis and therefore unlikely to be of any worth in an insolvency. Exploring insurance that protects from business interruptions will mitigate the loss and also protect the customer from a provider's inability to make data available.

Under the US Chapter 11, the debtor is still in business and continues to operate, so any attempt to disrupt the business will be viewed unfavourably. This is one instance where it may be better to "ask for permission" than for forgiveness, and seek relief from the automatic stay, even if the data is technically not "property of the estate." During the course of the Chapter 11 case, close attention should be paid to disposition of the contract. If there is a sale of the debtor's assets under Section 363 of the Bankruptcy Code, the contract may be assumed and assigned to the purchaser of the assets under

Section 365. However, the rules governing the ability to "assume and assign" executory contracts do not extend to patent and copyright licenses. So, the intellectual property lawyers should be consulted as well.

Data privacy may also become an issue in the bankruptcy case when the business assets are being sold and those assets include private consumer data. Assets using Internet of Things technology may raise particular difficulties. Several jurisdictions have concerns over the sale of private consumer data in bankruptcy sales. In the USA, Section 332 allows for the appointment of a "consumer privacy ombudsman" to represent consumer's interests before the court. The bankruptcy court may order the U.S. Trustee to appoint a "disinterested" individual who can act as a consumer privacy ombudsman. These individuals then provide the court with information that is required. This information may include the debtor's privacy policy, the potential losses or gains of privacy to consumers if the sale is approved by the court, the potential costs to consumers if the sale is approved by the court; and the potential alternatives that would mitigate potential privacy losses or privacy costs to consumers.

In the rough and tumble of a bankruptcy, the focus is to protect the assets of the debtor for the eventual benefit of creditors, however in digital service insolvencies customers could suffer great losses in the event of a sudden closedown. There is a limit to the extent to which customers of technology companies can stay out of the skirmish altogether or quickly escape with careful planning and with aid of law. A legal framework needs to provide greater assurance for customers that their data and business processes will be protected. But both UK and India needs to step up and design a framework that provides greater protection.

The Way Forward for India

Recently a few fintech companies are facing liquidation. One such fintech company which is currently going into Liquidation Rubique Technologies India Pvt. Ltd. The petition was brought under section 9 of IBC for non payment of salary. In another case of TMW Fintech Pvt. Ltd., a wallet start-up company which purchased goods from MCT Cards & Technology Pvt Ltd., of SIM cards and smart cards for biometric identification and payment facilitation went into CIRP. In 2019, MCT Cards (Operational Creditor) took TWM Fintech (Corporate Debtor) to NCLT for defaulting on its repayment of debt and pressed for its liquidation. The court allowed the petition against the

Corporate Debtor. While both the cases await the final verdict, the question of technology companies coming under insolvency is now a reality. The unique nature of such companies needs to be recognised by the law and insolvency laws in India will have to step up to meet the challenge. Further, there are various new ways of designing sale for a distressed tech companies such as “Acqui-Hire” – License and Waiver, assignment for benefit of creditors etc which are not usual practice in other companies. The law needs to be kept flexible to allow such innovative practices to be adopted while designing resolution plan.

Some challenges that insolvency of tech companies include valuation of assets, determination of ownership of data, protection of data and third-party rights. Also, the moratorium over the assets of such companies may pose threat to business of related companies for who the technology company were offering services.

While it is not possible to list down all the challenges may arise, a better way in law could be to give scope for easing out certain rules under IBC to accommodate the interest of related parties and help smooth CIRP process.

India must continue to develop sound regulatory system for the companies to grow. The growth of companies will require easy entry and exit of such companies, for which the regulatory framework should be well defined. Insolvency laws in India in its current form may not be suitable for technology companies. Insolvency of tech companies is complexed giving rise to myriad of regulatory issues relating to asset location, jurisdiction, blanket moratorium, true valuation etc. The law needs to be kept flexible to allow such innovative practices to be adopted while designing resolution plan. There is need to identify the key provisions of insolvency laws in India that may require some tweak.

Assignment of Actionable Claims

Pooja Mahajan and Clare Tanner

Assignment of Actionable Claims

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The Insolvency and Bankruptcy Code, 2016 ("**IBC**") brings a tectonic shift in jurisprudence relating to insolvency and bankruptcy in India. One of the key features of the IBC, as opposed to its predecessor statutes, is its stress on maximisation of value of assets of the corporate debtor in a time bound manner. When IBC was enacted, India had one of the lowest recovery rates in the world, primarily on account of delays in the recovery process. The recovery to creditors, be it in a corporate insolvency resolution process or liquidation, is dependent on realisation of value from the estate of the corporate debtor in a timely manner. The estate of the corporate debtor can comprise of 'choses in action' which in literal sense means 'thing in action' or a thing which can be recovered by action (as opposed to by taking physical possession)[142]. 'Choses in action' are essentially claims that a corporate debtor may have against third parties for property, debt or money. These could be in the form of actionable claims such as debts, receivables, claim for property not in possession or bare right to litigate and recover monies or claims that resolution professional or liquidator may have against third parties for avoidance transactions or for fraudulent or wrongful trading.

Realisation of such claims by the resolution professional and liquidator would result in increasing the kitty of the corporate debtor for the benefit of its creditors. However, the working of IBC in the last more than five years has shown the difficulty in realisation of such 'choses in action'. Realisation of 'choses in action' often requires action by the resolution professional and liquidator in form of legal proceedings against third parties, which can be costly and time consuming. On account of lack of funding, the resolution professional and liquidator may not be able to effectively realise such claims

[142] Halsbury's Laws of England, Volume 13 (2017)

for the benefit of the creditors. Further, even where funding is available, given the protracted nature of legal proceedings in India, the realisation may take indefinite time. Pertinently, as recognised by the Insolvency and Bankruptcy Board of India ("**IBBI**") in its 'Discussion Paper on Corporate Liquidation Process', the realisable amount remains, at best, a guesstimate[143].

Non-realisation of such 'choses in action' by the resolution professional and liquidator in a time bound manner is proving to be detrimental to the twin objectives of the IBC – value maximization in a time bound manner. One of the solutions for addressing this problem statement would be to allow the resolution professional and the liquidator to assign these claims to third parties for a consideration. Such assignment would result in unlocking value for the creditors. However, while assignment is an attractive option, there must be checks and balance in place to ensure that the assignment actually results in value maximization for the creditors and at the same time, does not result in abuse of process by the resolution professional and the liquidator.

India has limited precedents of assignment of 'choses in action' in the context of insolvency and bankruptcy. On the other hand, transfer of 'choses in action' i.e. cause of action including officeholder claims has been considered in the United Kingdom, both under the statute as well as through judicial precedents.

The aim of this article is to study the legal position on assignment of 'choses in action' in the UK and India in the context of insolvency. Based on the study, the article will make recommendations if any amendments to law/ regulation are needed in India to facilitate assignment of choses in action in insolvency and liquidation process and what best practices can be followed by the resolution professional/ liquidator while considering assignment of such claims.

An English Law perspective

General rule

As a matter of English law, the purported assignment of a cause of action will be void if it involves unlawful maintenance and/or a specific type of maintenance called champerty[144]. Additionally, until 1967, maintenance and

[143] Discussion paper LIQUIDATION.pdf (ibbi.gov.in)
[144] Snells Equity - para 3-38

champerty were criminal offences and gave rise to claims in tort. In *Re Trepca Mines (No 2)* [1963] Ch 199, Lord Denning described these two principles as follows:

"Maintenance may, I think, nowadays be defined as improperly stirring up litigation and strife by giving aid to one party to bring or defend a claim without just cause or excuse. At one time, the limits of "just cause or excuse" were very narrowly defined. But the law has broadened them very much of late … and I hope they will never again be placed in a strait waistcoat. But there is one species of maintenance for which the common law rarely admits of any just cause or excuse, and that is champerty. Champerty is derived from campi partitio (division of the field). It occurs when the person maintaining another stipulates for a share of the proceeds… The reason why the common law condemns champerty is because of the abuses to which it may give rise. The common law fears that the champertous maintainer might be tempted, for his own personal gain, to inflame the damages, to suppress evidence, or even to suborn witnesses. These fears may be exaggerated; but, be that so or not, the law for centuries has declared champerty to be unlawful"

The long history of maintenance and champerty was described in *Giles v Thompson* [1994] 1 A.C. 142, where Lord Mustill referred to the "*local oppressions practised by overweening magnates in the 15th century*" and outlined the rationale for the criminal offence in the following terms:

"… the crimes of maintenance and champerty are so old that their origins can no longer be traced, but their importance in medieval times is quite clear. The mechanisms of justice lacked the internal strength to resist the oppression of private individuals through suits fomented and sustained by unscrupulous men of power. Champerty was particularly vicious, since the purchase of a share in litigation presented an obvious temptation to the suborning of justices and witnesses and the exploitation of worthless claims which the defendant lacked the resources and influence to withstand. The fact that such conduct was treated as both criminal and tortious provided an invaluable external discipline to which, as the records show, recourse was often required."

The Criminal Law Act 1967[145] abolished the crime and torts of maintenance and champerty but the legislation expressly preserved the rule of law as to cases in which a contract was to be treated as contrary to public policy or otherwise illegal[146]. In *Trendtex Trading Corp & another -v- Credit Suisse* [1982] A.C. 679, Lord Wilberforce explained that:

"Although ancient in origin, and so no doubt encrusted with disposable obsolescences, [champerty] has been given statutory recognition by the Criminal Law Act 1967, sections 13 and 14, which, while abolishing criminal and tortious liability for champerty, expressly preserves any rule of law as to the cases in which a contract involving champerty is to be treated as contrary to public policy and/or otherwise illegal."

As a matter of English law, an assignment of a cause of action will not always fall foul of the rule against maintenance and champerty including where: (i) the assignee has a genuine and substantial interest in the success of the litigation[147]; (ii) the cause of action is incidental to the assignment of a property right[148]; (iii) the assignment is of a liquidated debt, as a species of property[149]; or, of particular note for this paper, (iii) in the insolvency context.

The Insolvency context

As a matter of English law, a liquidator has a statutory power to assign a cause of action (i.e. the bare right to litigate divorced from any transfer of property[150]) vested in the company at the time of the winding up[151].

The relevant statutory provisions are found at s165(2) and 167(1) of the Insolvency Act 1986 ("**the 1986 Act**"), in the case of voluntary and compulsory winding up respectively, and permit the liquidator to use the powers specified in Schedule 4 of the 1986 Act including, at paragraph 6, the power to *"sell any of the company's property by public auction or private contract, with power to transfer the whole of it to any person or to sell the same in parcels."*

[145] s13 and 14(1) Criminal Law Act 1967
[146] s14(2) Criminal Law Act 1967
[147] Trendtex, at 694(E)
[148] Trendtex, at 703
[149] *Camdex International v Bank of Zambia* [1998] QB 22
[150] *Brownton Limited v Edward Moore Inbucon Limited* [1985] 3 All ER 499
[151] In *Re Longmeade Ltd (in liquidation) [2016] EWHC 356 (Ch)* the property of the company at the commencement of its liquidation included a debt owed to it which subsequently gave rise to a right to claim under a Chapter 11 Plan in the United States and, when that claim was not filed, a right to claim damages from a third party for losses arising from the failure to file. Snowden J expressed a provisional view, without hearing full argument, that it would be very odd if the claim for damages could not be assigned by the liquidator.

Similar provisions apply where a company enters administration[152] or where an individual is made personally bankrupt[153]. The definition of property is found at s436 of the 1986 Act and includes "*money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property*"

As was explained, in the context of an administration, by the Judge in *LF2 Limited v Supperstone* [2018] EWHC 1776 (Ch): "*The administrator's power to assign a cause of action is conferred by paragraph 2 of Schedule 1 to the 1986 Act, as a cause of action is "property" within that paragraph."*

The statutory power to assign bare causes of action in an insolvency context, long pre-dates the 1986 Act. As early as 1880, the Court of Appeal in *Seear v Lawson* (1880) 15 Ch D 426 considered the reasons why a trustee in bankruptcy might wish to assign a claim:

"The proper office of the trustee is to realise the property for the sake of distributing the proceeds amongst the creditors. Why should we hold as a matter of policy that it is necessary for him to sue in his own name? He may have no funds, or he may be disinclined to run the risk of having to pay costs, or he may consider it undesirable to delay the winding-up of the bankruptcy till the end of the litigation."

The Court of Appeal went on to find that the relevant provisions of the Bankruptcy Act 1869[154] permitted the trustee to assign a bare cause of action. In *Re Park Gate Waggon Works Co (1881) 17 Ch D 234,* the Court of Appeal made an equivalent finding in respect of a company in liquidation in reliance on the relevant provisions of the Companies Act 1862[155]. In both *Seear* and *Re Park Gate* the consideration paid by the assignee was not contingent on the outcome of the litigation but in *Guy v Churchill (1888) 40 Ch D 481* the Court decided that a contingent arrangement was permissible. In *Guy* a creditor took an assignment on terms that he would pay 25% of any net recovery to the insolvency estate and Chitty J found that:

[152] Paragraph 60 of Schedule B1 and paragraph 2 of Schedule 1 of the Act
[153] S314(1) and Schedule 5, paragraph 9 of the Act
[154] s4, 17 and 25 Bankruptcy Act 1869
[155] s95 Companies Act 1862

"The policy of the [Bankruptcy Act] appears to be to give power to the trustee, with the sanction of the committee, to make arrangements in reference to choses in action which are considered beneficial to the creditors. It would be a strange and inconsistent result to say that although the right of action may be sold out and out it cannot be disposed of on the terms that some part of the fruit of the action if successful shall come back to the bankrupt's estate for division among his creditors."

Following the coming into force of the 1986 Act, the continued application of the statutory power to assign was confirmed by the House of Lords in *Norglen Limited (in Liquidation) v Reeds Rains Prudential Limited & Ors* [1999] 2 AC 1. In that case, Lord Hoffman[156] explained that:

"The law is traditionally hostile to the assignment of causes of action in return for a share of the proceeds. … The position of liquidators and trustees in bankruptcy is however quite different. The courts have recognised that they often have no assets with which to fund litigation and that in such case the only practical way in which they can turn a cause of action into money is to sell it, either for a fixed sum or a share of the proceeds, to someone who is willing to take proceedings in his own name. In this respect they are of course no different from many other people. But because trustees and liquidators act on behalf of creditors, the courts have for the past century construed their statutory powers as placing them in a privileged position."

Before 2015, the statutory power permitting assignments did not extend to causes of action vested in officeholders by reason of their office. In *Re Oasis Merchandising Services Limited* [1998] Ch 170, the Court of Appeal drew a distinction between: (a) assets which were the property of the company at the time of the commencement of the liquidation (and the property representing the same); and (b) assets which only arose after the liquidation of the company and were only recoverable by the liquidator pursuant to statutory powers (such as fraudulent or wrongful trading claims). It was only the former which fell within the "property of the company" which an officeholder could sell.

[156] Lord Hoffman's judgment provides a different perspective on the reasons for the doctrines of maintenance and champerty as he notes that: "*Judges said that it would encourage malicious suits, but treating such arrangements as criminal was also… an effective way of preventing poor people from obtaining legal redress.*"

The position changed with the coming into effect of s 118 - 119 of the Small Business Enterprise and Employment Act 2015 ("**SBEEA**") which brought s246ZD and s 176ZB of the 1986 Act into force. This measure permitted liquidators and administrators to assign causes of action arising from fraudulent[157] or wrongful trading[158], transactions at an undervalue[159], preferences[160] or extortionate credit transactions[161] with the proceeds of the assignment made available to the insolvent estate and not for the satisfaction of claims by a floating charge holder. Judicial comment in *Re Oasis* anticipated the introduction of s246ZD subject to the officeholder retaining the conduct and control of the officeholder claim[162] but, in the event, SBEEA provided for assignment on an unqualified basis.

As was explained in the Economic Impact Assessment ("**EIA**")[163] accompanying the proposed legislation: "…*not many of these actions have been taken forward in the past. Government intervention is required to ensure that all opportunities are given to officeholders, to recover monies from those individuals who cause loss to creditors (particularly the unsecured creditors) by taking advantage of the privilege of limited liability, where there has been misconduct.*"[164] It was hoped that the legislation would have a deterrent effect[165]. The EIA identified the risk of speculative or opportunistic claims but concluded that: "*this risk should be small as we expect insolvency professionals to have regard to existing professional and ethical standards in judging when to assign causes of action. An assignment of such a claim should also be capable of challenge in court by the person against whom such an action would be brought, i.e. the person aggrieved by such an assignment, e.g. a director.*"[166]

In *Re Totalbrand Ltd [2020] EWHC 2917 (Ch), an application for permission to appeal* (thought to be the first reported case on s246ZD of the 1986 Act),

[157] s213 and s246ZA 1986 Act
[158] s214 and s246ZB1986 Act
[159] s238 1986 Act
[160] s239 1986 Act
[161] s244 1986 Act
[162] "*As a matter of policy we think that there is much to be said for allowing a liquidator to sell the fruits of an action … provided that it does not give the purchaser the right to influence the course of, or to interfere with the liquidator's conduct of, the proceedings. The liquidator as an officer of the court exercising a statutory power in pursuing the proceedings must be free to behave accordingly.*" Re Oasis Merchandising Services Limited [1998] Ch 170
[163] Produced by the Insolvency Service - the government agency responsible for advising ministers and other government departments and agencies on insolvency related issues
[164] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/322337/Enabling_ Liquidators_and_Administrators_to_assign_to_third_parties_certain_rights_of_action_that_only_they_can_bring_under_the_Insolvency_Act_1986.pdf
[165] Ibid - para 29: "*We anticipate that a market in these actions would develop, and increase the prospect of actions being taken against directors more frequently where there has been misconduct. Once directors realise that the threat of action is more likely, long-term changes to behaviour (i.e. less detrimental conduct) could potentially result.*"
[166] ibid - para 79

Snowden J found that the plain wording of the provision envisaged, among other things, "*an outright assignment of the entire right of action and all proceeds to the assignee*". If it were otherwise: "*after the right of action was assigned by a liquidator or administrator, the company would have to be kept artificially alive and the insolvency proceeding kept open whilst the claim was on foot so as to provide a vehicle and mechanism for receipt and distribution to creditors of any proceeds of the action pursued by the assignee.*" Thus, where appropriate, applicable officeholder claims and their proceeds may be assigned outright and efficiencies achieved by early closure of the insolvency proceeding.

Considerations for insolvency practitioners prior to assignment

Whilst English law provides for the assignment of certain causes of action in the insolvency context, assignment will not be the right answer in every case.

1. *The insolvency practitioner's approach to assignment*

Generally, officeholders have a duty to realise the property of an insolvent company or individual for the benefit of creditors but, as was noted in the EIA, the assignment of a cause of action can have consequences for third parties. Thus, additional considerations arise when an officeholder is considering an assignment of a cause of action.

In *Re Papaloizou* [1999] BPIR 106, Browne-Jacobson J, when considering a trustee in bankruptcy's assignment of a bare cause of action back to the bankrupt, sounded a "*note of warning to trustees*". The Judge accepted that the assignment was not contrary to public policy, per se, but thought that: "*trustees should exercise their power to take such a step with great circumspection. It must not be forgotten that by so doing they are enabling the bankrupt to conduct possibly vexatious litigation against third parties who will have no effective remedy in costs against him, since all his assets have been vested in the trustee*". The Judge considered that there should be no assignment unless clear and certain benefits were obtained for creditors. This decision was followed in *Cummings v The Official Receiver* [2002] EWHC 2894 (Ch) where Blackburne J indicated that it was for the bankrupt seeking the assignment to demonstrate that the causes of action were not frivolous or vexatious. In *Dixon v Myers* [2020] EWHC 2803 (Ch), the Judge found that the expression "frivolous or vexatious" was synonymous with the test for summary judgment under Part 24 of the Civil Procedure Rules namely that the claimant has no real prospect of succeeding on the claim and there is no other compelling reason why the case should be disposed of at trial.

In *Hockin v Marden* [2014] EWHC 763 (Ch), the Judge proceeded on the basis that the court should not direct the assignment of a claim if it was frivolous or vexatious including on grounds of public policy. Specifically, that it would be unjust to direct an assignment if the consequence was to submit a third party, the proposed defendant, to being harassed with a claim having no serious prospect of success. Further, the Judge held that the burden was on the prospective assignee to establish that the claim was not frivolous or vexatious.

These authorities were considered by Morgan J, in *LF2 Limited*, who rejected the proposition (based on *Re Papaloizou*) that an administrator was under a positive duty not to assign a cause of action which was without merit. Additionally, Morgan J rejected the proposition that when it is not clear whether the cause of action has merit, the administrator ought not to assign it and should instead place the burden on the party seeking the assignment to demonstrate that the claim is not frivolous or vexatious. Morgan J preferred the findings of the Federal Court of Australia in *Citicorp Australia v Official Trustee in Bankruptcy [1996] FCA 1115*:

"Where a creditor or intervening party contends that an assignment should not be authorised because the proposed claim has no prospect of success it is for that party to demonstrate the absence of any prospect of success. This follows from the general principle that a party who asserts a proposition carries the evidentiary onus of establishing the necessary facts to support it."

In *LF2 Limited*, Morgan J went on to identify, albeit on an obiter basis, a number of principles applicable when administrators are considering an assignment of a cause of action:

- The statutory power (discussed above) permitting an administrator to assign a cause of action was not limited by any words requiring the administrator to be satisfied as to the arguability of an alleged cause of action.

- A viable claim by a company against a third party is an asset of the company. A claim which is arguably viable, is a potential asset of the company and an administrator ought to investigate whether such an asset should be preserved and pursued. If the administrator has no funds with which to take legal advice, it may be open to the body of creditors to provide the necessary funds.

- If the administrator has no funds to investigate a possible claim against a third party and receives an offer from a potential assignee of the claim to pay for an assignment, that offer will potentially constitute an asset of the company. The administrator should normally preserve and pursue that asset.

- If it is clear to the administrator that the claim would be hopeless and that the potential assignee is bent on pursuing a hopeless claim in order to harass a third party, then the administrator should normally decline to assign the hopeless claim. The administrator is an officer of the court and the court expects him or her to behave honestly and fairly. In such a case, the administrator is not required to seek directions from the court.

- If the administrator does not have a clear view that the proposed claim would be vexatious and he or she is offered a sum of money for the assignment of the claim, the administrator should obtain a proper payment for the assignment. If it is not clear that the offer reflects the true value of the cause of action, then the administrator may well be advised to conduct some process of inviting rival bids or to hold an auction of the cause of action.

- Practical considerations and time pressures may need to be taken into account. If there is a high risk that the limitation period for the claim may be about to expire, the administrator may have to issue a protective claim form or conduct swift negotiations to obtain the best available offer for an assignment of the cause of action.

- The administrator's focus should be on realising the assets or potential assets of the company for the benefit of the creditors rather than on protecting a third party from the possibility of being harassed by litigation. If the alleged claim is assigned and the assignee then issues a claim form, the defendant will be able to apply to strike out the claim form or to seek a reverse summary judgment if the defendant wishes to contend that the claim is frivolous or vexatious.

- It is undesirable for the court (when it is dealing with a challenge by a potential assignee to an administrator's refusal to grant an assignment) to have a lengthy hearing as to whether the claim is frivolous or vexatious rather than, save in a clear case, allowing or directing the administrator to assign the alleged cause of action. It is more appropriate for an argument as to whether the claim is frivolous and vexatious to be conducted in the ordinary way between the assignee of the claim and third party (without involving the administrator) rather than between the potential assignee and the administrator (with possible limitations on the part to be played by the third party at any hearing).

Morgan J's remarks in *LF2 Limited* may tend to encourage assignment in all but the most obviously hopeless, frivolous or vexatious cases.

2. *Circumstances in which a cause of action may not be assigned by an insolvency practitioner*

In some cases, a cause of action cannot be assigned by an officeholder and, given the principles discussed in *LF2 Limited*, it will be preferable for this to be identified sooner rather than later. The reasons why a cause of action cannot be assigned include:

- A contractual prohibition against assignment[167].

- In the case of personal insolvency, the cause of action does not vest in the trustee in bankruptcy. In *Heath v Tang* [1993] 1 WLR 1421, Lord Justice Hoffman explained that: "*The property which vests in the trustee includes 'things in action:' see section 436. Despite the breadth of this definition, there are certain causes of action personal to the bankrupt which do not vest in his trustee. These include cases in which 'the damages are to be estimated by immediate reference to pain felt by the bankrupt in respect of his body, mind, or character, and without immediate reference to his rights of property: see Beckham v Drake (1849) 2 H.L.Cas. 579, 604, per Erle J. and Wilson v United Counties Bank Ltd [1920] A.C. 102*". Thus, such personal claims cannot be assigned. However, where a claim is in part personal and in part relates to property (a "hybrid claim"), it will vest in the trustee with the right to recover the damages which are personal and any damages recovered

[167] Ruttle Plant Hire Ltd v Secretary of State for the Environment, Food and Rural Affairs [2007] EWHC 2870 (TCC)

held on a constructive trust for the bankrupt by the trustee[168]. Thus, any assignee of a hybrid claim will necessarily take the assignment subject to the bankrupt's rights pursuant to the constructive trust.

- Whilst SEEBA permitted the assignment of certain specified officeholder claims, other provisions of the 1986 Act are thought to remain unassignable [169]. Further, SEEBA did not provide for the assignment of misfeasance claims pursuant to s212 of the 1986 Act. This provides a procedural mechanism whereby causes of action vested in the company may be pursued by the officeholder. It was thought that a claim for misfeasance was assignable pursuant to the officeholder's statutory power[170] but this has recently been doubted in *Manolete Partners Plc v Hayward and Barrett Holdings Limited* [2021] EWHC 1481 (Ch). s246ZD of the 1986 Act does not apply to personal bankruptcy cases and thus a trustee in bankruptcy cannot assign an officeholder claim. The trustee may be able to assign a share of the damages as an: "*agreement to assign future property (damages if and when awarded)*"[171].

3. *Funding considerations and alternatives*

As was identified in the earliest cases such as *Seear* and, more recently, in *Norglen* a lack of funding may be a reason for an officeholder to consider the assignment of a cause of action. This was discussed in the EIA where reasons for the relatively modest number of officeholder claims in the period between 1986 and 2013 (on average about six cases a year) were thought to include: *"insufficient assets in the insolvency estate with which to fund an action by the officeholder and creditors being reluctant to fund them where that is the case… It may be the case that there is a potential right of action, but it requires additional funds to proceed with the action. There may not be enough monies from asset realisations to fund an action and creditors may be unwilling to fund the action as they have already lost monies due to the insolvency of the company. Since money is limited, officeholders are only likely to proceed with an action where they believe the case has a very good chance of success and they are funded to bring it."*

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[168] Ord v Upton [2000] 2 WLR 755 where the hybrid claim was an action in negligence for personal injuries including a claim for general damages for pain and suffering, the personal claim, and a claim for loss of earnings which was property forming part of the bankruptcy estate.
[169] Sealy & Milman: Annotated Guide to the Insolvency Legislation 24th Ed. - 2021: "*Other sections of IA 1986 which are sometimes mentioned in the cases as possibly being unassignable have (it is submitted, rightly) been omitted: to have a post-petition disposition of property declared void under s.127, or a floating charge declared void under s.245.*"
[170] *Re Totalbrand Ltd [2020] EWHC 2917 (Ch)*
[171] *Re Oasis Merchandising Services Limited* [1998] Ch 170

If insufficient funds are available in the insolvent estate to fund the pursuit of a cause of action, the officeholder may wish to consider alternative means of funding before proceeding to an assignment. Such means of funding might include: (i) creditor funding - particularly where there is a deep pocket, majority creditor with an appetite for litigation; (ii) third party funding from a commercial litigation funder - this type of funding is well established in the English market; (iii) alternative funding arrangements with legal or other advisers; (iv) after the event insurance to meet adverse costs risk (see further below); or (v) a combination of (i) to (iv). In some cases, alternative means of funding may provide a better outcome for creditors generally than an assignment of the claim.

4. *Cost implications*

If alternative means of funding are not available or are not available on acceptable terms, assignment may be a more attractive option. However, an officeholder will need to give careful thought to the costs implications of an assignment.

In England & Wales, the "loser pays" principle applies in litigation. In very broad terms, if a party wins, it will recover a proportion of its costs from the losing party but if it loses, it should expect to pay the majority of the winning party's costs.

Pursuant to *section 51(1), Senior Courts Act 1981*, the English court has a wide discretion as to costs including full power to determine by whom and to what extent the costs are to be paid. This includes the ability to make a third party costs order i.e. an adverse costs order against a non-party to the proceedings.

If a cause of action is assigned outright (i.e. for a fixed price) the assignor will not be exposed to a third party costs order and the resulting liability for the costs of any action taken by the assignee. This outcome provides the officeholder with the greatest certainty as to the amount of the recovery and the costs exposure[172] but may not elicit the best price. If the cause of action

[172] Where an adverse costs order is made against an insolvent company, such costs are payable as an expense and rank in priority ahead of the officeholders' remuneration. *Re MT Realisations Ltd [2003] EWHC 2895*

is assigned on terms that the assignor retains an interest in the proceeds of the cause of action (for example by taking a percentage share of any recovery) it is possible that a third party costs order could be made against the assignor. Notwithstanding the cost risk, if the claim is ultimately successful, a better recovery may well be achieved by the assignor retaining a share of the proceeds.

5. Realising value

As a matter of English law, the function of a liquidator is to get in and realise the assets of the company and distribute the proceeds to the company's creditors[173] and a trustee in bankruptcy has a corresponding function[174]. Administrators owe overriding duties to the company's creditors and are required to seek to achieve the purposes set out in para 3 of Sch. B1 of the 1986 Act[175]. An officeholder owes a duty to exercise reasonable care and skill in the performance of their functions to the standard of an ordinary, reasonably skilled and careful insolvency practitioner[176]. Further, when disposing of assets, officeholders are under a duty to obtain the best price reasonably obtainable[177].

Particular challenges can arise when an officeholder seeks to realise value in a cause of action. In *Faryab v Smith* [2000] 12 WLUK 340 Robert Walker LJ noted that: "*the realisation of a cause of action (especially a cause of action of some complexity) is a different matter and less obviously a matter for business common sense than the realisation of more conventional assets such as freehold or leasehold property, stock in trade or other tangible moveable property).*" The Judge went on to stress the importance of obtaining legal advice stating that: "*in a case of this sort involving the evaluation of a complex claim, [the trustee in bankruptcy] badly needed independent legal advice and, through no fault of his own, he was unable to obtain it. His own evaluation of the merits of the claim was, in my view, inadequate.*"

Such legal advice (including as to merits, quantum, the risks on enforcement, costs and assignability) will be an important factor in the assessment of whether the claim can and should be: pursued, using funds from the estate

[173] S107 and 143 of the 1986 Act
[174] Ibid at s 305
[175] *PJSC Uralkali v Rowley [2020] EWHC 3442 (Ch)*
[176] See for example, *Re One Blackfriars Limited (in Liquidation)* [2021] EWHC 684 (Ch) at paragraph 205
[177] Ibid

or alternative means of funding; assigned and on what terms including as to price; or abandoned. In carrying out that assessment, the officeholder will take into account factors such as: (i) whether the funds in the insolvent estate are sufficient to meet the costs of the action and the adverse costs risk; (ii) the "price" associated with and availability of any alternative means of funding, however structured; (iii) the terms of any offer to take an assignment to include the adequacy of any indemnity as to costs; (iv) whether the merits, expected return and recovery risk warrant the costs and costs risk associated with the pursuit of the claim and, in particular whether the anticipated costs are proportionate to the sums in dispute; (v) whether the advice on the merits, quantum and the recovery risk is caveated due to factual or other uncertainties; and (vi) the anticipated return to creditors.

In order to elicit offers to take an assignment, officeholders may approach stakeholders such as a company's creditors, shareholders and directors. Further, officeholders operating in the English market commonly approach the well-established third party firms whose business model involves purchasing and pursuing claims. Additionally, the defendant / prospective defendant may have an interest in acquiring the claim. In *Re Edennote* [1996] BCLC 389, the Court of Appeal held that the office holder should have invited offers from such a defendant.

If the officeholder receives an offer for the assignment of the claim but it is not clear that the offer reflects the true value of the cause of action, the officeholder may well be advised to conduct a process of inviting rival bids or holding an auction of the cause of action[178]. In an appropriate case, the process of testing the market by holding an auction may make it reasonable to proceed without seeking valuation advice, particularly where the claim is a difficult one to value[179]. In the course of any bidding process, all of the parties should be provided with the same information to avoid a challenge based on material unfairness in the conduct of the bidding[180]. An officeholder may wish to specify that he or she will not necessarily accept the highest or any bid. This enables the officeholder to look at the offer in the round and consider factors other than price such as the costs risk, any offer of indemnity and the strength of the indemnity. Following the coming into force of s120 SBEEA, there are no longer any requirements for court or creditor sanction relevant

[178] LF2 at paragraph 67
[179] *Re Meem Limited (in Administration)* [2017] EWHC 2688 (Ch)
[180] *Hellard v Michael* [2009] EWHC 2414 (Ch)

when an officeholder is granting an assignment but the officeholder may well take the opportunity to consult creditors. Further, the officeholder should document the process adopted to realise the value in the cause of action.

Legal Position in India

As a matter of Indian law, an 'actionable claim' can be transferred, however, a 'mere right to sue' cannot be transferred.

An 'actionable claim' is defined in Section 3 of the Transfer of Property Act, 1882 ("**TPA**"), as a claim to (a) unsecured debts or (b) beneficial interest in movable property not in possession of the transferor, whether present or future, conditional or contingent.

An actionable claim is considered a specie of property. Section 5 read with Section 8 and Section 130 of the TPA permits transfer of an actionable claim by execution of an instrument in writing signed by the transferor or his duly authorised agent. Once such instrument is executed, all the rights and remedies of the transferor, whether by way of damages or otherwise, vests in the transferee and the transferee can sue or institute proceedings for the same in his own name without obtaining the transferor's consent to such suit or proceeding and without making him a party. Section 131 of the TPA mandates that every notice of transfer of an actionable claim shall be in writing, signed by the transferor or his agent duly authorised in this behalf, or, in case the transferor refuses to sign, by the transferee or his agent, and shall state the name and address of the transferee.

As discussed by J Rankin in *Messrs. Sadasook Ramprotap vs Hoare Miller and Co*[181], Section 130 has features of both English common law and equity. The learned judge observed:

"*In construing Sections 130 and 131 of the Transfer of Property Act, it has to be remembered that they contain a very special scheme which must be regarded as a whole in itself. At common law a chose in action was not assignable, in equity it was freely assignable upon certain principles as to notice. The Indian Legislature in 1900 has composed a new scheme which has some of the features of both, and, as I read Section 130 it says this that the law, while regarding the transfer of an actionable claim as valid if effected*

[181] 80 Ind Cas 632

in a certain manner, will not undertake to enforce against a debtor the assignment except upon the terms that the debtor may arrange with his original creditor unless and until he has received in writing a particular kind of notice."

There is a robust body of case law on what constitutes an actionable claim. A claim to an unsecured debt is included within the definition of actionable claim. A debt though not defined in TPA is well understood as an obligation to pay a liquidated or certain sum of money. On the other hand, a beneficial interest in moveable property will include a right to recover insurance money or a partner's right to sue for an account of a dissolved partnership or a decretal debt or a right to recover the insurance money or the right to claim the benefit of a contract not coupled with any liability.[182] Claims held by Indian courts to be actionable claims include claims for arrears of rent[183], claim for future rent[184], benefit of an executory contract[185],, right to receive dividends on a share in a company.[186]

Section 130 needs to be read with Section 6 of the TPA which states that property of any kind may be transferred, except as otherwise provided by law. Section 6 (e) provides that a mere right to sue cannot be transferred. Prior to its amendment in 1900, the clause provided that "*a mere right to sue for compensation for a fraud or for harm illegally caused cannot be transferred*". However, by way of an amendment section 6 (e) was amended to prohibit transfer of "*a mere right to sue*" and not just transfer of a mere right to sue for fraud or for harm illegally caused. Hence the scope of Section 6 was expanded and while an actionable claim can be transferred as per Section 130 of the TPA, a mere right to sue cannot be transferred. The genesis of this provision is the rule against champerty in maintenance.

As held by the Supreme Court in *Union of India v. Sri Sara Mills Ltd*[187], an assignment of property is valid even though that property may be incapable of being received without litigation. However, a bare right of action for damages, be it under contract or tort is not assignable because, the law will not recognise any transaction which may savour of maintenance of champerty. It is only when there is an interest in the subject- matter that a transaction can be saved from the imputation of maintenance. That interest

[182] *Union of India v. Sri Sarada Mills Ltd*, 1973 SCR (2) 484
[183] *Daya Debi v. Chapala Debi*, AIR 1960 Cal 378
[184] *Chidambaram Pillai v. Doraiswamy Chetty*, AIR 1916 Mad 974
[185] *Jahar Mehr Ali v. Budge-Budge Jute Mills*, ILR 34 Cal 289
[186] *Daya Bai v. Amba Lal*, AIR 1981 SC 156
[187] *Union of India v. Sri Sarada Mills Ltd*, 1973 SCR (2) 484

must exist apart from the assignment and to that extent must be independent of it. When the right of action is one of the incidents attached to the property or contract assigned it will not be treated as a bare right of action.

In *Gangaraju vs. Gopala*[188], the Full Bench of the Andhra Pradesh High Court examined whether a transfer of the right to recover profits which, arose out of land along with a transfer of the land itself is hit by Section 6(e) of the TPA. The Court observed that the real reason why equity did not allow the assignment of 'a bare right of action' was on the ground that it was likely to lead to maintenance. The Court added that:

"*…soon an exception to the rule of a bare right of action being assignable came to be recognised. This exception provides that a right of action may be assigned if it be incidental or subsidiary to a conveyance of property. From the aforesaid historical background it is clear how closely Section 6(e) of the Transfer of Property Act, which provides that a mere right to sue cannot be transferred is associated with the exception of the bare right of action not being assignable. It is equally clear that the provision being aimed against transactions which according to English Law would amount to champerty and maintenance, whenever a transaction be free of such a charge it would be valid…".*

The Court also recognized that "*the doctrine of champerty and maintenance not having been fully adopted in this country, Section 6 (e) of the Transfer of Property Act should not be extended beyond that it was intended to prohibit*" and that Section 6 (e) of the TPA should not cover that assignment of the right to recover profit, which is supported by the alienation of the property out of which the profits arose, and is sufficiently connected with the enjoyment of the property.

The distinction between what constitutes assignment of actionable claim and what constitutes assignment of a mere right to sue on a claim has been examined in many cases by Indian courts. For instance, benefits under a contract are considered actionable claims and can be assigned, a mere right to sue for damages in case of breach of the contract is not considered an

[188] *Gangaraju Vs. Gopala* AIR 1957 AP 190

actionable claim and hence cannot be transferred in light of Section 6 (e) of the TPA.[189] Where a property is transferred along with the right to recover damages or compensation in respect of that property, the assignment of that right is valid and is not hit by Section 6 (e) of the TPA.[190]

In the context of insolvency

Under Section 3 (27) of the IBC, “property” includes actionable claims. Section 35 (b) empower and mandates the liquidator to take into his custody or control, all the assets, property, effects and actionable claims of the corporate debtor. Section 36(3)(f) provides that the liquidation estate shall comprise any asset or their value recovered through proceedings for avoidance of transactions.

Liquidator also has the power and duty, under Section 35 (f), to sell, subject to Section 52 of the IBC, the immovable and movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract to a person who is not disqualified under Section 29A of the IBC.

This is similar to the position under the Companies Act, 1956 where the liquidator had the power to sell *inter alia* actionable claims of the company in liquidation.

Hence, actionable claim, as a specie of property, can be assigned or transferred by the liquidator under the IBC following the mode and manner of sale prescribed under the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 (“**Liquidation Regulations**”). The liquidator can sell such actionable claims as part of the overall company or business (in case of sale of company as a going concern or sale of business as a going concern). She could also sell actionable claims separately, as a specie of property of the corporate debtor. So long as the corporate debtor has a claim that is an actionable claim and not a mere right to sue, the same can be assigned by the liquidator in accordance with Section 130 of the TPA and the principles that apply to meaning and transfer of actionable claim in a non-insolvency situation would equally apply in case of sale of actionable claim by the liquidator.

As far as sale of actionable claims during the corporate insolvency resolution process (“**CIRP**”) is concerned, there is a moratorium on disposal of assets by the corporate debtor under Section 14 of the IBC, unless the disposal is in

[189] *Union Of India vs Raman Iron Foundry*, 1974 SCR (3) 556
[190] *Murlidhar Agarwalla v. Rupendra Methere*, AIR 1953 Cal 321

ordinary course of business or is under Regulation 29 of the Insolvency and Bankruptcy Board of India (Corporate Insolvency Resolution Process) Regulations, 2016 (which provides for sale outside the ordinary course if necessary for better realisation subject to certain conditions, including approval of committee of creditors). Hence, transfer of actionable claims by the resolution professional during CIRP has limited relevance, except in relation to transfer of claims for preferential transactions[191], undervalued transactions[192], fraudulent transactions[193], extortionate credit transactions[194] and claims for fraudulent or wrongful trading[195] ("**officeholder claims**", discussed later).

The resolution professional as well as the liquidator have the power and duty to institute and/or continue suits and proceedings on behalf of the corporate debtor,[196] though liquidator is required to take prior approval of the National Company Law Tribunal ("**NCLT**") before instituting a suit or other legal proceeding on behalf of the corporate debtor[197]. Hence, in ordinary course, the resolution professional and the liquidator would be expected to take action, i.e. institute or continue (where already pending), proceedings in relation to causes of action.

In fact, in cases of winding up under Companies Act, 1956 (prior to the IBC), the official liquidator would take out proceedings for actionable claims and while there are precedents relating to transfer of property rights (such a tenancy or leasehold rights) by official liquidator in liquidation, there are limited precedents of official liquidator assigning actionable claims in liquidation under the Companies Act, 1956.

However, the liquidation regime under the IBC is different. The liquidation process is run by an insolvency practitioner (and not by official liquidators). The liquidators are facing tremendous cost constraints in even covering their own costs, leave alone costs involved in pursuing causes of action on behalf of the corporate debtor. Also, unlike winding up regime under the Companies Act, 1956, the liquidation process under the IBC is time bound. The liquidator is expected to complete the liquidation process within one year of liquidation commencement date unless this period is extended by the NCLT. Pursuit of

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[191] Section 43
[192] Section 45
[193] Section 49
[194] Section 50
[195] Section 66
[196] Section 25 (2) and Section 35
[197] Section 33 (5)

causes of action by the liquidator herself would require time and money, both of which are in short supply during liquidation. Hence, it is desirable for the liquidator to sell the actionable claims and close the liquidation process as quickly as possible.

However, there may be causes of action which do not fall within the category of actionable claim and instead be considered as ‘mere right to sue’ (for instance any litigation by the corporate debtor for damages in tort). Such claims would not be assignable by the liquidator and hence, where there are proceedings/ suits pending in respect of such claims, proceedings/ suits may need to be closed by the liquidator before dissolution. Similarly, there will be causes of action that vest in the resolution professional or liquidator by virtue of their office (example officeholders claims). These claims may also fall within the category of ‘mere right to sue’ and hence may not be assignable on account of prohibition under Section 6 (e) of the TPA, unless the IBC makes an overriding exception allowing assignment of such claims.

Amendment to Liquidation Regulations

In August 2020, IBBI came out with the ‘Discussion Paper on Corporate Liquidation Process’ inviting comments on its proposed amendment to the Liquidation Regulations in respect of assignment of ‘not readily realisable assets’ (“NRRA”). In the paper, IBBI recognised that the liquidation estate also consists of assets which may require an indefinite time for their realisation on account of peculiar nature of such assets or special circumstances. Such assets fall in the category of sundry debts, including refunds from Government and its agencies; contingent receivables, disputed receivables, sub-judice receivables, disputed assets (where, for example, legal ownership is not clear), and assets underlying avoidance transactions.

IBBI recognised that presence of NRRAs in the liquidation kitty is detrimental to attainment of the objective of time bound closure of liquidation process as envisaged under the IBC and creates a situation of stalemate as realisable amount remains, at best, a guesstimate. IBBI also recognised that lack of funding for meeting the legal expenses involved in realisation of NRRA by the liquidator itself and the delay and uncertainty in realisation is a major hurdle in unlocking value in the assets. Hence, it is worth considering assignment of NRRA for whatever amount, the market is willing to pay, and distribute the same among stakeholders and close the liquidation process.

Various options along with checks and balance and principles to be followed by the liquidator for assignment of NRRAs were discussed in the paper. After receiving comments on the draft regulations, IBBI issued an amendment to the Liquidation Regulations and added Regulation 37A to the Liquidation Regulations.

Regulation 37A defines NRRA as any asset included in the liquidation estate which could not be sold through available options and includes contingent or disputed assets and assets underlying proceedings for preferential, undervalued, extortionate credit and fraudulent transactions referred to in sections 43 to 51 and section 66 of the IBC.

Regulation 37A provides that a liquidator may assign or transfer a NRRA through a transparent process, in consultation with the stakeholders' consultation committee for a consideration to any person, who is eligible to submit a resolution plan for insolvency resolution of the corporate debtor.

Hence Regulation 37A provides a framework for assignment of NRRA in liquidation, many of which would fall within the meaning of causes of action and/or actionable claims. As discussed, dehors the Liquidation Regulations, Liquidator has the power to assign actionable claims. Importantly, the definition of NRRA includes contingent and disputed assets and assets underlying proceedings for preferential, undervalued, extortionate credit and fraudulent transactions referred to in sections 43 to 51 and section 66 of the IBC. Hence NRRA is a 'property' of the CD, either in the form of immovable or movable asset (subject in some cases to avoidance proceedings) or in the form of an intangible right or an actionable claim.

However, a mere right to sue is still not assignable on account of prohibition under Section 6 (e) of the TPA and hence, claims of the company/ liquidator which fall within such category, such as claims for fraudulent or wrongful trading under Section 66 may still be barred irrespective of Regulation 37A. Further, any claim that CD had which falls within mere right to sue (for instance any litigation by CD for damages in tort) would also not be assignable by the liquidator. In such circumstances, if such cases are pending, they will need to be closed before dissolution.

As discussed, the doctrine of champerty and maintenance has not been fully adopted in India and hence, Section 6 (e) of the TPA should not be extended beyond that which it was intended to prohibit. The rule has its genesis in public policy and in insolvency context, where the liquidation estate needs to be liquidated, the amounts distributed to the stakeholders and CD dissolved in a time bound manner, assignment of claims under all pending proceedings and assignment of officeholder claims should not offend any public policy. Rather, allowing such assignments would promote the objective of the IBC, being maximization of value of the assets of the CD in a time bound manner.

However, given the nature of claims involved, as well as challenges that are bound to arise in valuation of such claims for purpose of sale, the regulator should provide a framework for assignment of such claims. Some of the framework has in fact been provided under Regulation 37A which provides for oversight of stakeholder consultation committee.[198]

Another issue that ought to be considered is the possibility of assignment of officeholder claims by the resolution professional in case of resolution of the corporate debtor. This may be achieved through the mechanism of a resolution plan and the assignment could be in favour of creditors or resolution applicant. It has been seen that such claims often remain unadjudicated by the time a resolution plan is approved by the NCLT and the creditors seldom get benefit of these proceedings. Even where adjudicated by NCLT prior to approval of the resolution plan, there may be an appeal filed against the order of the NCLT which remains pending at the time of approval of the resolution plan. Further, upon approval of the resolution plan by the NCLT, the resolution professional becomes *functus officio.* After the judgment of the Delhi High Court in Venus Recruiters[199], unless the resolution plan provides for it, the resolution professional is not permitted to continue with such proceedings after approval of the resolution plan. It is also seen that resolution professionals do not have any support, especially in form of funds for pursuing these proceedings after approval of the resolution plan. In such circumstances, it is desirable that a framework of assignment of claims under such proceedings be provided.

Recently, IBBI has released a consultation paper on issues related to reducing delays in the corporate insolvency resolution process. The consultation paper recognizes that according to information available as of 28 February 2022 with the IBBI, 708 applications in respect of avoidance transactions valued at around INR 200,000 crore have been filed with the NCLT and of these, only a handful of applications have been disposed of by the NCLT and few appeals have been filed against the orders of the NCLT

[198] This committee comprises of representatives of various stakeholders of the corporate debtor. The committee is purely consultative.
[199] M/s Venus Recruiters Pvt Ltd Vs Union of India & Others, W.P.(C) 8705/2019

disposing these applications. Several such applications are pending even after approval and implementation of resolution plan. The IBBI considered by whom and how the applications would be taken to logical conclusion and has suggested an amendment to the Insolvency and Bankruptcy Board of India (Corporate Insolvency Resolution Process) Regulations, 2016 requiring that the resolution plan should provide for the manner in which proceedings in respect of avoidance transactions or fraudulent or wrongful trading will be pursued after the approval of the resolution plan.

Lessons from UK Law

Both under English and Indian law, a claim is considered the property of the insolvent/ bankrupt and can therefore be assigned by the liquidators for value, for the benefit of the creditors. However, English and Indian law differ when it comes to assignment of a cause of action which is a bare right to litigate divorced from any transfer of property in the insolvency context.

While prohibition on assignment of mere causes of action stems from rule against unlawful maintenance and champerty, English law recognises the special position of liquidators, administrators and trustees and has given them statutory powers to assign bare causes of action in an insolvency/ bankruptcy context. Before 2015, in UK, this statutory power only extended to assignment of causes of action that were vested in the company at the time of winding up and did not extend to causes of action vested in the administrators or liquidators by reason of their office, such as causes of action arising from avoidance transactions or fraudulent or wrongful trading (i.e. officeholder claims). In 2015, with an amendment in 1986 Act through SBEEA, administrators and liquidators were permitted to assign even officeholder claims on an unqualified basis.

On the other hand, in India, while the doctrine of champerty and maintenance has not been fully adopted, Section 6 (e) of the TPA prohibits transfer of mere right to sue. There is no specific exception recognized in the context of insolvency, either for assignment of bare causes of action vested in the company at the time it enters formal insolvency or for officeholder claims that vest in resolution professional or liquidator.

There are various reasons why a resolution professional or liquidator would wish to assign or transfer actionable claims as well as bare causes of action and officeholder claims. The resolution professional or liquidator often would not have funds to take action on such claims and are loath to spend money where the outcome is uncertain and protracted. Further, given that liquidation is a time bound process, there needs to be a mechanism for assignment of the claims under pending proceedings so that the liquidator has immediate funds to for distribution and can dissolve the company expeditiously. In a resolution process, the resolution professional may wish to assign officeholder claims where such claims remain unadjudicated at the time of approval of the resolution plan.

Since assignment of some of these claims may be prohibited under Section 6 (e) of the TPA, the IBC should be amended to permit: (a) assignment of bare causes of action; (b) assignment of officeholder claims, notwithstanding the TPA.

Further, whilst law should allow assignment of causes of action by the resolution professional and liquidator, assignment may not be the right answer in every case. Many lessons can be drawn from judicial precedents in the UK, on approach that should be followed by the resolution professional and liquidator before proceeding to assign a cause of action. Some of these are:

- The resolution professional/ liquidator should identify all present and potential causes of action that the company may have and the defendant(s) that are or will be parties to the cause of action.

- Where the claim is viable, the resolution professional/ liquidator should investigate whether the same should be pursued by her as opposed to assigning the claim to a third party. In the context of resolution process, the resolution professional would also need to keep in mind the moratorium on disposal of assets, except where disposal is in ordinary course or in accordance with Regulation 29 of the Insolvency and Bankruptcy Board of India (Corporate Insolvency Resolution Process) Regulations, 2016.

- There are various factors that the resolution professional/ liquidator may consider while taking a decision on assignment – such as - whether she has sufficient funds to investigate and pursue the claims on her own, the potential time it would take to recover the claims, whether there are any restrictions on assignment such as contractual prohibition on assignment. The resolution professional/ liquidator should also consider limitation issues and whether she needs to take immediate steps (even before assignment) to preserve the limitation period for the claim.

- If there are insufficient funds for the resolution professional/ liquidator to pursue the cause of action on her own, the resolution professional/ liquidator may wish to consider alternative means of funding before proceeding to an assignment, such as approaching creditors for funds or third-party funding. As the market for third-party litigation funding gets developed in India, this may prove to be a better alternative in some cases as opposed to outright assignment of claims.

- If even the alternate means of funding is not available, assignment of a cause of action should be considered. Various forms of assignment may be considered by the resolution professional/ liquidator such as outright assignment for a fixed price or assignment where company retains an interest in the proceeds of the cause of action. The resolution professional/ liquidator should consider which of these would be more suitable for assignment of a particular cause of action. For instance, where the resolution professional/ liquidator believes that the relevant proceedings will take a long time to close or where there is a risk of third party costs order, an outright assignment may be more desirable. On the other hand, where the claim is of high value and likely to be decided in a short time, a better recovery may well be achieved by the assignor retaining a share of the proceeds.

- The resolution professional/ liquidator should evaluate if the claim is frivolous or vexatious. However, their focus should be value maximisation for the benefit of the creditors rather than on protecting a third party from the possibility of being harassed by litigation. The resolution professional/ liquidator should decline assignment only if it is clear that the claim is hopeless and that the assignee may pursue the claim only to harass a third party.

- The assignment of causes of action should not require court (i.e. NCLT) consent and this should be left to the wisdom of the resolution professional/ liquidator. However, there should be some oversight over resolution professional/ liquidator decision on assignment. During insolvency resolution, assignment of causes of action may be made subject to committee of creditors approval and during liquidation, subject to consultation of stakeholder consultation committee.

- Specifically in the context of insolvency resolution process, resolution plan should provide a mechanism for who will pursue the officeholder claims. The resolution plan may provide for a mechanism for either retention of officeholder claims or its assignment to resolution applicant or the committee of creditors. Such mechanism can then be discussed and voted on by the committee of creditors as part of approval of the resolution plan.Resolution professional/ liquidator should take independent legal advice including on the merits, quantum and costs of the claim and consider the enforcement risk while assessing if the claim can and should be pursued, abandoned or assigned and if assigned, on what terms.

- In order to elicit offers to take an assignment, officeholders may approach stakeholders such as a company's creditors, shareholders and directors or third-party funders. Additionally, the defendant / prospective defendant may have an interest in acquiring the claim. However, the assignee must be disqualified under Section 29A of the IBC.

- Challenges are likely to arise in relation to valuation of the cause of action and there may not be enough expertise to properly evaluate a complex claim. The resolution professional/ liquidator should consider the need for valuation advice and also an auction or other competitive bidding process to elicit the best price for the assignment. Since the assignment of causes of action may have terms other than price (such as indemnities which may be provided by the assignee to the officeholder in case of adverse cost order), the officeholder should not be obligated to accept the highest odder. In all cases, the officeholder should document the process adopted to realise the value in the cause of action.

- The resolution professional/ liquidator should consider form of assignment and ensure that the same is in writing and in proper legal form. The resolution professional/ liquidator should also consider the need for indemnities against adverse costs and whether to seek fortification of the indemnity.

There is no gainsaying that assignment of choses in action can create value for the creditors and can help in early closure of the liquidation process. A legal and regulatory framework to facilitate such assignment is desirable in India. Lessons from the United Kingdom would be invaluable for developing a robust regime for India.

ADR Techniques in Resolution Process

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Abstract

This paper provides an overview of Singapore's insolvency regime, focusing on the key aspects of corporate insolvency in the categories of liquidation, schemes of arrangement, judicial management and receivership. In particular, new features relating to the scheme of arrangement and compromise procedure under the Insolvency, Restructuring and Dissolution Act are highlighted.

The second part of this paper discusses alternative dispute resolution in Singapore, in particular mediation and arbitration. The paper discusses mediation and arbitration in the general context as well as application in the insolvency context. Where relevant, challenges in relation to the use of alternative dispute resolution (ADR)in the insolvency context are also discussed.

Overview of Singapore Insolvency Law

Introduction

Insolvency law in Singapore is broadly divided into personal insolvency (or bankruptcy) and corporate insolvency. The primary source of legislation governing these areas is the Insolvency, Restructuring and Dissolution Act 2018 (the "**IRDA**"), as supplemented by various subsidiary legislation and by the Companies Act. Previously, personal insolvency and corporate insolvency were governed primarily by the Bankruptcy Act and the Companies Act respectively, although certain aspects of the Bankruptcy Act also applied to corporate insolvency. The IRDA consolidates Singapore's personal and corporate insolvency and debt restructuring laws, modernises the law on corporate insolvency, and strengthens the various debt restructuring regimes to provide greater opportunity for the rehabilitation of companies in financial distress. Corporate insolvency can broadly be divided into the following four categories: liquidation, schemes of arrangement, judicial management and receivership. The focus of this article is on corporate insolvency, rather than personal insolvency.

Liquidation

"Liquidation" or "winding up" refers to a process where the assets of a company are collected and realised. The resulting recoveries are used to pay the company's liabilities, with any surplus going to the shareholders. In the distribution of the company's assets among the non-preferential unsecured creditors of the company, the rule is usually distribution on a pro-rata or *pari passu* basis. The result of liquidation or winding up is usually the dissolution of the company.

There are two main types of liquidation: voluntary and compulsory. The main difference lies principally in the manner in which the liquidation process is initiated and the date of its commencement pursuant to the IRDA:

- For a voluntary liquidation, the company generally initiates the process by passing a resolution in a general meeting of shareholders to liquidate the company.

- For a compulsory liquidation, the company, or some other party with the right (such as a creditor), initiates the process by making an application to the court to liquidate the company. The IRDA provides a list of grounds upon which the court may make an order to wind up a company, including that the company is “unable to pay its debts”.

Regardless of whether a liquidation is voluntary or compulsory, a number of consequences will follow once the process has commenced. In general, the consequences include the following:

- The company's business will generally cease. However, the liquidator may continue the company’s business if it is necessary for the beneficial winding up of the company.

- Generally, the directors' powers cease upon commencement of liquidation and the appointment of the liquidator.

- Every invoice, goods order or business letter is to include the words "in liquidation" after the company's name to serve as a notice to all those dealing with the company.

- Any disposition of the property of the company made after the commencement of a compulsory liquidation shall be void unless the court otherwise orders. Any transfer of shares or alteration in the status of the members will also generally be void.

- There is a moratorium on legal proceedings after the commencement of winding up.

- The liquidator is armed with certain powers to clawback claims in relation to properties which have been transferred to third parties.

- To avoid the consequences of winding up, an insolvent company has three options. It can attempt to enter into a scheme of arrangement and compromise with its creditors, enter into an arrangement with its creditors under section 187 of the IRDA, or seek to be put under judicial management.

Schemes of Arrangement and Compromise

Under a scheme of arrangement and compromise, a company must formulate a scheme proposal for consideration by its creditors. Typically, this will include a proposal for a compromise of the company's debts by way of various methods, such as payment of a reduced amount or issuance of equity for debt, etc. The company must then seek the court's approval to call a meeting of its creditors. If approval is granted, the meeting of creditors will be held and the creditors will consider the proposal and vote on it. At least three-fourths majority in value and a majority in number of the creditors or class of creditors present and voting must approve the scheme (unless the court orders otherwise).

If the requisite majority in number and value of creditors or class of creditors approve the scheme, in order for the scheme to become binding, the court must sanction the scheme. In making such a decision, the court will consider relevant factors including whether the statutory requirements to effect a scheme have been complied with, whether sufficient information has been provided to the company's creditors, whether the creditors were properly grouped in the relevant classes (if at all) for purposes of voting, whether the terms of the scheme are reasonable and whether the terms of the scheme discriminate unfairly against any creditor or class of creditors. If the court sanctions the scheme and the order sanctioning the scheme is filed with the Accounting and Corporate Regulatory Authority, it becomes binding between the debtor company and its creditors. A scheme can also be sought in a judicial management.

On 23 May 2017 and on 30 July 2020, new provisions came into force aimed at enhancing Singapore's restructuring framework and status as a centre for international debt restructuring, including provisions adapting parts of Chapter 11 of the United States Bankruptcy Code. Key provisions include:

Ipso Facto Clause Restrictions: New provisions prohibit a party from terminating a contract with an insolvent company, or from taking certain actions, e.g. terminating or modifying any rights or obligations, or accelerating payment (by relying on a contractual provision), by reason of the company's insolvency or commencement of scheme of arrangement or judicial management proceedings ("ipso facto clause(s)"). The above prohibition does not affect parties from terminating contracts or taking certain actions (i) for reasons which do not rely on insolvency or the commencement of scheme or judicial management proceedings (e.g. by relying on a substantive payment or performance default), (ii) prior to the commencement of scheme or judicial management proceedings, or (iii) if the contract or company in question falls within a prescribed list of carve-outs which the above ipso facto clause restrictions are deemed not to apply to.

Moratorium: There is a limited automatic moratorium in certain circumstances and the court may further order a moratorium in favour of a company that is proposing or intends to propose a new scheme, preventing creditors from, among other things, taking action against the company and giving the company breathing room to put forward its restructuring proposal. This moratorium may extend to holding companies or subsidiaries of the company proposing or intending to propose a new scheme, and may also restrain certain creditors from taking action against the company outside Singapore.

Cram-Down Provisions: Previously, the court could only sanction a scheme if the requisite majority approval had been obtained from all classes of creditors. Under the new cram down provisions, the court may approve a scheme even if there are dissenting creditor classes, provided that: (a) a majority in number of creditors who are meant to be bound by the compromise or arrangement and who were present and voting (either in person or by proxy) at the relevant meeting, and representing three-fourths in value of those creditors, must have agreed to the compromise or arrangement; and (b) the court must be satisfied that the compromise or arrangement does not discriminate unfairly between two or more classes of creditors, and is fair and equitable to each dissenting class. The new provisions prevent a minority dissenting class of creditors from unreasonably frustrating a restructuring that benefits creditors as a whole.

Priority for Rescue Financing: The court is empowered, subject to certain safeguards, to order that rescue financing be given equal or super priority. This power is found in section 67 of the IRDA which permits the Singapore court to make any of several orders, essentially giving priority to rescue financing in the event of the company's winding up as follows:

- as if it were part of the costs and expenses of winding up; priority over all preferential debts and unsecured debts, if the company could not have obtained the rescue financing unless this priority is given;
- security on property that is not otherwise subject to any security, or subordinate security on property subject to existing security, if without such security the rescue financing could not be obtained; and
- to have the same or higher priority security than an existing security if without such security the rescue financing could not be obtained and there is adequate protection for the interests of the holder of the existing security.

Pre-packaged Scheme: The court may approve, subject to certain safeguards, a compromise or an arrangement proposed by a company without a meeting of the creditors being ordered to be summoned by the Singapore court or held by the company, if it is satisfied that had such a meeting of creditors been summoned, the requisite majority of creditors would have approved the compromise or arrangement.

Arrangement with Creditors under Section 187 of the IRDA

An option that bears some similarity to a scheme of arrangement and compromise is the procedure under section 187 of the IRDA which states that any arrangement entered into between a company about to be or in the course of being wound up and its creditors shall, subject to the right of appeal under this section, be binding on the company if sanctioned by a special resolution, and on the creditors if acceded to by at least three-fourths majority in value and a majority in number of the creditors, with every creditor for under $50 being reckoned in value only.

The advantage of this procedure is that no application to court for the sanction of the arrangement is necessary, unlike in the case of a scheme of arrangement and compromise. That said, this option is rarely used in practice, as it is significantly more difficult to obtain the requisite consent from the creditors under this procedure as compared to a scheme of arrangement and compromise.

Judicial Management

Introduction

An application may be made to court to place a company under judicial management. The judicial management regime aims to provide a company, which is or is likely to become unable to pay its debts as and when they fall due, with some "breathing space" so that it can either be nursed back to financial health or achieve a better realisation of its assets than it would in a liquidation.

In general, all companies may be placed under judicial management, with the exception of companies which have gone into liquidation, or certain excluded classes which have been excluded by statute such as banks or insurers, among others.

As an alternative to applying to court for judicial management, a company may under the IRDA commence judicial management by way of a creditors' resolution, without the need to make any application to court. There are some parallels between the in-court and out-of-court process. The below is a description of the court-based judicial management process.

Commencing a court-based judicial management process

The court-based judicial management process begins with a court application which is to be supported by an affidavit. The affidavit is to state, among other things, that the company is or is likely to become unable to pay its debts and that there is a reasonable probability of rehabilitating the company, preservation of all or part of its business as a going concern or that otherwise the interests of creditors would be better served than in a winding up. The application for a judicial management order may be made by the company or its directors (pursuant to a resolution of its members or the board of directors) or a creditor or creditors (including any contingent or prospective creditor or creditors).

Grant of judicial management order

The court may make a judicial management order in relation to a company if it is satisfied that the company is or is likely to become unable to pay its debts and that there is a real prospect that the order will achieve one or more of the following three purposes:

- the survival of the company, or the whole or part of its undertaking, as a going concern;
- the approval under the Companies Act or the IRDA of a compromise or an arrangement between the creditors and/or members, or any class of them; or
- a more advantageous realisation of the company's assets than on a winding up.

The mere satisfaction of these conditions will not necessarily lead to the grant of a judicial management order. For example, the court may scrutinise the judicial management application to ensure that judicial management is not directly or indirectly used by the directors or shareholders to the detriment of creditors, and in particular those whose claims are unsecured. Also, given that the result of judicial management is that there is a moratorium on claims against the company (this is discussed further below), which is an inroad into the rights of creditors, judicial sentiment has been expressed that the regime should not be abused or lightly brought.

Exceptionally, the court may grant a judicial management order notwithstanding that the conditions for judicial management stated above are not satisfied. This exceptional jurisdiction of the court may be exercised on the ground that it is in the public interest to do so.

Effect of judicial management order

The main effect of the commencement of proceedings for judicial management is that a moratorium is imposed on claims against the company. A statutory moratorium ordinarily arises automatically upon an application being made for judicial management, which is extended upon the making of a judicial management order. The purpose of the moratorium is to assist the company in achieving the stated purposes of judicial management as outlined above.

Unless discharged, a judicial management order will remain in force for 180 days (which may be extended by the court). A judicial manager will be appointed and empowered to do all things for the management of the company's affairs, business and property, which are necessary to achieve the judicial management purposes. The judicial manager must prepare and send proposals for achieving these purposes to the creditors within 60 days (which may be extended by the court) of the judicial management order. If the creditors approve the proposals, the judicial manager must then manage the company in accordance with them. Such proposals may include the company entering into a scheme of arrangement or selling any part of its undertaking which remains viable.

Discharge of judicial management order

The judicial manager is under a statutory obligation to apply for the discharge of the judicial management order when it appears that the purposes specified in it have either been achieved or are incapable of achievement.

The result of a judicial management's successful completion largely depends on the judicial manager's proposals and the circumstances of each case. If the proposals lead to a scheme of compromise, this may result in part of the company's debts being extinguished or reduced in accordance with the scheme. The failure of judicial management will result in the company reverting to its pre-judicial management position. This may well lead to liquidation because one of the prerequisites for a judicial management application is a company's inability or likely inability to pay its debts, which is a ground for the winding up of the company.

Receivership

Secured creditors are able to enforce their security rights via the appointment of receivers or receivers and managers. Receivers may be appointed by the court, or appointed privately pursuant to rights granted under security documents or instruments. The latter is much more common in today's practice, due to the comparative speed and ease of such a contractual appointment and the more extensive powers which would customarily be conferred upon a receiver under such security documents or instruments.

Upon appointment, the receiver's key duty is to collect the assets which are the subject matter of the debenture, realise these assets and settle the dues of the creditors. Where the receiver is also appointed a manager, the receiver / manager will have the additional power to manage the company's business. Going into receivership does not necessarily spell the end for a company; it can continue to exist as an entity.

A receiver does not owe a general duty of care to the company in enforcing the security. However, the receiver does owe specific duties such as a general duty of good faith to the company to exercise his or her powers for the purpose of realising the security and discharging the secured debt, and to take reasonable steps to obtain a proper price for the secured assets.

Alternative dispute resolution in Singapore

Singapore offers alternative mechanisms to help parties resolve their disputes other than through the courts. Common forms of alternative dispute resolution ("ADR") include mediation, arbitration and expert determination.

Mediation

General

Mediation forms a part of Singapore's full suite of dispute resolution services, one which serves to complement court litigation and arbitration. It is cost effective, flexible and fast.

Mediation services are offered by, among others, the Singapore Mediation Centre (the "**SMC**") and the Singapore International Mediation Centre (the "**SIMC**").

The Singapore International Mediation Institute (the "**SIMI**") and the SIMC were officially launched on 5 November 2014 with a view to developing Singapore into a centre for international commercial mediation. As a professional standards body for mediation, the SIMI implements and maintains a credentialing scheme for mediators, and audits and ensures that high standards are met with registered partners who run training and/or mediation services.

The SIMC focuses on mediating international commercial disputes with a panel of internationally-respected mediators. The SIMC has signed Memoranda of Understanding with other mediation centres in the region to promote and develop mediation in Asia.

The SMC focuses on domestic commercial mediation, and also provides other dispute resolution services such as adjudication. The SMC has a panel of highly qualified mediators and neutrals which includes retired Supreme Court Judges, Members of Parliament, former Judicial Commissioners, Senior Counsel and leaders from different professions and industries. To facilitate the use of mediation in restructurings, the SMC has constituted a panel of specialist insolvency mediators comprising some of the leading practitioners in the Singapore insolvency space. The SMC is located in the Singapore Supreme Court building, giving parties the confidence of a judicially-endorsed centre.[200]

On 1 November 2017, the Mediation Act came into force. The Mediation Act strengthens the enforceability of mediated settlements in providing a legislative framework for mediation. It also provides much-valued certainty for cross-border mediation users in areas where the common law position is unclear or differs from jurisdiction to jurisdiction.

The Mediation Act allows parties the ability to agree to apply to court to have their settlement agreement recorded as a court order to strengthen its enforceability. It also provides that communications made in mediation cannot be disclosed to third parties to the mediation and cannot be admitted in court or arbitral proceedings as evidence, except under the circumstances set out in the Mediation Act. For example, a person may disclose a mediation communication to a third party to the mediation if the disclosure is made with the consent of all the parties to the mediation (including the maker of the communication). The Mediation Act also allows parties to apply to court to stay ongoing court proceedings in relation to the same dispute.

[200] The Honourable Justice Andrew Phang, "4th Asian Mediation Association Conference, Mediation and the Courts – The Singapore Experience" (20 October 2016) at paras 8 and 19.

On 12 September 2020, the Singapore Convention on Mediation (the "**Singapore Convention**"), also known as the United Nations Convention on International Settlement Agreements Resulting from Mediation, entered into force, marking a significant development in international commercial dispute resolution. Businesses around the world will now have greater certainty in resolving cross-border disputes through mediation, as the Singapore Convention allows parties seeking enforcement of a mediated settlement agreement across borders to do so by applying directly to the courts of countries that have signed and ratified the treaty, instead of having to enforce the settlement agreement as a contract in accordance with each country's domestic process.

Mediation in the insolvency context

In 2015, the Singapore Ministry of Law established the Committee to Strengthen Singapore as an International Centre for Debt Restructuring (the "**Restructuring Committee**"), which was tasked with recommending initiatives and/or legal reforms that should be undertaken to enhance Singapore's effectiveness as a centre for international debt restructuring. The relevance of mediation (and arbitration) as a way to find effective restructuring solutions was highlighted in a report which the Restructuring Committee issued in 2016. The Restructuring Committee observed that mediation could be used effectively in restructuring proceedings in the following situations, among others.

First, mediation could be used to resolve individual creditor disputes with the debtor (in the context of a multi-creditor restructuring), or to manage multiple creditor disputes of the same nature ("**Similar Claims Mediation**").[201] In Similar Claims Mediation, a mediator is typically appointed to facilitate the resolution of multiple claims with a common nexus of law or fact. An example of this would be the US insolvency proceedings of Lehman Brothers Inc., where a structured mediation protocol led to the expedient resolution of the majority of derivatives-related claims, involving thousands of derivatives contract-related termination disputes and claims involving over 6,000 derivative contracts with 900,000 underlying transactions.[202]

[201] Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring, 2016 (the "2016 Restructuring Report") at paras 3.54 and 3.55.
[202] 2016 Restructuring Report at para 3.55.

Second, mediation may be helpful in obtaining consensus in the restructuring plan between the debtor and its creditors ("**Plan Mediation**").[203] In Plan Mediation, a mediator is appointed to help stakeholders achieve consensus in a restructuring plan or in cases where debtors are subject to dual insolvency proceedings in competing jurisdictions. An example of this occurred in the insolvency of MF Global Holdings Ltd, where mediation resolved potential disputes between insolvency proceedings in the US and the UK and led to substantial assets of the bankruptcy estate (which would have been used to pay fees and expenses that would have arisen from a court based litigation) being distributed to the creditors.[204]

The advantages of Plan Mediation have been judicially recognised by the Singapore High Court in *Re IM Skaugen SE*,[205] where the Honourable Justice Kannan Ramesh stated as follows:

"*Another aspect, which surprisingly has not been resorted to by debtors and creditors, is to enlist the help of an experienced and skilled insolvency mediator to develop the restructuring plan, whether it be an individual or group restructuring plan. Frequently, the discussions on the plan are partisan, and the positions adopted are therefore reflective of that. I see tremendous utility in deploying the services of a neutral third party skilled in mediation techniques, and with the relevant domain knowledge. Such a party can play the invaluable role of building consensus between the debtor and the creditors in the development of the restructuring plan, and build trust in the process. In this way, the mediator can assist to iron out many of the wrinkles and creases that frequently erupt in a restructuring and which perhaps are not best resolved in the adversarial cauldron of the court. It is important that this be explored with vigour, as it seems to me to be self-evident that bridging differences and the trust divide is fundamental to a successful restructuring outcome. While there is always a place for the jousting that is typical of an adversarial process, a more considered, constructive and measured approach in restructuring can often lead to better outcomes for all parties involved. One must not lose sight of the fact that the end objective of the process, after all, is to make a considered assessment of whether a feasible and acceptable economic solution to the financial problems of the debtor is possible, and if so, how that can be facilitated with the interests of the relevant stakeholders in mind. To this end, facilitating discussions between the debtor and creditors, secured and unsecured, and promoting a more cooperative, collaborative and transparent environment wherein all parties involved work towards a common objective of attaining an effective and sustainable restructuring, seems to be quite clearly the correct approach.*"

[203] 2016 Restructuring Report at paras 3.54 and 3.56.
[204] 2016 Restructuring Report at para 3.56.
[205] [2019] 3 SLR 979; [2018] SGHC 259 at [94].

Mediation is generally voluntary rather than mandatory

In Singapore, the courts generally do not compel parties to undergo mediation. In practice, however, parties to court proceedings (including insolvency proceedings) are generally encouraged by the court to consider mediation in appropriate cases. In the insolvency context, mediation has been utilised by litigants in Singapore in relation to disputes over creditors' claims, adjudication of proofs of debt, and insolvency practitioners' fees, among others. The Singapore Supreme Court Practice Directions, issued by the Singapore courts, expressly states that it is the professional duty of advocates and solicitors to advise their clients about the different ways their disputes may be resolved using an appropriate form of ADR,[206] and that ADR should be considered at the earliest possible stage in order to facilitate the just, expeditious and economical disposal of civil cases, especially where ADR may save costs, achieve a quicker resolution and a surer way of meeting their client's needs.[207] The Singapore Supreme Court Practice Directions itself contains detailed guidelines for advocates and solicitors that are advising clients about ADR. These guidelines set out, among other things, the ADR options available as an alternative to litigation and specific guidelines on choosing the most suitable ADR process.

The Singapore Supreme Court Practice Directions states that advocates and solicitors should advise their clients on potential adverse costs orders for any unreasonable refusal to engage in ADR.[208] Order 59, Rule 5(c) of the Singapore Rules of Court states that: "*The Court in exercising its discretion as to costs shall, to such extent, if any, as may be appropriate in the circumstances, take into account — … the parties' conduct in relation to any attempt at resolving the cause or matter by mediation or any other means of dispute resolution*". As such, it is possible that the Singapore courts may refuse to award costs to a successful party because that party may have been found to have unreasonably refused to engage in mediation.

At the pre-trial conference stage in relation to adversarial proceedings before the Singapore courts, the court routinely directs parties to consider ADR, and requires that parties provide updates to the court regarding their efforts towards settling their dispute via ADR.

[206] Supreme Court Practice Directions paragraph 35B(2).
[207] Supreme Court Practice Directions paragraph 35B(4).
[208] Supreme Court Practice Directions paragraph 35B(5)

The ordinary procedure for parties to court proceedings who wish to attempt mediation or any other means of dispute resolution are set out in the Singapore Supreme Court Practice Directions, which states that:

- A party who wishes to attempt mediation or any other means of dispute resolution should file and serve on all relevant parties an ADR Offer in Form 28 of Appendix A of the Practice Directions. [209]

- An ADR Offer may be made by any party at any time of the proceedings and shall be valid for a period of 14 days after its service.[210]

- Within 14 days after service of the ADR Offer, the relevant parties shall file and serve a Response to ADR Offer in Form 29 of Appendix A of the Practice Directions, failing which they shall be deemed to be unwilling to attempt ADR without providing any reasons.[211] The Response to ADR Offer requires the Respondent to expressly certify that:[212]

- The Respondent's solicitor has explained to it the available ADR options.

- The Respondent is aware of the benefits of settling its case by ADR.

- The Respondent has been advised and understands that the Judge may take the view that ADR is suitable for its case, and that any unreasonable refusal on its part to resolve the matter via mediation or other means of ADR may then expose the Respondent to adverse costs orders.

- If all the parties are willing to attempt ADR, directions may be given by the court in relation to the relevant civil case, including an adjournment of pending proceedings in court with stipulated timelines for the completion of the ADR process.[213]

- In exercising its discretion as to costs, including costs of any claim or issue in any proceedings or of the entire action, the court may consider all the relevant circumstances of the case, including the ADR Offer and the Response to ADR Offer.[214]

[209] Supreme Court Practice Directions para 35C(1).
[210] Supreme Court Practice Directions para 35C(2).
[211] Supreme Court Practice Directions para 35C(3).
[212] Response to ADR Offer, Form 29 of Appendix A of the Supreme Court Practice Directions.
[213] Supreme Court Practice Directions para 35C(4).
[214] Supreme Court Practice Directions para 35C(5).

Arbitration

General

Arbitration is commonly used as a dispute resolution mechanism in Singapore. The number of international cases administered by the Singapore International Arbitration Centre (the "**SIAC**") has been consistently increasing year on year. The Singapore courts encourage the use of arbitration as a means to resolve disputes and this is evidenced by the fact that they recognise arbitration agreements and have stayed legal proceedings because of such agreements.[215] Statutory rules have been enacted in the form of the Arbitration Act (which deals with domestic arbitration) as well as the International Arbitration Act (which deals with international arbitration) to provide for the said stay of legal proceedings in such cases.

The legislative framework concerning arbitration in Singapore has been frequently revisited by the Singapore Government (amendments were made in 2010 and 2012) in order to ensure that the arbitration regime is on par with other jurisdictions and that Singapore remains an attractive venue for arbitration.

The SIAC was established in July 1991 as a not-for-profit, non-governmental organisation to meet the demands of the international business community for a neutral, efficient and reliable dispute resolution institution in Asia. The SIAC comprises a Court of Arbitration which oversees the case administration and arbitral appointment functions of the SIAC and the Board of Directors which oversees its corporate and business development functions. On 30 December 2016, the SIAC announced the official release of the first edition of the Investment Arbitration Rules ("IA Rules") of the SIAC, a specialised set of rules to address the unique issues present in the conduct of international investment arbitration. The IA Rules 2017 came into effect on 1 January 2017.

In addition, an arbitration facility centre (Maxwell Chambers) was launched in 2010 with the Government's support. There are many arbitration bodies represented in Singapore, such as the International Court of Arbitration of the International Chamber of Commerce (ICC), the International Centre for Dispute Resolution (ICDR) (the international division of the American Arbitration Association (AAA)), the Arbitration and Mediation Centre of the World Intellectual Property Organization (WIPO), the Singapore Chamber of Maritime Arbitration (SCMA) and the Singapore Institute of Arbitrators.

[215] *Yee Hong Pte Ltd v Tan Chye Hee Andrew (Ho Bee Development Pte Ltd, Third Party)* [2005] 4 SLR(R) 398; [2005] SGHC 163.

Further strengthening Singapore's attractiveness as an arbitration hub is the fact that Singapore is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, commonly referred to as the New York Convention, affording ease of enforcement of arbitral awards. The judiciary has also consistently delivered pro-arbitration decisions with a policy of minimal curial intervention.

In *Aloe Vera of America, Inc v Asianic Food (S) Pte Ltd & Anor,*[216] the Singapore court expressly opined that the courts should give effect to foreign arbitration awards:

"[T]here is the principle of international comity enshrined in the [Convention on the Recognition and Enforcement of Foreign Arbitral Awards concluded on 10th June 1958] that strongly inclines the courts to give effect to foreign arbitration awards.

As Litton PJ observed in the decision of the Hong Kong Court of Final Appeal in Hebei Import & Export Corp v Polytek Engineering Co Ltd [1999] 2 HKC 205, woven into the concept of public policy as it applies to the enforcement of foreign arbitration awards 'is the principle that courts should recognise the validity of decisions of foreign arbitral tribunals as a matter of comity, and give effect to them, unless to do so would violate the most basic notions of morality and justice'."

The judiciary's support of arbitration in Singapore is further evidenced by the appointment of specialist judges, a move which began in 2003, to preside over all arbitration matters brought before the High Court.

The Civil Law (Amendment) Act 2017, which came into force on 1 March 2017, amended the Civil Law Act to enact a framework for third-party funding in Singapore, providing businesses with an additional financing option for international arbitration. Third-party funding is already available in other international arbitration centres and its introduction here will strengthen Singapore's position as a key arbitration seat in the world. The Civil Law (Amendment) Act 2017 provides that entities which provide third-party funding must meet certain specific criteria and also states that the common law tort of champerty and maintenance is abolished in Singapore.

[216] [2006] 3 SLR(R) 174; [2006] SGHC 78 at [40].

Insolvency context

In the context of insolvency claims, it should be noted at the outset that there are certain aspects of insolvency law which are non-arbitrable. The reason for this, as recognised by the Singapore courts, is that arbitration and insolvency processes embody, to an extent, contrasting policies. In *Larsen Oil and Gas Pte Ltd v Petroprod Ltd (in official liquidation in the Cayman Islands and in compulsory liquidation in Singapore)*[217] *("**Larsen Oil**")*, the Singapore Court of Appeal held:

"Arbitration and insolvency processes embody, to an extent, contrasting legal policies. On the one hand, arbitration embodies the principles of party autonomy and the decentralisation of private dispute resolution. On the other hand, the insolvency process is a collective statutory proceeding that involves the public centralisation of disputes so as to achieve economic efficiency and optimal returns for creditors."

In *Larsen Oil*, the Court of Appeal was concerned with the non-arbitrability of certain types of disputes involving an insolvent company that was in liquidation. The Court of Appeal held that a distinction ought to be drawn between a dispute arising only upon insolvency and by reason only of the insolvency regime (in other words, an insolvency law dispute) and a dispute arising from the insolvent company's pre-insolvency rights and obligations (in other words, a private law dispute):[218]

The Court of Appeal held that an insolvency law dispute is not arbitrable. Part of the purpose of the insolvency regime is to enable insolvent companies to recover assets for the collective benefit of the company's creditors. This very often requires pursuing insolvency law claims against the company's pre-insolvency management. This aspect of the insolvency regime's purpose could be compromised if management were permitted to bind the company's insolvency officeholders to arbitrate insolvency law disputes. Further, the insolvency regime envisages that a single insolvency law dispute could arise against multiple persons, some of whom might be counterparties to an arbitration agreement with the insolvent company but others of whom might not be counterparties to *any* agreement with the insolvent company at all, let

[217] [2011] 3 SLR 414; [2011] SGCA 21 at [1].
[218] *Larsen Oil* at [47] to [51]; *BTY v BUA and other matters* [2019] 3 SLR 786 at [151] to [153].

alone an arbitration agreement. Having all insolvency law disputes determined under the collective procedure set out in the insolvency regime, regardless of the presence or scope of an arbitration agreement, prevents conflicting findings by different adjudicators.

On the other hand, the Court of Appeal considered that a private law dispute is arbitrable, at least where it does not affect the substantive rights of the creditors. Where an arbitration agreement obliges a company's insolvency officeholders to arbitrate a private dispute, there is usually no good reason not to give effect to the arbitration agreement. This is despite the fact that the arbitration agreement affects the *procedural* rights of all of the insolvent company's creditors in the following two senses. First, the creditors collectively have the real economic interest in the outcome of the private law dispute but can be compelled to submit to having the dispute resolved through arbitration even though the creditors are not parties to any arbitration agreement. Second, an arbitration agreement can be seen as an attempt to contract out of the specialised procedure for resolving private law disputes which is mandated by the insolvency regime, *i.e.* by the lodgement and adjudication of proofs of debt. But where an arbitration agreement affects the *substantive* rights of the creditors, the liquidator cannot be compelled to arbitrate the private law dispute.

In relation to arbitrable disputes, the Restructuring Committee has recognised that there are in particular certain types of disputes between the debtor and creditors where arbitration may be particularly helpful. These disputes include:[219]

- Disputes involving cross-border issues, as arbitration would prevent issues from being re-litigated across various jurisdictions.
- Complex cases (e.g., disputes involving highly complex financial instruments) where there may be a need for specialist knowledge in the subject area and where it is likely that there will be inconsistent court decisions.

[219] 2016 Restructuring Report at para 3.61.

- The Restructuring Committee also noted that arbitration could also be used to effectively resolve issues that arise post-insolvency, including:[220]
- Resolving intercompany claims between affiliates across multiple jurisdictions within a large enterprise group.

- Resolving issues across multiple concurrent insolvency proceedings. For example, where the business of a large multinational enterprise is sold as a going concern, proceeds of the sale may have to be allocated across various insolvency proceedings. Arbitration can be used to resolve disputes as to how the distribution of the proceeds of the sale should be done.

- Determining a debtor's centre of main interests, to avoid the situation where different jurisdictions claim that the primary administration of a restructuring proceeding should be based in the local forum.

The advantage that arbitration proceedings have over traditional court-based insolvency proceedings is greater enforceability.[221] An arbitral award benefits from the New York Convention which allows enforcement of the arbitral award in over 150 countries. This allows an arbitral award to be enforced in far more countries than the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments or the European Insolvency Regulation. Using arbitration to resolve common issues in different jurisdictions and other transnational issues may also prevent inconsistent court decisions across jurisdictions.

There are, however, several challenges to using arbitration to resolve disputes that arise in insolvency proceedings. For example, it has been observed in Singapore that:[222]

One challenge to using arbitration stems from the general acknowledgment across jurisdictions that certain "core" aspects of insolvency law are non-arbitrable, as discussed above. Insolvency issues that are not considered to be a "core" aspect of insolvency law (i.e. "non-core" issues) can be arbitrated. However, there is no consistent approach to the treatment of "non-core" issues across jurisdictions and an issue that is arbitrable in one jurisdiction may not be arbitrable in another. For example, in Singapore, the UK and

[220] 2016 Restructuring Report at para 3.62
[221] 2016 Restructuring Report at para 3.63.
[222] 2016 Restructuring Report at para 3.64.

Australia, this issue is left to be decided by case law. Other jurisdictions, such as the US, have a non-exhaustive list of “non-core” insolvency issues that are arbitrable. Finally, jurisdictions such as Switzerland have broadly worded statutes that suggest that most types of insolvency issues are arbitrableCourts may therefore reach inconsistent decisions on whether certain disputes referred to arbitration involve “core” insolvency issues. This in turn creates a lack of clarity and uncertainty over whether the arbitration of an insolvency issue would be recognised as validly commenced in other countries.

Another challenge is that arbitration is founded on the existence of an agreement to arbitrate between parties. An arbitration clause is normally included in contracts to create the agreement to arbitrate. However, as part of insolvency law, some insolvency officeholders have powers to disclaim / set-aside contracts, and this may effectively destroy the agreement to arbitrate.

Also, many insolvency proceedings often involve a stay of legal proceedings between stakeholders in the insolvency, and this includes arbitration. Therefore, it is possible that there may be inconsistent application of the stay of proceedings such that some arbitration proceedings are permitted to continue under one set of laws, while another set of arbitration proceeding under a different set of law is stayed.

Expert determination

Expert determination is a means by which parties to a contract instruct a third party to decide an issue. The third party would ordinarily be an expert chosen for his expertise in relation to the issue between the parties. The Singapore courts have decided that where the expert’s determination has been agreed between the parties as final, that expert’s determination will be binding on them.[223] This dispute resolution tool has proven very useful in shipping cases, particularly when highly technical matters are at issue.

Specifically, in the context of a scheme of arrangement, there is a statutory mechanism for the appointment of an independent assessor for disputes in relation to the rejection of proofs of debt. The IRDA provides that such disputes may be adjudicated by an independent assessor appointed: (a) by the agreement of all parties to the dispute; or (b) if there is no such agreement, by the Court on the application of any party to the dispute; or the company (whether or not a party to the dispute). Where a creditor, the

[223] *Evergreat Construction Co Pte Ltd v Presscrete Engineering Pte Ltd* [2006] 1 SLR(R) 634; [2005] SGHC 224.

company or the chairperson disagrees with any decision of an independent assessor on an adjudication in relation to the inspection, admission or rejection of a proof of debt, the creditor, company or chairperson (as the case may be) may file a notice of disagreement regarding that decision for consideration by the Court when the Court hears an application for the Court's approval of the compromise or arrangement in question.[224]

Conclusion

With the IRDA coming into effect on 30 July 2020, Singapore now has an enhanced insolvency regime to facilitate the restructuring and insolvency of corporate debtors more effectively, which also seeks to safeguard the interests of creditors and other stakeholders. While the use of ADR in the insolvency context is still not as widespread in Singapore, not least because of some of the challenges outlined above, with an accommodating ecosystem comprising judicial support, efficient infrastructure and relevant legislation, ADR is expected to play a bigger role in insolvency matters going forward.

As Singapore continues to explore the use of ADR in the insolvency context, it is hoped that the experiences gained, and the lessons learnt, along the way may offer some reference to other jurisdictions, including India, that are studying the role of ADR in debt resolution.

[224] This approval being that under section 210(4) of the Singapore Companies Act.

Liability of Insolvency Professionals: Roles, Duties and Liabilities

Dhananjay Kumar, Craig Montgomery and Miryam Farrelly

Liability of Insolvency Professionals: Roles, Duties, and Liabilities

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Introduction

Insolvency professionals play a critical role in many corporate insolvency regimes across the world. This is as opposed to those roles played by officials employed by the insolvency court or the relevant Government or in some countries, by the insolvency judges. Insolvency by definition requires balancing of the interests of the stakeholders (as there is not enough money to go around) and therefore, the conduct of the insolvency professional is likely to have an important role in the outcomes of the insolvency process. The insolvency profession was introduced in India with the introduction of the Insolvency and Bankruptcy Code, 2016 and has since acquired great significance in the resolution of stressed assets. In England and Wales, the framework for insolvency practitioners' duties and obligations is based on longer-standing legislation and case law: there are clear principles, but which continue to evolve.

In this article, adopting a comparative approach, we look at India and England and Wales, two jurisdictions where insolvency professionals are at the centre of the insolvency process. We have focussed on the "rescue" processes in both jurisdictions (corporate insolvency resolution process for India and administration for England) rather than winding up. Part A deals with the Indian regime and Part B deals with the regime in England and Wales. Part C concludes.

Part A- Indian legal regime for insolvency professionals

1. Overview of officeholders' duties and different legal sources

The profession of insolvency professional ("**IP**") came into existence with the introduction of the Insolvency and Bankruptcy Code, 2016 ("**Code**"). The report of the Bankruptcy Law Reforms Committee dated November 4, 2015 ("**BLRC Report**") described IPs as a crucial pillar upon which rests the effective, timely functioning as well as credibility of the entire edifice of the insolvency and bankruptcy resolution process. IPs constitute a new class of professionals accredited under the Code. They are regulated by the Insolvency and Bankruptcy Board of India ("**IBBI**"). The Code lays down functions and obligations of the IP as the administrator, resolution professional and liquidator in fresh start process, individual insolvency resolution process, corporate insolvency resolution process ("**CIRP**"), pre-packaged insolvency resolution process ("**Pre-pack**"), liquidation and bankruptcy process.[225] During any of the aforesaid processes under the Code, IPs are duty bound to take reasonable care and diligence while discharging their duties and comply with the requirements under the Code and bye-laws applicable to respective insolvency professional agency.

IPs discharge their duties and obligations during a CIRP and Pre-pack in the capacity of Interim Resolution Professional/Resolution Professional ("**RP**"). Section 5(27) of the Code defines a 'Resolution Professional' as *"an insolvency professional appointed to conduct corporate insolvency resolution process or the pre-packaged insolvency resolution process, as the case may be, and includes an interim resolution professional."* Essentially, the RP is tasked with facilitating the entire resolution process while attempting to address and balance the interests of all stakeholders. In this regard, Section 23 of the Code requires that the resolution professional should conduct the entire CIRP and manage the operations of the corporate debtor ("**CD**") during the CIRP period.

One of the primary legal duties of the RP is to assume the powers vested in the board of directors and manage the operations of the CD as a going concern. The key duties of the RP with respect to the conduct of the CIRP

[225] Section 208 of the Code

include verification of claims, preparation of the Information Memorandum (“**IM**”), conduct of the valuation, facilitation of diligence by potential resolution applicants. After preparing an IM and pursuant to receipt of the resolution plans, the RP is required under section 30 of the Code read with Regulation 38 of the CIRP Regulations, to ensure that the resolution plans submitted conform to the IBC and the regulations.

Likewise, during a liquidation process, a liquidator is entrusted with the task of verifying claims of all creditors, taking control of assets of the CD, carrying the business of the CD for its beneficial liquidation, taking measures he/she deems necessary for preserving the assets of the CD and distribution of proceeds out of the sale of the CD as a going concern or out of the liquidation estate of the CD.

For carrying out the duties under the Code, the IPs also need freedom to function without fear of legal proceedings and actions being against them for decisions taken in good faith. In furtherance of this, Section 233 of the Code categorically provides no suit, prosecution or legal proceedings will lie *inter-alia* against an IP or liquidator for anything which is done or intended to be done in good faith under the Code, regulations or rules made thereunder.

Historically, in India, the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 provided for appointment of official assignees/official receivers for the purpose of carrying out relevant procedures under the said Acts. Further, Section 448 of the Companies Act, 1956 provided for appointment of official liquidators attached to High Court for carrying out liquidation of those companies which are ordered to be wound up by the High Court. The Companies (Second Amendment) Act, 2002 extended the eligibility, which never came into force, to be appointed as official liquidator, by permitting the appointment of a professional, from a panel-chartered accountants, advocates, company secretaries, costs and works accountants, or firms, or bodies corporate consisting of such professionals, as empanelled with the Central Government, The Companies Act, 2013, however, brought this change vide Section 275. A ‘company liquidator’, whether in case of winding up by NCLT or voluntary winding up, has to be appointed from a panel of professionals maintained by the Central Government. With the amendments made by the Code, this section will now be relevant only in case of compulsory winding up other than on grounds of inability to pay.

Qualifications of IPs

The instrumentality of an insolvency professional has been highlighted by the UNCITRAL[226] in the Legislative Guide On Insolvency Law[227] ("**UNCITRAL Insolvency Guide**"), which states that – "*an insolvency representative plays a central role in the effective and efficient implementation of an insolvency law, with certain powers over debtors and their assets and a duty to protect those assets and their value as well as the interests of the creditors and employees, and to ensure that the law is applied effectively and impartially. Accordingly, it is essential that the insolvency representative be appropriately qualified and possess the knowledge, experience and personal qualities that will ensure not only the effective and efficient conduct of the proceedings and but also that there is confidence in the insolvency regime.*"

This qualification requirement stipulated under the UNCITRAL Insolvency Guide has been embodied in the qualifications and eligibility criteria provided for under the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016[228]("**IP Regulations**").

A professional will not be eligible to be an IP if he:

(i) is a minor;
(ii) is not resident in India;
(iii) has been convicted for an offence;
(iv) is an undischarged insolvent;
(v) is declared to be of an unsound mind; or
(vi) he is not a fit and proper person.

The criteria for adjudging a person as fit and proper will involve analysis of his integrity, reputation, character, absence of convictions and restraint orders and competency.[229]

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[226] United Nations Commission on International Trade Law
[227] UNCITRAL, Legislative guide on Insolvency https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf
[228] Regulation 4 and 5 of the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016
[229] Regulation 4 of the IP Regulations

To be eligible for registration as an IP, an applicant has to (a) pass the limited insolvency examination within twelve months before the date of his application for enrolment with the insolvency professional agency; (b) complete a pre-registration educational course from an insolvency professional agency after his enrolment as a professional member, (c) successfully completed: (i) the National Insolvency Programme; (ii) the Graduate Insolvency Programme; and (iii) has experience of (a) ten years in the field of law, after receiving a Bachelor's degree in law, (b) ten years in management, after receiving a Master's degree in Management or two-year full time Post Graduate Diploma in Management, or (c) fifteen years in management, after receiving a Bachelor's degree or from a university established or recognised by law or an Institute approved by All India Council of Technical Education; or (iv) ten years' of experience as (a) chartered accountant registered as a member of the Institute of Chartered Accountants of India, (b) company secretary registered as a member of the Institute of Company Secretaries of India, (c) cost accountant registered as a member of the Institute of Cost Accountants of India, or (d) advocate enrolled with the Bar Council.[230]

Recently, with effect from July 22, 2021, the stipulation in respect of experience has been elaborated upon and made more objective (as set out in serial no. (c)(iii) above) by amending the erstwhile provision requiring fifteen years' of experience in management.

2. Causes of action available to the company / creditors for breach of duty by an officeholder

The IRP as proposed by the financial creditor or the operational creditor is appointed by the adjudicating authority.[231] The CoC can continue with such nominated person and appoint him as the resolution professional or if the CoC is not satisfied with the performance of the IRP, then it can replace him with another resolution professional at a meeting with a 66% majority of the voting shares.[232] If not satisfied for any reason, the CoC can also remove the current RP under section 27(2) of the Code and appoint a new RP by

[230] Regulation 5 of the IP Regulations
[231] Section 16 of the Code
[232] Section 22 of the Code

following the same procedure. The proposed name of the new RP is then given to the NCLT. The cause of action for initiating a proceeding against the IP could be multiple, ranging from breach of duties like not taking appropriate and timely action, misuse of power or defaulting with the duties and processes as mentioned in the Code.

NCLT Chennai in *Indian Overseas Bank v. Gopala Krishna Raju*[233] held that despite three directions to the IRP from the tribunal to present himself for the hearing, the IRP is flouting the orders of the Tribunal intentionally and avoiding personal appearance and noted - "*Further, it is on record that Indian Overseas Bank (Applicant) has sent letter to the IRP for conducting the 2nd meeting of the CoCs to replace him and to propose RP. In response to the said letter, the IRP has given the reply stating that the Applicant may approach to the Adjudicating Authority for the said purpose. This abdication of duties is serious in nature and hence the IRP is declared to be unfit person for being given any assignment under the provisions of the I&B Code, 2016 as Resolution Professional.*"[234] Basis this finding, the IRP was removed from the assignment. Removal of the IRP/current RP and replacement with another RP therefore, is the first level remedy available to the creditors/CoC against an IRP/RP for non-performance of his duties.

The IP Regulations stipulate Code of Conduct[235] applicable to IPs to set a minimum threshold of professional expectation while discharging duties under the Code. This enables the CD or the creditors to supervise or assess actions or omissions of IPs on parameters of integrity and objectivity, independence and impartiality, professional competence, correctness of facts, timeliness, information keeping, confidentiality, remunerations and costs etc. direct the IP to conduct a process in fair and transparent manner. On observing breach of confidentiality, not maintaining proper record, delayed actions/responses etc. while discharging duties and obligations by the IP, the same will result in not abiding by the Code of Conduct and provide a cause of action to the relevant stakeholder.

In case of an errant IP, the creditors' body can initiate a disciplinary action under Section 217 of the Code, against the IP by filing a complaint with IBBI. An investigating authority is appointed by the IBBI and consequently, based

[233] Order dated March 14, 2019
[234] Indian Overseas Bank v. Gopala Krishna Raju, 2019 SCC OnLine NCLT 7401
[235] First Schedule under Regulation 7(2)(h) of the IP Regulations

on the investigation report, show cause notice may be served on the IP.[236] Following this, the IBBI shall constitute a disciplinary committee for the disposal of the show cause notice while taking into consideration the findings of the investigation.[237] The IBBI acts as the authority for disciplinary and administrative actions against RP.

3. Court process – how courts see insolvency professionals

The Bankruptcy Law Reforms Committee Report stated that the insolvency professional acts as an agent of the adjudicator.[238] The National Company Law Tribunal, Mumbai Bench in *Asset Reconstruction Company (India) Private Limited vs. Shivam Water Treaters Private Limited*[239] held that an RP acts as an officer of the court and discharges it duties as a court officer, thus any non-compliance of the court officer or hindrance in the working of the corporate insolvency resolution process would amount to contempt of court. It was also observed by the Chandigarh Bench of the NCLT[240], that the insolvency professional does not act as an agent of the applicant but has the duty to abide by the code of conduct and follow the norms framed by the IBBI.

While the courts have rightly held the IP to be an officer of the court which smoothens functioning of the IPs in seeking cooperation from the local authorities and stakeholders at large, the same at times delays decision making by the IPs when discharging day to day functions of the CD as for the IP approaching the adjudicating authority for significant directions in conflicting situations result in substantial delay due to backlog/pressure of numerous cases on the adjudicating authority. In order to facilitate the IPs in discharging duties, the Code provides that once the IRP is appointed, the board of directors of the corporate debtor is suspended and the IRP is vested with the management of the affairs of the CD.[241] To execute this duty, IP is authorized to undertake various actions such as having access to the electronic records of financial information[242], books of accounts and other such documents [243], executing necessary acts and deeds in its name[244] and

[236] Regulation 11 of the IP Regulations
[237] Section 220 of the Code
[238] Section 4.4 of the Bankruptcy Law reforms committee report <https://ibbi.gov.in/uploads/resources/BLRCReportVol1_04112015.pdf>
[239] Orders dated January 16, 2019 and February 18, 2019
[240] 2017 SCC Online NCLT 1423
[241] Section 17(1) of the Code
[242] Section 17(2)(c) of the Code
[243] Section 17(2)(d) of the Code
[244] Section 17(2)(a) of the Code

taking all such actions which are required for being in compliance with the Code and therefore, a fine balance needs to be maintained to facilitate the IPs to take independent and speedier commercial decisions.

4. The attitude of the court (contrasting the general position and approach to pre-pack administrations)

The role of IPs has been looked at from several quarters and have received both praise and criticism. In *Shri Krishna Agri Projects Private Limited* v. *Feedatives Pharma Private Limited*[245], NCLT, Kolkata Bench lauded the resolution professional for completing the CIRP efficiently within the extended period of 270 days and successfully getting the resolution applicant to take over the assets above the fair market value. Similarly, NCLAT Bench in the case of *Vandana Garg, RP of Jyoti Structures Ltd. v. State Bank of India*[246] reversed the order of NCLT Bench where the latter had made negative observations against the RP and held that the RP had acted in bona fide manner on the request of financial creditors and ensured that the Corporate Debtor did not go for liquidation. Hence, negative remarks against her were unwarranted.

Unlike the above instance, the NCLT Kolkata in the case of *State Bank of India v. Coastal Projects*[247] criticized the RP and CoC for not adhering to the timeline set out in the Code and reprimanded them for having a lax approach while communicating with each other and not observing the object of the Code which is resolution and maximization of value. Similarly, in *Sunrise Polyfilms Pvt. Ltd.* v. *Punjab National Bank*[248], NCLT Ahmedabad criticized the RP and CoC and noted that the RP failed to comply with his statutory duties as he didn't invite prospective resolution applicants as per Section 25 of the Code. Moreover, it also reprimanded CoC for not taking active interest in achieving the goal of revival of the company.

Contrary to the creditor in control model in a CIRP, the Pre-pack follows a debtor in possession model i.e., the management of the CD is not transferred to the RP, unless voted upon by the CoC with 66% majority and approved by the adjudicating authority. Unlike CIRP, where the board is suspended, there is no change in management in Prepack and the RP has to ensure that the

[245] CA(IB) No. 194/KB/2019, 964 & 848/KB/2019 in CP (IB) No. 187/KB/2018
[246] Vandana Garg, RP of Jyoti Structures Ltd. v. State Bank of India, 2018 SCC OnLine NCLAT 660
[247] State Bank of India v. Coastal Projects, CP(IB) No. 593/KB/2017
[248] IA 27 of 2018 in C.P. (I.B) No.89/7/NCLT/AHM/2017

dealings are fair and transparent. The RP guides the CD in all tasks prior to initiation of the Pre-pack and assists stakeholders in finalizing a plan. The RP is also vested with power to file applications before the adjudicating authority as regards issues relating to the conduct of the Pre-pack. Due to limited role of the RP and adjudicating authority in Pre-pack, the scope of praise or criticism is also limited.

5. The different types of breaches of duty, standard for breach and sanctions for breach

The Code read with regulations and circulars imposes various duties on the IP that he is required to comply with in various capacities of RP or liquidator or administrator.

There are four broad level key duties that the IP, in his capacity as the IRP or RP, has to fulfil:

(i) First such duty is to convene and attend all the CoC meetings.[249] He is responsible for conducting the CoC meeting. He has to provide notice and agenda of the meeting to every participant;[250]

(ii) Secondly, the RP has the duty to conduct proper evaluation of claims and consequently, maintain an updated list of claims.[251] Section 18(a) of the Code also mandates him to collect all information relating to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor and receive and collate all the claims submitted by creditors to him, pursuant to the public announcement.[252] The disciplinary committee in the order dated April 13, 2018 observed that the IRP not only disregarded the claim of the claimant, but also didn't respond to him despite repetitive follow ups. He remained incommunicative to the requests of the claimant as well as the board and therefore, this was in violation of his statutory duties;[253]

(iii) Thirdly, the RP has to prepare information memorandum and provide access to the relevant information and documents to every resolution applicant so that the latter can formulate the resolution plan accordingly.[254] This duty further includes maintaining and sharing documents, information and records pertaining to the Corporate

[249] Section 25(2)(f) of the Code
[250] Section 24(3) of the Code
[251] Section 25(2) (e) of the Code
[252] Section 18 of the Code
[253] Order dated April 13, 2018 (No. IBBI/Ref-Disc.Comm./02/2018) https://ibbi.gov.in/webadmin/pdf/whatsnew/2018/Apr/DC_Dhaivat_2018-04-13%2020:35:48.pdf
[254] Section 29 of the Code

Debtor at the CoC meeting.[255] The Hon'ble Supreme Court reiterated the importance of these duties of the RP in the case of *Vijay Kumar Jain V/s Standard Chartered Bank* where it held that every participant is entitled to a notice of every meeting of the CoC. The RP is further obligated to provide agenda of the meeting and provide access to all the 'relevant documents' which includes resolution plan as well to every participant.[256] Therefore, basis the facts of the case, the Supreme Court held that the IP was in contravention of the Code since he didn't share the resolution plan with the suspended director of the corporate debtor; and

(iv) Fourthly, RP is required to submit the details at the CoC of following transactions, if found by him:
   (a) Preferential transactions under Section 43;
   (b) Undervalued transactions under Section 45;
   (c) Extortionate credit transactions under Section 50; and
   (d) Fraudulent transactions under Section 66.

The RP as well as the liquidator has the paramount duty to file application with the adjudicating authority for avoidance of these transactions.[257]

Section 35 of the of the Code lists down the duties that the liquidator is required to discharge i.e., the liquidator is entrusted with the task of verifying claims of all creditors, taking control of assets of the debtor, carrying the business of the CD for its beneficial liquidation, taking measures he deems necessary for preserving the assets of the CD and distribution of proceeds of sale of the CD.[258] Similarly, an administrator assumes the role to administer the insolvency and bankruptcy fund created for the purpose of insolvency resolution, liquidation and bankruptcy of individuals.[259]

Breaches of duty and standard of breach

The different types of breaches of duty include conflict of interest which is a breach of duty under Section 208 (2)(a) of the Code and Regulation 7(2)(a) and (h) of the IP Regulations. Apart from these, lack of reasonable care and diligence while making disclosures[260], negligence in performing duties of

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[255] Section 25(2) (i) of the Code
[256] Vijay Kumar Jain V/s Standard Chartered Bank, (2019) 20 SCC 455
[257] Sections 25(2)(j) and 35(1)(l) of the Code
[258] Section 35 of the Code
[259] Section 224 of the Code
[260] Order dated July 22, 2021 (IBBI/DC/74/2021)
https://ibbi.gov.in//uploads/order/0341ec9713c25e4bad8ef69fb6f11e64.pdf

invoicing[261], acting with mala fide intention[262], undertaking assignment without valid authorization,[263], delegating his authority to other person without prior approval of CoC[264], raising fee invoice in the name of the firm where only RP is entitled to receive the fee in his name[265] also constitute breach of duty.

By virtue of the central role of an IP in various processes under the Code, duty of an insolvency professional to perform its responsibilities with utmost care and diligence is crucial. The UNCITRAL further emphasises that establishing a standard of care with which the insolvency professional carries out its duties and functions and determining the personal liability of insolvency professionals is important to the conduct of insolvency proceedings. The extent of liability of an insolvency professional as specified by the UNCITRAL is to ensure a balance between a standard that will ensure competent performance of the duties and one that is so stringent that it invites law-suits against the insolvency professional.[266]

Insolvency law will also need to take into consideration the fact that the liability of the insolvency representative may often involve the application of law outside insolvency or, where the IP is a member of a professional organization, the relevant professional standards of the organization.[267] In India, Section 206 of the Code makes it mandatory for the IPs to get registered with the Insolvency Professional Agency.[268] Consequently, they are required to adhere to the standard for professional and ethical conduct set by such agencies. The Disciplinary Committee in an order[269] laid down the standard of care that the RP is duty bound to follow. It held that the RP must conduct CIRP with fairness and diligence and must ensure that the resolution plan is not in contravention of any law. He must also maintain absolute independence while discharging his statutory duties. It further held that *"The AA relies on the work of an IP, as an insolvency proceeding is*

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[261] Order dated August 9, 2021 https://ibbi.gov.in//uploads/order/cb47a2c91437584ec33bd61bcc2b6adf.pdf
[262] Clause 14, First Schedule, IP Regulations
[263] Regulation 7A of the IP Regulations
[264] Section 28(1)(h) of the Code
[265] Order dated March 05,2021 (ibbi/dc/68/2021) https://ibbi.gov.in//uploads/order/99021d25ea6922dc843d3c792ef85443.pdf
[266] UNCITRAL, Legislative guide on Insolvency,Page 183 https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf
[267] UNCITRAL, Legislative guide on Insolvency,Page 183 https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf
[268] Section 206 of the Code
[269] Order dated November 12, 2018 (No. IBBI/DC/12/2018) https://ibbi.gov.in/webadmin/pdf/whatsnew/2018/Nov/Order%20in%20the%20Matter%20of%20Martin%20S.%20K.%20Golla_2018-11-13%2014:37:09.pdf

mostly not adversarial in nature." In one such instance where the RP failed to take reasonable care and exercise due diligence while making certain disclosures, the Disciplinary Committee imposed penalty on the RP and barred him for accepting new assignments under the Code.[270]

Sanctions for breach

If the IP breaches any provision of the Code or rules or regulations, the Disciplinary committee may dispose of the show-cause notice by providing a warning or any penalty as provided for under Section 220 of the Code or any other action or direction that it considers appropriate.[271] Under the Code, if an insolvency professional has contravened any provisions of the Code or any relevant regulations it may impose a penalty which shall be (i) three times the amount of the loss caused or likely to have been caused to the persons concerned; or (ii) three times the amount of the unlawful gain made on account of such contravention, whichever is higher. However, if the loss caused is not quantifiable, the total amount of penalty imposed shall not exceed more than one crore rupees.[272] Further, under the Code, the Board may direct any person who has made an unlawful gain or averted loss by contravening any provision of the Code, to disgorge an amount equal to such unlawful gain or aversion of loss. It must also be noted that an insolvency professional would be subject to imprisonment for a term of which may extend to six months, or with fine which shall be not less than one lakh rupees and may extend to five lakh rupees if it deliberately contravenes the provisions of the Code.[273]

The disciplinary committee analyses each complaint based on the facts and circumstances of each case and thus, provides different sanctions based on the severity and gravity of that specific breach. Thus, the disciplinary committee may dispose the matter by only providing a warning that the IP should take reasonable care and be extremely careful and diligent while performing his duties under the Code[274] or even take a lenient view while providing sanctions if the insolvency professional was not aware of certain

[270] Order dated July 22, 2021 (No. IBBI/DC/74/2021)
https://ibbi.gov.in//uploads/order/0341ec9713c25e4bad8ef69fb6f11e64.pdf
[271] Regulation 13 of the Insolvency and Bankruptcy Board of India (Inspection and Investigation) Regulations, 2017
[272] Section 220 (3) of the Code
[273] Section 70(2) of the Code
[274] Order dated April 16, 2021 (ibbi/dc/70/2021)https://ibbi.gov.in//uploads/order/429e28f26385420ea0676c74e7f93f13.pdf ; Order dated September 17, 2021 (ibbi/dc/77/2021) https://ibbi.gov.in//uploads/order/ae82e3b9e2db0ef038e69003cf11a7ad.pdf

settlements made by the corporate debtor to the financial creditor.[275] In instances where the nature of the breach committed by the IP is serious and grave, the disciplinary committee may direct the IP to pay penalty equivalent to 10 percent of the fee that he received from the assignment[276] and further, bar him from accepting any new assignment or rendering services under the Code for a specified period of time. [277]

The sanctions that may be imposed against IPs by the insolvency professional agency has been amended to become more stringent and uniform, whereby under circular dated July 28, 2021[278], the Board notified that the insolvency professional agencies may impose a "*graduated system of penalties, where minor non-compliances will result in monetary fines and major violations will result in monetary fines and major violations will result in expulsion from the agency".*

The circular provides that a fine of Rs. 1,00,00 or 25% of the fee, whichever is higher shall be paid by the insolvency professional if it *inter-alia* fails to submit disclosures, returns or inadequate or incorrect disclosures under the Code and the relevant regulations. Further, a fine of Rs. 2,00,000 or 25% of the fee, whichever is higher shall be paid by the insolvency professional if it *inter-alia* accepts an assignment which has conflict of interest with stakeholders. Similarly monetary penalty has been provided for a variety of non-compliances by the IPs such as failure to maintain records, failure to comply with directions issued by the adjudicating authority, failure to make public announcement in the manner provided under the relevant regulations, failure to reject resolution plan from ineligible resolution applicants and various other non-compliances in its duties under the Code.

In India, the extent of personal liability on the IP is largely fixed by regulations and remains relatively stringent, whereby the IP would be personally liable if there is any loss or penalty imposed on the corporate person on account of non-compliance with any provisions of applicable laws if it is on account of his or her conduct.[279] Further in India, the Code specifically provides for the extent of monetary penalty that may be prescribed for any breach of duty or

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[275] Order dated July 8, 2021 (IBBI/DC/72/2021)
https://ibbi.gov.in//uploads/order/fbe3335c2327ac029dd3f9592bfbb6ed.pdf
[276] Order dated August 09, 2021 (ibbi/dc/75/2021)
https://ibbi.gov.in//uploads/order/cb47a2c91437584ec33bd61bcc2b6adf.pdf
[277] Order dated December 04, 2020 (ibbi/dc/51/2020)
https://ibbi.gov.in//uploads/order/e4dbc09f8da57699c9b70e57ea47fc58.pdf
[278] Circular dated July 28, 2021 (No. IBBI/IPA/43/2021)
https://ibbi.gov.in//uploads/legalframwork/c3d5d1bd7b451572b4dea0cfd7bcba3d.pdf
[279] Circular no. 2 of 2018 issued by IBBI dated January 3, 2018
https://ibbi.gov.in//webadmin/pdf/legalframwork/2018/Jan/CIRP 2_2018-01-03 18:42:00.pdf

contraventions of any regulations under the Code[280] under Section 220 of the Code and under Clause 24 (2) (d) of the Schedule to the IBBI (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016. We have not seen any cases where a liability is sought to be imposed on the insolvency professionals.

Part B – accountability under the English legal regime for insolvency professionals

1. Introduction

The context in which administrators will typically be appointed to manage a company means that their position is accompanied by a significant degree of legal risk. Administrators will often find themselves managing a company in crisis and will have to make swift decisions in circumstances where not all of the company's stakeholders will receive what they had expected or hoped for from the company (from shareholders whose shares in the company no longer have value, to secured creditors who can only recover part of their lending).

This Part B explores the way in which administrators' conduct can be challenged by stakeholders. Section 2 of Part B sets out an overview of administrators' duties, to whom they are owed and the different thresholds the Court will apply when assessing whether those duties have been breached. Section 3 sets out the mechanisms for challenge that may be available to stakeholders where those duties are breached. Section 4 provides a summary of three recent cases to illustrate of the key points identified in Sections 2 and 3. Section 5 discusses the process for challenging an administrator's compliance with his or her duties in court, and the implications for practitioners. Finally, Section 6 outlines the regulatory framework that applies to insolvency practitioners (including administrators) and explains how that framework also provides a basis for administrators to be held accountable for misconduct in the performance of their duties.

[280] Section 220 of the Code

2. Administrators' duties and standard for breach

As a preliminary point, as individuals acting as administrators are qualified professional insolvency practitioners. In recognition of the fact that many of their decisions will be commercial decisions, the courts have generally shown a degree of deference to their decision making.[281]

An administrator has duties to the company as its agent,[282] to the Court as an officer of the court,[283] and professional duties as a qualified professional who is authorised or a member of a professional body.[284] These duties overlap.

Many of the administrator's duties are statutory.[285] At the outset of an administration, an administrator has a duty to set the objective of the administration according to the statutory hierarchy of objectives, as set out in paragraph 3 to Schedule B1 of the Insolvency Act 1986:

(i) rescue the company as a going concern;

(ii) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration); or

(iii) realising property in order to make a distribution to one or more secured or preferential creditors.

Importantly, the objective the administrator selects to pursue will influence which stakeholders' interests take priority and to whom the administrator's duties are primarily owed: for example, if an administrator selects one of the first two objectives, his or her duty will be to act in the interests of the

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[281] Lightman & Moss, 12-008; *In re CE King Ltd* [2000] 2 BCLC 297, 302—3: "First, prima facie, what the administrators should do about [a particular] contract is a commercial decision. Secondly, at least in principle and in general, it is not for the court to interfere with such commercial decisions: those are to be left to the administrator. Thirdly, if the administrators are proposing to take a course which is based on a wrong appreciation of the law and/or is conspicuously unfair to a particular creditor or creditors or contractor of the company, then the court can and, in an appropriate case, should be prepared to interfere. I put it in that somewhat neutral way because even it is appropriate for the court to interfere, the actual course the court should take must inevitably depend on the actual facts and circumstances of the case." *Goel v Grant / In re Meem SL Ltd (in administration)* [2017] EWHC 2688 (Ch): "The threshold for the court to interfere with the decision of an administrator regarding the sale of an asset is at least as high as it is in the case of a liquidator, given that administrators are typically appointed in order to achieve speedy results" (emphasis added) [37].

[282] Insolvency Act 1986 (IA 1986), para 69 sch B1.

[283] IA 1986, para 5 sch B1.

[284] IA 1986, para 6 sch B1 and ss.390 and 390A IA 1986.

[285] In addition to the statutory duties outlined below, an administrator has other duties as an officer of the company (for example in relation to employment and health and safety). The focus of [chapter] will be the duties specific to administrators. (Lightman & Moss, 12-055).

company's creditors as a whole.[286] By comparison, if he or she selects the third statutory objective ("realising property in order to make a distribution to one or more secured or preferential creditors"), his or her duty will be to the relevant secured or preferential creditor. In that case, the administrator only has an obligation not to unnecessarily harm the interests of the creditors of the company as a whole.[287] The administrator's decision about which objective to pursue is only subject to challenge if it was made in bad faith or clearly perverse (in the sense that no reasonable administrator could have thought it was not reasonably practicable to pursue an objective that is higher in the statutory hierarchy).[288]

Furthermore, an administrator has broad statutory powers and duties in relation to the management of the company and to realise its assets to achieve the statutory objective of the administration.[289] These statutory duties are closely linked to several of an administrator's common law duties. The three key common law duties are (i) the administrator's duties as a fiduciary; (i) the administrator's duty to act with reasonable care and skill; and (iii) the administrator's duties under *Ex parte James*.

First, an administrator owes fiduciary duties to the company as its agent. Those duties include the duty of loyalty, the duty to exercise independent judgment,[290] and to avoid conflicts of interest.[291] The threshold for the Court to find that an administrator has breached a fiduciary duty is high: the Court "*will only interfere … if [the administrator has] done something so utterly unreasonable and absurd that no reasonable man would have done it*."[292] There are many instances in the case law where challengers have alleged a breach of fiduciary duty by an administrator, for example, based on allegations that an administrator has surrendered his or her discretion to a particular stakeholder or adviser[293]; or failed to take into account relevant matters and not irrelevant ones when exercising their powers and functions.

The scope of the administrator's fiduciary duty will be modified if he or she chooses to pursue the third objective of an administration. In those

[286] Para 3(2) sch B1.
[287] Para 3(4) sch B1.
[288] *Davey v Money* [2018] EWHC 766 (Ch) at [255]; *In Re Zinc Hotels* [2018] EWHC 1936 (Ch) at [98]
[289] Paras 59 and 70-72 sch B1 and sch 1.
[290] *Davey v Money* [2018] EWHC 766 (Ch) at [590]
[291] In *Davey v Money* [2018] EWHC 766 (Ch), the administrator's duty to use their powers for proper purposes was considered a fiduciary duty; whereas in *Re ARY Digital UK Ltd; Brewer v Iqbal* [2019] EWHC 182 (Ch) it was not: see [44].
[292] *Re Edennote Ltd* [1996] B.C.C. 718 (CA), 722.
[293] *Davey v Money* [2018] EWHC 766 (Ch) at [588]; *Re ARY Digital UK Ltd; Brewer v Iqbal* [2019] EWHC 182 (Ch).

circumstances, the administrator may put the interests of the secured or preferential creditors first, although he or she will continue to owe the unsecured creditors a fiduciary duty. In this regard, a complete surrender of discretion by an administrator to the interests of a secured or preferential creditor could be a breach of that fiduciary duty.[294]

Second, an administrator also owes the company a duty to act with reasonable care and skill in performance of his or her functions. This is a wide-ranging duty and arises in all aspects of an administration. The threshold for the Court to find that an administrator has breached this duty is where his or her conduct falls below the standard of the "ordinary, skilled practitioner" or the "reasonably skilled and careful practitioner."[295] Although this is not a fiduciary duty, failings by administrators which breach this duty can (as discussed further below) constitute a breach of fiduciary duty if, for example, they also entail a surrender of discretion or a failure to take relevant matters into account.

Third, an administrator has a duty as an officer of the court under *Ex parte James* to act fairly.[296] Where an administrator fails to do so, the Court may intervene pursuant to its supervisory jurisdiction. This is based on the principle that "*The court will not permit its officers to act in a way that it would be clearly wrong for the court itself to act.*"

However, this duty is rarely applied by the Court, and its application will be very fact specific.[297] It may, for example, apply where the administrator's insistence on adhering to a strict legal position would result in an outcome that is unfair, dishonest or dishonourable.[298] Such was the case in *Lehman Brothers Australia Ltd (In liquidation) v Downs*, where the incorrect currency conversion rate had been included in a claims determination deed in error, leading to a windfall to the estate, and the administrator did not consent to amending the deed. Finding that permitting the administrator to maintain the strict legal position would be in breach of the *Ex parte James* principle, the Court of Appeal granted relief to the counterparty to correct the error.

In addition, an administrator may assume other legal duties (and so potential personal liability) by a course of conduct during the administration. Such

[294] *Re One Blackfriars Ltd (In Liquidation) / Hyde v Nygate* [2021] EWHC 684 (Ch) at [230]-[231].
[295] Lightman & Moss, 12-042.
[296] Authority has been divided over whether the rule was limited to "unconscionable" behaviour or "unfair" behaviour: the Court of Appeal recently established that the test is one of fairness in *Lehman Brothers Australia Limited v Downs and others* [2020] EWCA Civ 321 at [68]. Given this finding, there is likely to be overlap between the application of the principle in *Ex parte James* and paragraph 74 of Schedule B1.
[297] *Lehman Brothers Australia Limited v Downs and others* [2020] EWCA Civ 321 at [68]-[69].
[298] Lightman & Moss, 12-044.

liability may be established under general legal principles (such as negligence or in respect of one of the economic torts, such as lawful means conspiracy or unlawful means conspiracy). However, an administrator needs to have acted in a particular way to owe such a duty to a stakeholder: it is not an automatic part of the administrator's statutory or common law duties. The test for an assumption of responsibility is an objective one, and the primary focus must be on things said or done by the administrator in his or her dealings with the stakeholder, viewed in light of all of the relevant facts and circumstances of a case. Specifically, an administrator needs to have made specific representations that are relied up on by the stakeholder, or there needs to be special circumstances or a special relationship between the administrator and the relevant stakeholder.[299] Recent examples where stakeholders have asserted this sort of relationship in making a claim against administrators include: (i) an unsuccessful purchaser of the company's assets, asserting a claim in negligent misrepresentation (in *PJSC Uralkali v Rowley*);[300] and (ii) a creditor whose interest in the company was affected by the sale of the company's assets (*Fraser Turner Ltd v PricewaterhouseCoopers LLP*).[301] In both cases, the claims failed. In *PJSC Uralkali v Rowley*, the Court indicated that such a duty would be unusual, commenting that:

I consider that the imposition of a personal duty of care on the administrators on facts such as the present would be inimical to the single-minded duty placed on administrators to act in the interests of the company's creditors. One can never say never, and there may be exceptional cases where administrators will be found to have taken on a personal responsibility to third parties.

Finally, there is the possibility that stakeholders may also seek to argue that administrators have incurred personal liability either by inducing the company to commit a tort or by participating directly in a tort such as unlawful means conspiracy. There are several cases in which parties challenging the conduct of administrators in a sale process have alleged or implied collusion between the administrators and another party, or between parties influencing the conduct of the sale.[302] However, in these examples the Court has not given

[299] *Fraser Turner Ltd v PricewaterhouseCoopers LLP* [2019] EWCA Civ 1290 at [70]-[71].
[300] *PJSC Uralkali v Rowley* [2020] EWHC 3442 (Ch)
[301] *Fraser Turner Ltd v PricewaterhouseCoopers LLP* [2019] EWCA Civ 1290
[302] *Clydesdale Financial Services Ltd v Smailes* [2009] EWHC 1745 (Ch) at [31]; *Davey v Money* [2018] EWHC 766 (Ch) at [588]; *In Re Zinc Hotels* [2018] EWHC 1936 (Ch) at [119]-[129]; *Re ARY Digital UK Ltd; Brewer v Iqbal* [2019] EWHC 182 (Ch) at [95]-[96].

these allegations serious consideration, suggesting that there would need to be compelling evidence that an administrator had behaved improperly for such a claim to be successful.

3. Mechanisms for challenging administrators in Court

There are two key statutory mechanisms for challenging the conduct of administrators, as set out in paragraphs 74 and 75 of Schedule B1 to the Insolvency Act 1986 and outlined below. The main difference between paragraphs 74 and 75 is that paragraph 74 concerns management of the company in administration, and paragraph 75 concerns an administrator's misconduct.[303] As set out below, the focus in paragraph 74 applications is whether the applicant has suffered unfair harm; misconduct by an administrator is an important factor but not a prerequisite.[304] On that basis, there is the possibility for an individual creditor to get relief under paragraph 74.[305] In contrast, where a stakeholder (with standing) wishes to assert a breach of duty by the administrator, the appropriate route will frequently be an application under paragraph 75.[306] Under paragraph 75, the relief is directed at restoring the administration estate for the collective benefit of the creditors or contributories, rather than providing an individual remedy.[307]

Challenges under paragraph 75

The statutory mechanism more frequently used for stakeholder challenge in relation to many of the duties set out above is paragraph 75 of Schedule B1. Under paragraph 75, the official receiver, an administrator, a liquidator, a creditor or a contributory may apply to court for the conduct of an administrator of the company to be examined.[308] The application under paragraph 75 must allege that the administrator:

(i) has misapplied or retained money or other property of the company;
(ii) has become accountable for money or other property of the company;
(iii) has breached a fiduciary or other duty in relation to the company; or
(iv) has been guilty of misfeasance.[309]

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[303] *In re Coniston Hotel (Kent) LLP* [2013] EWHC 93 (Ch) at [69].
[304] *Lehman Brothers Australia Limited v Downs and others* [2020] EWCA Civ 321; *Four Private Investment Funds v Lomas* [2008] EWHC 2869 (Ch); *Fraser Turner Ltd v PricewaterhouseCoopers LLP* [2019] EWCA Civ 129, as discussed below.
[305] *In re Coniston Hotel (Kent) LLP* [2013] EWHC 93 (Ch) at [69].
[306] Lightman & Moss, 12-064.
[307] *In re Coniston Hotel (Kent) LLP* [2013] EWHC 93 (Ch) at [69].
[308] A broader range of stakeholders therefore have standing to make an application under paragraph 75 compared with paragraph 74. Para 75(2).
[309] Para 75(3).

A wide variety of conduct is therefore capable of being challenged within the ambit of paragraph 75. In particular, any breach of the duty to exercise reasonable care and skill or any breach of fiduciary duty can be raised through a paragraph 75 challenge. The standards of review that the Court will apply in respect of those different types of duty are as set out above. If an application for relief under paragraph 75 is successful, the Court has the power to order an administrator to repay, restore or account for money or property; to pay interest; or to contribute a sum to the company's property by way of compensation for breach of duty or misfeasance.

It is possible for an administrator, if found liable under paragraph 75, to apply for relief from liability on the basis that he or she acted honestly and reasonably, and having regard to the circumstances of the case, he or she ought fairly to be excused from liability.[310]

Challenges under paragraph 74

In addition, a creditor or member of a company in administration may apply to the Court for relief under paragraph 74 of Schedule B1 where:

(i) the administrator is acting or has acted so as unfairly to harm the interests of the applicant (whether alone or in common with some or all other members or creditors); or

(ii) the administrator proposes to act in a way which would unfairly harm the interests of the applicant (whether alone or in common with some or all other members or creditors; or

(iii) the administrator is not performing his functions as quickly or efficiently as is reasonably practicable.

So what will constitute unfair harm? Certain principles have emerged through case law, although the Court of Appeal has recently reiterated that paragraph 74 has a wide ambit, and the test the Court will apply is that of unfairness – the principles established in case law do not limit that test.[311] Nevertheless, the existing case law provides useful as guidance as to what may constitute unfair harm:

[310] Companies Act 2006, s.1157; Lightman & Moss 12-067.
[311] *Lehman Brothers Australia Limited v Downs and others* [2020] EWCA Civ 321 at [83].

(i) First, it will be an important factor if the administrators were acting otherwise than in accordance with their obligations under Schedule B1 of the Insolvency Act 1986, or an order of the Court, or with their obligation to carry out their functions in good faith in the interests of the creditors as a whole: without any suggestion to the contrary, it is unlikely that the administrator's conduct will be unfair for the purposes of paragraph 74.[312]

(ii) Second, if there is unequal or differential treatment towards the affected creditors or members, that may well be an indication of unfair harm, though it may be justified by reference to the interests of the creditors as a whole or to achieving the objective of the administration.[313] Although differential or discriminatory conduct towards the affected creditors or members is not required for there to be unfair harm,[314] there is some authority that – without any differential or discriminatory conduct – it may be necessary to show that the administrator's decision is perverse for the Court to intervene.[315]

(iii) Third, the lack of commercial justification for a decision causing harm to the creditors as a whole may be unfair in the sense that the harm is not one which they should be expected to suffer.[316]

(iv) Finally, a remedy under paragraph 74 will only be available to a creditor in its capacity as a creditor: for example, a creditor would not be entitled to relief under paragraph 74 if the harm it complained of related to its contractual relationships with third parties.[317]

Only creditors or members of companies have standing to make an application under paragraph 74, and (in relation to the first two aspects) the unfair harm can affect the applicant alone or all creditors or members. If an application for relief under paragraph 74 is successful, the Court has wide powers, including to direct the administrator to take or not take a certain action or to be removed entirely.[318] An application under paragraph 74 can be used to prevent the administrator from taking a proposed course of action (as well as to review an action that has been taken). In this way, it can be

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[312] *Lehman Brothers Australia Limited v Downs and others* [2020] EWCA Civ 321 at [84] limits the question of whether the administrators are complying with their obligations to "a factor of great importance", rather than breach being a prerequisite for intervention under paragraph 74, as established in *Four Private Investment Funds v Lomas* [2008] EWHC 2869 (Ch) at [39] and followed in *Fraser Turner Ltd v PricewaterhouseCoopers LLP* [2019] EWCA Civ 1290 at [76].
[313] *Hockin v Marsden* [2014] EWHC 763 (Ch) at [19]; *Goel v Grant / In re Meem SL Ltd (in administration)* [2017] EWHC 2688 (Ch) at [44(i)]
[314] *Lehman Brothers Australia Limited v Downs and others* [2020] EWCA Civ 321 at [83].
[315] *Goel v Grant / In re Meem SL Ltd (in administration)* [2017] EWHC 2688 (Ch) at [44(ii)]
[316] *Hockin v Marsden* [2014] EWHC 763 (Ch) at [19]
[317] *Fraser Turner Ltd v PricewaterhouseCoopers LLP* [2019] EWCA Civ 129 at [77].
[318] Para 74(4).

similar to an application for an injunction and the Court may rely on similar principles in deciding whether to grant the application.[319] The Court's powers are broad enough to permit the Court to order compensation to be paid by the administrator to an affected creditor, although this is not the purpose of paragraph 74.[320]

Challenges under paragraph 88

In addition, the Court may order the removal of an administrator under paragraph 88 of Schedule B1. Unlike paragraphs 74 and 75, standing to make an application under paragraph 88 is not limited to certain categories of stakeholder. However, the Court has held that it should not be easy to remove administrators simply because their conduct has fallen short of the ideal.[321] As a result, it is unlikely that breaches of some of the duties set out above would be a sufficient basis for the Court to make an order to remove an administrator under paragraph 88.

An example of an administrator being removed under paragraph 88 of Schedule B1 can be found in the case of *Vegas Investors IV LLC v Shinners*. The administrators of the relevant company had sold assets through a pre-pack administration in circumstances where there were concerns that the sale had been at an undervalue. As the administrators' firm had advised on the pre-pack sale, there was also a concern that the administrators had a conflict of interest that prevented them from effectively investigating whether their firm had been negligent in its pre-appointment advice. The administrators opposed the application and their conduct at the hearing of the application, which the Court found to be defensive rather than impartial, highlighting their lack of objectivity and conflict of interest.[322] Prior to ordering the removal of the administrators, the Court considered the impact of the order on the administrators' professional standing and reputation and whether the order would encourage unjustified applications.[323] This judgment confirms that the Court is unlikely to grant applications under paragraph 88 unless there is clear evidence of a breach of key duties or the risk of such a breach.

[319] For example in *In re Zinc Hotels, Zinc Hotels Investment v Beveridge* [2018] EWHC 1936 (Ch), the Court applied the American Cyanamid principles applicable to injunctions when considering an application by the shareholders under paragraph 74 to appoint an additional administrator.
[320] Lightman & Moss, 12-064; *In re Coniston Hotel (Kent) LLP* [2013] 2 BCLC 405, [36].
[321] *Vegas Investors IV LLC v Shinners* [2018] EWHC 186 (Ch)
[322] *Vegas Investors IV LLC v Shinners* [2018] EWHC 186 (Ch) at [27]-[33].
[323] *Vegas Investors IV LLC v Shinners* [2018] EWHC 186 (Ch) at [35]-[36].

4. Case studies: breach of fiduciary duty in selling assets of the company

As noted above, the administrator's fiduciary duties and his or her duty to exercise reasonable skill and care can overlap. The threshold for showing a breach of fiduciary duty is higher that it is to show a breach of the duty to exercise reasonable skill and care. Why, then, do challengers seek to establish a breach of fiduciary duty when the circumstances permit both a breach of fiduciary duty and a breach of the duty to exercise reasonable skill and care to be alleged? As shown by the recent case of *Brewer v Iqbal*, a breach of fiduciary duty means that restitutionary or restorative remedies available in the equitable jurisdiction are available, rather than the compensatory remedies available for breach of the duty of skill and care.[324] In *Brewer v Iqbal*, where the breach of duty meant that the company's main asset had been sold at an undervalue, the implication was that equitable compensation was assessed as the difference between the sale price and the value of the asset at the date of the judgment, as opposed to the date of the breach.[325]

There are three recent cases in which the value at which an administrator sold the company's main asset or assets was the subject of challenge under paragraph 75 on the basis that the administrator(s) had breached both their fiduciary duties and their duty to exercise reasonable skill and care in doing so: *Davey v Money*, *Brewer v Iqbal* and *Hyde v Nygate*. These cases provide an interesting illustration of how the Court will assess an administrator's conduct and whether a breach will constitute a breach of fiduciary duty or not. In overview:

(i) In all three cases, an administrator or the administrators marketed and sold the company's main asset after their appointment, and the sale was alleged to have been at an undervalue. Both *Davey v Money* and *Hyde v Nygate* concerned sales of London property with development potential, where there were a range of variables affecting value and a range of views on valuation. *Brewer v Iqbal* concerned the sale of "EPGs", which are digital menus providing programming scheduling information shown on cable or satellite television channels.

[324] *Re ARY Digital UK Ltd; Brewer v Iqbal* [2019] EWHC 182 (Ch), applying *Bristol & West v Mothew* [1998] Ch 1 at [37], [55], [98]-[99].

[325] Another consideration that may be important to a stakeholder seeking to challenge the conduct of an administrator as a breach of fiduciary duty (rather than a breach of the duty to exercise reasonable care and skill) is that such a breach may provide the basis for a claim in dishonest assistance and/or knowing receipt against a third party, whereas negligence will not.

(ii) In each case, there were allegations that the administrators had failed to undertake a proper sales process to realise the value of the relevant asset, had failed to act independently and had failed to properly assess the value of the asset.

(iii) *Davey v Money* was an application by the company's sole shareholder and director. *Hyde v Nygate* and *Brewer v Iqbal* were applications brought by the companies' liquidators.

(iv) In *Brewer v Iqbal*, the administrator did not obtain any valuation of the EPGs. He carried out very limited marketing before selling the assets to the company's directors: he arranged for the assets (the EPGs, which were specialised and unusual) to be listed on a non-specialised agent's website under "Machinery sales", with limited particulars, for only seven days, without seeking any advice on whether that was a reasonable process for that sort of asset or ascertaining whether the agent had any experience of selling that sort of assets.

(v) In *Davey v Money* and *Hyde v Nygate*, the administrators carried out a sales process over several months with the support of an independent agent. There were allegations that they had deliberately set the sale price at the level of the secured creditors' debt, to the detriment of other creditors.

(vi) In addition, in *Davey v Money*, the applicant alleged that the administrators had acted out of personal antipathy to her in the way they had carried out the sale.

In each case, the Court carried out a detailed factual assessment of the administrators' conduct and the sale process based on oral witness and expert evidence, having regard to the following propositions of law derived from existing authorities:

(i) Where an applicant asserts that a property has been sold at an undervalue, it must establish that there has been a failure in the sales process before the Court will consider hypothetical expert evidence as to value.[326]

(ii) As a general proposition, an administrator's duty when selling the company's assets is not a fiduciary one: their duty is to take reasonable care to obtain the best price that the circumstances (as the administrator reasonably perceives them to be) permit. Put

[326] *Re One Blackfriars Ltd (In Liquidation), Hyde v Nygate* [2021] EWHC 684 (Ch) at [455].

another way, the duty is not an absolute duty to obtain the best price that circumstances permit, but only to take reasonable care to do so.

(iii) The relevant circumstances are those as the administrator reasonably perceives them to be. He or she will not be made liable because his perception is wrong, unless it is unreasonable.[327]

(iv) However, it is possible for an administrator's failings in the way he or she carries out a sales process to amount to a breach of fiduciary duty where it amounts to a failure of decision making (to take into account relevant information, and not to take into account irrelevant information). For example, in *Brewer v Iqbal*, the administrator was found to have breached his fiduciary duty in this way, as well as the duty to exercise reasonable care and skill, where he had not obtained a valuation or carried out a reasonable sales process before selling the assets to the company's directors.

One aspect of the sales process that was subject to scrutiny in each case was marketing and advertising. There is no legal obligation for an administrator to advertise an asset for sale: the duty is to take reasonable care to obtain the best price, which will often involve advertisement but not always – this will be question of fact.[328] In *Brewer v Iqbal*, the administrator's limited approach to marketing was taken without seeking any advice on whether that was a reasonable process for that sort of asset or ascertaining whether the agent had any experience of selling that sort of assets. This was a breach of duty on his part. In contrast, in *Davey v Money* and *Hyde v Nygate*, the applicant criticised the level of and approach to marketing. The administrators had appointed selling agents who were not the leading agents in the market, did not have the international reach of their competitors, and only contacted a selection of potential bidders. However, while other professionals might have made different judgment calls, the administrators' approach was not unreasonable or inadequate. As a result, in these cases the Court found there was no breach of either the duty to exercise reasonable care and skill or of fiduciary duty.

Another key issue in challenges to administrator's conduct is the value at which a key asset was sold . It will be important for the administrator to have reliable information about value, especially where the assets are specialised or unusual. In *Brewer v Iqbal*, the administrator's failure to seek any valuation of the assets (and instead rely on what the directors were willing to pay for

[327] *Charnley Davies (No.2)* [1990] BCLC 760, applied in *Davey v Money* [2018] EWHC 766 (Ch) at [383]-[387].
[328] *Davey v Money* [2018] EWHC 766 (Ch) at [455].

them) was a breach of duty.[329] In *Hyde v Nygate*, the administrators were criticised for not seeking a further valuation to clarify the position in circumstances where the market was uncertain and the administrators had two recent valuations that were very different. In these circumstances, the Court did not consider that there had been any breach of duty by the administrators in continuing the sale process without seeking a further valuation. This was distinct from a case of an administrator putting an asset on the market without any or any up to date information on value (as in *Brewer v Iqbal*): instead, where the market is unstable, the critical factor in determining the value is whether the marketing process was sound and achieved market value.[330]

In all three cases, the challenger alleged that the administrators had failed to act independently, instead surrendering their discretion to other stakeholders and acting in the interests of those stakeholders, rather than the company. Where that was the case, that would constitute a breach of fiduciary duty. Two themes emerge from the discussion of these criticisms. First, that it is not an inappropriate fetter on an administrator's discretion to outline a strategy for the administration at the outset.[331] On the other hand, it is an inappropriate surrender of discretion to adopt the approach proposed by the directors or secured creditors of the company, without question.[332] Second, where an administrator acts with speed to conclude a transaction, that will not be improper where he or she has seriously explored the available options to maximise value.[333] It will be improper if he or she is acting within that timeframe by reference to the interests of a third party, rather than in the interests of the company.[334]

5. Court process

Challenges to administrators' conduct (especially when the application is for review of past decisions, rather than to prevent administrators from taking a particular action) will be fairly long running, as with any English High Court litigation. There may be years between the application being issued and trial. The trial itself may be long (for example, *Davey v Money* and *Hyde v Nygate* were heard in trials that lasted several weeks). Before trial, parties will need

[329] *Re ARY Digital UK Ltd, Brewer v Iqbal* [2019] EWHC 182 (Ch) at [82].
[330] *Re One Blackfriars Ltd (In Liquidation), Hyde v Nygate* [2021] EWHC 684 (Ch) at [322].
[331] See *Davey v Money* [2018] EWHC 766 (Ch) at [267]; *Re One Blackfriars Ltd (In Liquidation), Hyde v Nygate* [2021] EWHC 684 (Ch) at [277].
[332] *Re ARY Digital UK Ltd, Brewer v Iqbal* [2019] EWHC 182 (Ch) at [90].
[333] *Davey v Money* [2018] EWHC 766 (Ch) at [520]; *Re One Blackfriars Ltd (In Liquidation), Hyde v Nygate* [2021] EWHC 684 (Ch) at [455].
[334] *Re ARY Digital UK Ltd, Brewer v Iqbal* [2019] EWHC 182 (Ch) at [90].

to exchange witness statements; at trial, those witnesses are likely to have to give oral evidence and be subject to cross examination. Expert evidence is likely to be required (for example, in *Hyde v Nygate*, expert witnesses gave evidence on insolvency practice, issues of sale and marketing of land, in relation to valuation and in relation to planning). Both parties are also likely to have to give broad disclosure of documents prior to the trial.

The limitation period for such applications to be brought will generally be six years.[335] This may mean that a considerable time may pass between the events in question and trial. For example, in *Brewer v Iqbal*, there were eight years between the sale of the asset and the trial in relation to whether the administrator had breached his duty in selling the asset. Given the potential gap in time between the relevant events and the litigation, it is important for administrators to record steps taken and their decision making. The people who were involved at the time may no longer be available, and individuals' memory of complex events that happened at speed and under pressure are notoriously unreliable years down the line.

6. Regulation and regulatory enforcement

In addition to the above, administrators are required to be qualified insolvency practitioners. They have professional standards of conduct. This is one reason why the Court is willing to defer to the administrator's commercial and professional judgment.

As well as owing duties to the company and the creditors, administrators may be held accountable by their professional body. Two recent examples include the administrators of Silent Night and Comet. Both companies were sold through prepack administrations. In both administrations, the administrator's firm had a professional relationship with the acquirer of the company. The regulatory tribunals found that, as a result, that the administrators lacked objectivity and their professional judgment was compromised, which was a breach of professional standards and ethics.

In both cases, the acquirer of the company made a profit, while creditors suffered losses. There was a public interest due to unpaid taxes and pension scheme shortfalls, which may suggest regulatory intervention is more likely where there is such public interest in the matter.

[335] *Re Eurocruit Europe Ltd (In Liquidation)* [2007] EWHC 1433 (Ch)

Part C - Conclusion

The role of the insolvency professionals is complex and wide-ranging. There appear to be some key differences in the two regimes analysed: firstly, as to whom the insolvency professional owes his or her duty (England seems to have a clearer answer than the Indian regime) and more importantly, in the role played by insolvency professionals on commercial decisions. The English regime provides administrators much wider power to make commercial decisions, but also imposes duties on administrators in respect of the creditors so that they can be held accountable if they do not protect the creditors' interests. The Indian regime on the other hand treat resolution professionals as "facilitators" with the commercial wisdom vested with the creditors. Fairness including equal treatment of creditors and transparency appear as common themes in both jurisdictions.

It is hoped that the duties and roles of the resolution professional in India will be defined further and the principles developed in England and Wales can aid such evolution.

Going Concern Sales in Insolvency and Liquidation

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Going Concern Sales in Insolvency and Liquidation

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Introduction

It is well-recognized that one of the key objectives of insolvency law regimes is to maximize value for all stakeholders.[336] The preamble to the [Indian] Insolvency and Bankruptcy Code, 2016 ('**IBC**') provides that "it is an Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India ('**IBBI**'), and for matters connected therewith or incidental thereto." It is notable that the preamble does not use the word liquidation at all even though the liquidation process is entirely prescribed by the IBC. Courts and tribunals have relied on the preamble of IBC to read into it a hierarchy of objectives, such as resolution followed by maximisation of value.[337] It has also driven the courts and tribunals to conclude that under the IBC all efforts must be made to rehabilitate the enterprise and only once it is clear that the enterprise cannot be rehabilitated, should it be liquidated. Liquidation is therefore the absolute last resort.[338] People may have differing views on the legal merits of such an interpretation, but it is readily conceded that maximisation of value for all stakeholders is best achieved through an insolvency resolution process

[336] International Monetary Fund, Orderly & Effective Insolvency Procedures (1999) at Chapter 2, page 6; The World Bank, Principles for Effective Insolvency & Creditor / Debtor Regimes (2015), at page 7, UNCITRAL Legislative Guide on Insolvency (2005), Recommendation 1 (b) and (c) and page 11.
[337] Binani Industries v. Bank of Baroda, 2018 SCC OnLine NCLAT 521, ¶ 17.
[338] ArcelorMittal v. Satish Gupta, (2019) 2 SCC 1, ¶ 83.

or rehabilitation rather than liquidation. This is predicated on the basic economic theory that greater value may be obtained from keeping the essential components of a business together, rather than breaking them up and disposing of them in fragments.

A distressed company's business undertaking is effectively a collection of assets, some of which may have a value that go towards discharge of outstanding debt. However, by virtue of how different creditors are positioned with respect to recourse to such assets, and the ability to exercise such recourse (e.g. secured and unsecured creditors, trade creditors and preferential creditors), the Creditors Bargain Theory of insolvency law suggests that *"a collective and regulated formal scheme of asset distribution to creditors, rather than piecemeal liquidation of company assets, would preserve the company's net asset value"*.[339] As seen from this lens, the common law system of "administration" is a natural creature of this theory. In this context, it Lord Justice Nicholls' statement regarding the fundamental nature of administration is pertinent:

"In contrast [to liquidation] an administration is intended to be only an interim and temporary regime. There is to be a breathing space while the company, under new management in the person of the administrator, seeks to achieve one or more of the purposes set out. There is a moratorium on the enforcement of debts or rights, proprietary or otherwise, against the company so as to give the administrator time to formulate proposals and lay them before the creditors and then implement any proposal approved by the creditors. In some cases, winding up will follow. In others, it will not".[340]

As the World Bank notes, the rescue of an enterprise preserves jobs, provides better returns for creditors as well as owners on going-concern basis, and also accrues benefits for the country by way of rehabilitation of the enterprise.[341] It is for this reason that the international frameworks recommend that laws provide for a switch between liquidation and insolvency proceedings.

At the same time, an orderly and quick liquidation of unviable enterprises is also one of the objectives of insolvency procedure. It allows for a more efficient allocation of resources and may provide better returns for stakeholders, or at least, for certain secured creditors. The key determinant in this respect is when an enterprise is deemed to be unviable. There are

[339] Jackson, "Bankruptcy, Non-Bankruptcy Entitlements and the Creditors' Bargain", (1982) 91 Yale Law Journal;
[340] *In Re Atlantic Computer Systems PLC*, Court of Appeal (Civil Division) - [1992] Ch. 505.
[341] The World Bank, Principles for Effective Insolvency & Creditor / Debtor Regimes (2015), at page 8. See also Elecon Engineering v. Enviiro Bulkk, C.P. (IB) No. 1319/MB/2017 (NCLT Mumbai, decided on 21.06.2021), at ¶29.

inherent tensions in various insolvency law objectives and competing interests of stakeholders in insolvency (e.g., secured and unsecured creditors, workmen and so on), and countries try to balance these by keeping in mind the prevailing market, social and economic conditions in the respective jurisdictions.

It is in light of the above that one must assess the IBC and its emphasis on preserving the going-concern basis of a distressed corporate debtor. As an example of how other jurisdictions approach this conundrum, the following paragraphs discuss UK insolvency processes.

Corporate Rescue and Rehabilitation Processes in the UK

To achieve the corporate rescue objective, different jurisdictions have (a) created specific insolvency resolution processes focussing on different stakeholders, e.g. pre-packs, administrations and company voluntary arrangements (CVAs), (b) created regimes suited to specific sectors or debtors (e.g. SMEs or gas and electricity markets), and (c) drafted laws or created judicial precedents which maximise the chances of success for distressed entities undergoing a rescue or rehabilitation insolvency procedure (e.g. laws dealing with ipso facto clauses (preventing termination of key contracts between distressed companies and essential suppliers of goods or services)). Rehabilitation processes push commercial stakeholders to compromise individual objectives to achieve the common goal of maximising value and avoiding the last resort of a fire sale of company assets. Some of these will be explored below.

Rescue and rehabilitation processes range from those which keep the debtor in possession during the insolvency resolution process to those that put the courts or insolvency practitioners in charge. For example, in an administration a qualified insolvency practitioner takes control of the distressed entity (whether such appointment is made by a vote of the shareholders, directors or by a creditor who is a qualifying floating charge holder), while a US Chapter 11 style restructuring keeps the current management in place rather than appoint insolvency practitioners to oversee the company management.

The UK has passed laws at various times to create over 28 specific insolvency frameworks applicable to particular sectors or "systemically important" industries where the normal focus on the rights and returns of creditors is balanced with the continued provision of business services (e.g., energy and banks) or other broader goals. For example, as a result of an unexpected surge in wholesale gas prices, UK's "special administration" regime (which applies modified insolvency laws to utilities, railways or other entities whose insolvency have a wider public impact) was tested for the first time with Bulb's collapse in 2021.

At the time the legislation was historically introduced (a decade before it was finally put to use), the government was providing for a "low probability but high impact event" which has proved prescient in the context of the energy crisis in Europe since 2021. Under the special administration regime for energy supply companies regulated by The Energy Act 2011, the Secretary of State (or the energy regulator Ofgem (Office of Gas and Electricity Markets) with its consent) rather than creditors may petition the court to appoint an administrator. As set out in Section 96 of the Energy Act, the "purpose" of this special administration is different from an ordinary administration:

"95. The objective of an energy supply company administration is to secure… that energy supplies are continued at the lowest cost which it is reasonably practicable to incur…..(2) those means are… the rescue as a going concern of the company subject to the esc administration order"

This gives the administrator a wider reaching objective than purely maximising value for creditors as a whole and prioritises the customers of the energy supply companies in the hierarchy of stakeholders. If this special administration would not apply, it would have particularly hit those energy consumers who were on fixed or capped contracts with Bulb as switching during a time of a sharp peak in wholesale markets would have meant a steep rise in the energy prices available to them under new contracts.

Going Concern and the IBC

Almost all insolvency regimes are concerned with preserving the going concern status of the corporate debtor to facilitate re-organisation or resolution rather than a piecemeal sale of assets. The continued operations of the corporate debtor are critical to maximise value in any insolvency process. The concept permeates various provisions of laws such as moratorium and post commencement /interim finance.

IBC and the regulations framed thereunder, also envisage that the resolution professional shall manage the operations of the corporate debtor as a going concern. A license or concession by a governmental authority cannot be terminated or suspended on the grounds of insolvency during the moratorium. Likewise, supply of goods and services that are critical to manage the operations of the corporate debtor shall not be terminated or suspended during the moratorium so long as dues during the period are paid. Costs incurred by the resolution professional in running the business of the corporate debtor as a going concern are treated as insolvency resolution which rank first in the payment waterfall. [342] The resolution plan must provide for resolution as a going concern. The Liquidation Regulations also refer to sale of corporate debtor or its business(es) on a going concern basis.

The term going concern is not defined under the IBC but is well recognised as a fundamental accounting assumption. The Indian AS-1 (Disclosure of Accounting Policies) standard notes that the enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

What constitutes sale as a going concern? The UNCITRAL Guide definition is not very helpful in defining "Sale as a going concern" as the sale or transfer of a business in whole or substantial part, as opposed to the sale of separate assets of the business. The discussion paper on the Corporate Liquidation Process dated April 27, 2019 issued by the IBBI is clearer when it notes that the sale of the enterprise as a going-concern involves "transfer along with the business, assets and liabilities, including all contracts, licenses, concessions, agreements, benefits, privileges, rights or interests to the acquirer".[343] There are dicta to the effect that in liquidation, a 'going concern' sale means that only assets are transferred and the liabilities of the Corporate Debtor have to be settled in accordance with Section 53 of the IBC. The acquirer therefore takes over the assets without any encumbrance or charge.[344]

In the context of the Corporate Insolvency Resolution Process (CIRP), the concept of going concern has not created much issue except (i) for audit purposes since auditors seek to qualify the going concern assumption in accounts post CIRP initiation; and (ii) on evaluation of resolution plans, where the stipulation of going concern has been interpreted to mean that the plan must be for whole of corporate debtor, meaning that there can be no cherry-picking of assets. Incurring capital expenditures and sale of assets outside the ordinary course of business are, of course, excluded from the context of continuation of business as a going concern.

[342] See Sections 5(13), 5(23C), 14(2A), 20 and 54H.
[343] Insolvency & Bankruptcy Board of India, Discussion Paper on Corporate Liquidation Process along with Draft Regulations, ¶3.2.1. There are various cases under Indian tax laws dealing with the concept of going concern sale.
[344] Gaurav Jain v. Sanjay Gupta, C.P. (IB) No. 1239/MB/2018 (NCLT Mumbai, decided on 09.03.2021), at ¶¶ 25, 28.

UK Insolvency Law: The Cork Report and "Rescue Culture"

Although, insolvency laws and practices in the UK have existed for centuries (through various historic legislation[345] and case law), much of modern insolvency laws originate from the Cork Report of 1982 (*Report of the Review Committee on Insolvency Law and Practice*) commissioned by the then British government in 1977. The report's purpose was to propose recommendations on reforming UK insolvency law and it was chaired by Sir Kenneth Russell Cork (who was a partner in Cork Gully, a firm that specialised in insolvency as well as being a qualified accountant). The report along with the government's 1984 white paper (*A Revised Framework for Insolvency Law* (1984) Cmnd 9175) helped construct the IA 1986.

The report raised several issues including:

- the necessity of a unified system of insolvency courts to be created to administer the laws;
- that interested creditors and stakeholders should have a greater say in the choice of liquidator;
- that new penalties should be introduced on persons deemed liable for the collapse and failure of a company; and
- that a set of checks and constraints should be introduced on the directors of companies (which was the genesis for the Company Directors Disqualification Act 1986).

Cork voiced concern over many companies being allowed to fail and go insolvent – indeed, the most common outcomes (pre- IA 1986) for distressed companies was a receivership instituted at the behest of the primary secured creditors to enforce its security and realise the charged assets in (partial) satisfaction of its debt, followed by a liquidation of the company. It was evident that receivership (different in design to an outright liquidation), led to an undesirable outcome in that companies rarely survived this procedure, as its aim was to maximise returns to creditors, in particular the principal creditor holding the floating charge.[346]

[345] 'Statutes dealing with the bankruptcy of individual debtors were enacted at intervals from the mid-16th century onwards' Chapter 1, Section 5, (1-016) Sweet & Maxwell The Law of Insolvency 5th Ed.).
[346] 'Corporate Rescue in the United Kingdom: Past, Present and Future Reforms' Paul J. Omar and Jennifer Grant.

The Cork report therefore focussed on creating a rescue process which had a higher likelihood of rehabilitating an insolvent company as a going concern. Cork's aim was to foster a 'rescue culture' in English insolvency law[347]. The two mainstays of the Cork Report were introducing the concept of an administrator (in contrast to a liquidator) into corporate insolvency law (and whose statutory purpose was aligned with Cork's focus on company rescue) and elevating the concerns of unsecured creditors who typically received nothing or very little in the end.

The Cork Report included proposals for two new or revised procedures:

1) *"administration"*, under which a company in trouble could seek an Order from the court for the appointment of an external "administrator" to manage the company, whether with a view to rescue of the business, its disposal as a going concern, or disposal of its assets, so as to provide creditors with a better return than would be obtained under liquidation;
2) *company voluntary administration (CVA)*, whereby a company, whether or not insolvent or facing insolvency, could make an arrangement with its creditors and members for satisfying its debts, on the basis of acceptance by creditors of a proposal made by the directors. The company would be able to continue to trade under the control of the directors and the general supervision of a "supervisor". A CVA could have the same purposes as an administration, including a liquidation, but would need Court sanction."[348].

Both schemes were implemented in the 1985 Insolvency Act, subsequently consolidated in the 1986 Insolvency Act, and implemented in detail by the 1986 Insolvency Rules[349]. Along with the IA 1986, the Company Directors Disqualification Act 1986, the Insolvency (England and Wales) Rules 2016 and the Enterprise Act 2002, the legislative framework in the UK refined (and implemented in large part) the key recommendations of the Cork Report.

Today, English law insolvency procedures can be roughly divided into two classes: first, those designed for, or at least those which contemplate, the rescue of the company as a going concern, and, secondly, insolvency procedures that are primarily concerned with the cessation of any ongoing business, the separation and realisation of assets and the return of any monies obtained from that sale process to creditors.

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[347] Chapter 24-1, Kerr & Hunter on Receivers and Administrators 21st Ed..
[348] Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558.
[349] Select Committee on Trade and Industry Second Report.

UK Law Rescue Procedures: Going Concern

Administration: Administration is a procedure whereby a company is given a "breathing space"[350] to allow it to be rescued or reorganised or, if necessary, have its assets realised. The company can be put into administration either by a court order following an administration application, or (more commonly), where the appointment is by the directors of the company, the company itself or the holder of a qualifying floating charge, by the simple filing of documents at the court (this is known as the out-of-court route, as no court hearing is involved). Once placed under administration, administrator(s) (typically a qualified insolvency practitioner) are appointed. An administrator is an officer of the court as well as an agent of the company. Upon appointment of the administrator, a moratorium comes into effect which, subject to some exceptions, estops any action instigated by creditors against the company or its assets unless the administrator consents or the court so permits.

An administration by statutory design has to achieve the following objectives (ranked in order of priority[351]):

1. "rescuing the company as a going concern;
2. achieving a better result for the company's creditors as a whole, than would be likely in a winding up (without first being in administration); or
3. realising [the company's] property in order to make a distribution to one or more secured or preferential creditors, (if it is not reasonably practicable to achieve either of the first two objectives and it will not unnecessarily harm the interests of creditors as a whole)."[352]

As a practical matter, the proposed administrator will normally review the company's affairs and finances and offer advice prior to appointment including on the timing and manner of appointment[353] – this is because in accepting such an appointment, the rules require the administrator to form a view that in the administrator's opinion, as a result of the appointment "*it is reasonably likely that the purpose of the administration will be achieved*".[354] The administrator(s) takes over the day to day running of the company and its business and runs the administration in accordance with the statutory

[350] Corporate insolvency: a guide, Practical Law UK Practice Note Overview 8-107-3973.
[351] There is some scholarly debate on whether the legislation prescribes a hierarchy of objectives.
[352] Insolvency Act, Schedule B1 Paragraph 3. Karen McMaster, Sarah Levin, Lynette Janssen and Matthew Fonti, Milbank LLP: The Insolvency Review: United Kingdom - England & Wales.
[353] Chapter 6-03, Lightman & Moss on The Law of Administrators and Receivers of Companies 6th Ed.
[354] Rule 3.2 (1)(h), The Insolvency (England and Wales) Rules 2016.

purposes which the administrator(s) think capable of achieving and in accordance with the proposals which they put to creditors for their approval. 'The proper purposes of administration are, it is submitted, wedded to the concept of maximising the value of the business for the creditors as a whole[355].

If the company is particularly distressed and there is little chance of its rescue, the administrator(s) will sell the company's business and assets and the company will be put into liquidation or dissolved. If the administration has not come to an end before then, the administration will end automatically after one year unless its term is extended in advance[356].

Company voluntary arrangement (CVA): A CVA is an arrangement between the company and its creditors implemented and supervised by an insolvency practitioner under Part I of the IA 1986. A CVA becomes binding on all unsecured creditors if and when it is approved by the appropriate majority of creditors[357]. It is used to avoid or to supplement (as relevant) other types of insolvency procedures. It may be used in conjunction with administration where a moratorium gives the company breathing space to agree any proposals with secured and unsecured creditors.

A pertinent feature of a CVA is that '*it is not a prerequisite for the application of this Part I of the IA 1986 that the company should be "insolvent" or "unable to pay its debts" within the statutory definitions of those terms*'[358] – this obviously helps companies that are stressed before the point of no return in terms of becoming insolvent. The Cork Report's focus on this procedure recognises the immediacy of actions required to preserve the going concern status of a company. CVAs are initiated by the company itself which is best placed to assess its cashflow situation and as such has been a powerful tool during the pandemic induced stress on revenues (particularly with respect to restructuring of property related costs borne by businesses that rely on a physical presence to generate revenue).

Scheme of arrangement: A scheme of arrangement is a compromise or other form of arrangement agreed between creditors (or any class of creditors) or members (or any class of members) and is made under Part 26 of the Companies Act 2006. The arrangement is ultimately binding if the appropriate majorities of each class of creditors/members agree. In contrast to a CVA under Part I of the IA 1986, a scheme of arrangement must be sanctioned by the court however similar to a CVA a scheme can be used both by solvent and insolvent companies.

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[355] Chapter 2-02, Totty, Moss & Segal: Insolvency.
[356] Chapter 24-3, Kerr & Hunter on Receivers and Administrators 21st Ed..
[357] Volume 1, Part 1 Company Voluntary Arrangements, Sealy & Milman: Annotated Guide to the Insolvency Legislation 24th Ed. – 2021.
[358] Volume 1, Part 1 Company Voluntary Arrangements, Sealy & Milman: Annotated Guide to the Insolvency Legislation 24th Ed. – 2021.

When a scheme is sanctioned by the relevant majority of creditors/members and the court (75% in value and a majority in number, of each class), the scheme will bind all members and creditors regardless of whether they had notice of the proposed scheme of arrangement. Again, a scheme of arrangement might be used in conjunction with other insolvency procedures such as administration whereby the deployment of a moratorium can provide “breathing space” for a company to agree any proposals with creditors.

Moratorium: A Part A1 moratorium a procedure under Part A1 of the IA 1986 (introduced by the Corporate Insolvency and Governance Act 2020 (CIGA 2020)) allowing the directors of a company to implement a moratorium on creditor action against the company. The moratorium lasts, once initially implemented, only 20 business days, but it may be extended.

The company remains under the control of the directors but their actions are reviewed by a monitor (who must be a qualified insolvency practitioner). During the moratorium creditors are precluded from taking action against the company, and suppliers of good and services cannot rely on contractual rights of termination to entitle them to stop supplying the company. The procedure is merely a moratorium: it does not involve the compromise of creditor claims, the realisation of assets for the benefit of creditors or any necessary move towards any other formal insolvency process.

Restructuring Plan: The newest tool available for use for insolvency lawyers and practitioners is a Part 26A restructuring plan and is essentially similar to a scheme of arrangement but is designed only for companies in financial difficulties. The procedure was introduced by the CIGA 2020. Most notably, the voting majority requirements are different to those for a scheme of arrangements (75% in value of each class, as for schemes, but, unlike schemes, there is no requirement that the plan be approved by a majority in number of the creditors in each class).

Most significantly (in terms of differences), a Part 26A restructuring plan allows for what is known as "cross class cram-down". This means that a dissenting class of voters cannot block the plan if the court is satisfied of both of the following:

- None of the members of the dissenting class would be worse off than they would be if the plan were not sanctioned (for example, if a liquidation were to take place) (the relevant alternative) (the “no worse-off test”).
- At least 75% by value of a class of creditor or members that would receive a payment or have a genuine economic interest if the relevant alternative were pursued voted in favour of the plan.

UK Law on 'Pre-Packs'

A 'pre-pack' can be used to describe different forms or amalgamations of available insolvency procedures across a variety of jurisdictions and have become an increasingly common tool in the UK and US for implementing a rescue plan for distressed companies. In the UK, they are usually deployed as part of an administration.

The UK Insolvency Practitioners Association describes the pre-pack as *'an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator and the administrator effects the sale immediately on, or shortly after, appointment'*[359]. It should be said the IA 1986 grants the administrator broad powers of sale but does not explicitly provide for a pre-pack administration[360].

Generally, a pre-pack is a twofold process; firstly, a restructuring is negotiated amongst interested parties and agreed with requisite stakeholders (this is usually on an informal basis) and secondly, the restructuring agreement is implemented through an available formal insolvency process. In the UK, pre-packs are essentially sale transactions, where the business and assets of the debtor are transferred to a purchaser and creditors are either rolled into the new structure, (to the extent that the sale is a share sale and they have structurally senior claims), or left behind[361].

Aim

Although no two pre-packs are identical, the ultimate aim remains the same, it is of corporate rescue and facilitating the continuity of the core business as a going concern. A pre-pack is an essential tool in creating a 'rescue culture' in UK restructurings. Although the IA 1986 was one of the first pieces of legislation to start this process, the Enterprise Act 2002 assisted in going further to amend the administration procedure and enable increased use of 'pre-pack' administrations: 'rescuing the company as a going concern' is intended to mean that 'the company and as much of its business as possible' is rescued[362].

[359] Statement of Insolvency Practice 16 and Jacqueline Ingram and Yushan Ng, Global Restructuring Review, The Art of the Pre-Pack.
[360] Schedule 1, Paragraph 2 and Schedule B1 of the IA 1986.
[361] Jacqueline Ingram and Yushan Ng, Global Restructuring Review, The Art of the Pre-Pack.
[362] Enterprise Act 2002, explanatory notes: Part 10 (insolvency), Paragraph 647647 and Global Restructuring Review, The Art of the Pre-Pack.

Common characteristics and advantages of pre-packs

One common theme seen across jurisdictions that use pre-packs is that they involve a private (and most often discrete) negotiation of a restructuring proposal and agreement. It is important to note, at this stage of the negotiation process, it may not involve all stakeholders concerned in the company. This can be explained by two reasons; one, often time is of the essence and by narrowing down the parties whose interests are or will be most directly implicated may help in expediting agreement of the restructuring proposal, and two, because of the rules and percentage of consent required later when implementing any restructuring agreement (usually three quarters or 75%), the company will want to focus their energy and efforts in convincing the stakeholders who will have the majority.

Their popularity is largely owing to their discretionary nature as it offers private market participants the opportunity to agree deals absent of media attention or in the public eye in contrast to a typical formal insolvency process. This also helps to preserve the goodwill of the distressed company for as long as possible. Recent examples include a number of retail outlets in the UK.

Secondly, pre-packs are often used when it's important to limit the amount of time the debtor spends on a formal insolvency process as once the restructuring agreement is agreed, it can be implemented relatively quickly as most of the issues and potential problems have been foreseen and discussed. This in many ways is vital to the debtor entity and wider group as insolvency and bankruptcy carry negative connotations which can in turn exacerbate financial difficulties and undermine confidence in the debtor and its group. The main aim of pre-packs is to retain value in the company by maintaining confidence.

Additionally, pre-packs can be more cost-efficient in the long run for debtors as they will only require limited parties for the negotiation and agreement which will ultimately help alleviate financial pressure.

Implementing pre-packs and duty of insolvency practitioner

A pre-pack administration begins with the directors of a distressed company resolving to engage the services of an insolvency practitioner to assess the company's financial state and advise on the best course of action.

At the preparatory stage, the insolvency practitioner is engaged in a business advisory role but there is an understanding that he or she will be appointed as the administrator when the company goes into administration, even if for a relatively short time. This indirectly imposes a duty on the insolvency practitioner to be mindful of his or her duties under the IA 1986 and Insolvency Regulations, a duty that is owed to all the creditors of the distressed company and not the proposed purchaser. The statutory objectives of an administration procedure are, therefore, a relevant consideration even at the preparatory stage.

There are broad powers of sale granted to the administrator under the IA 1986 and a pre-pack sale is consistent with these powers. In a traditional administration, the IA 1986 envisages that the administrator will put together a proposal as soon as is reasonably practicable and no longer than eight weeks after their appointment, and present this proposal to the creditors to vote upon[363]. The administrator, however, has the power to bypass the requirement for creditors' approval of the proposal if he or she determines that each creditor will be paid in full or that no distributions will be made to unsecured creditors[364]. Also, in achieving the purpose of the administration, the administrator can sell the assets of the company without the approval of creditors in certain circumstances although if there is a fixed charge over the assets, permission of the court to discharge the fixed charge is required.

In a pre-pack administration, the arrangements for sale are made before the administrator is appointed as the administrator (as opposed to an advisor).

Once a decision is made to complete a pre-packaged sale, the next step is to discretely find a suitable buyer and negotiate the terms of the sale and it is often the company's directors of secured creditors already have approached potential buyers and have loosely agreed terms of the sale.

After the terms of the sale are agreed and relevant documentation is prepared, the insolvency practitioner is officially appointed as administrator and the sale is concluded immediately or soon after the appointment. The formal appointment of the administrator can be made out of court by any one of the company, the directors or a qualifying floating charge holder (if there is one)[365]. Once the administrator assumes office, the immediate task is to effect the sale on the agreed terms. The administrator distributes the consideration received from the sale of the company to the creditors in the order of priority prescribed for administration procedures by the IA 1986. In reality, unsecured creditors are likely to be out of the money and only secured and preferential creditors tend to receive a return from the administration. The sale of the company is completed quickly and the business resumes normal solvent trading thereafter.

[363] Schedule B1, Paragraph 49(5) of IA 1986.
[364] Schedule B1, Paragraph 52, of IA 1986.
[365] Schedule B1, Paragraphs 14 and 22.

Valuation

An important part of the pre-pack process is a valuation of the company by an independent valuer for determination of fair consideration that reflects the value of the company. This is underscored by the duty of the insolvency practitioner to represent the interests of all creditors and ensure that the sale achieves the best result for them. Furthermore, there are regulatory requirements that now impose disclosure rules, which include the valuation and marketing strategy adopted for the sale.

Post-implementation

Following a pre-pack sale, the selling entity will often be left as a shell, housing only liabilities that were not transferred. The administrator determines what happens with the company. The options include a dissolution of the entity where there are no funds or property to distribute to creditors[366] and, less commonly, a creditors' voluntary liquidation of the company, a company voluntary arrangement or scheme of arrangement.

Criticisms

Although, as noted above early negotiation involving a limited number of stakeholders can be seen as an advantage, a stakeholder excluded from the negotiations and final restructuring agreement will view this as unfair. In the UK, it is often secured creditors who primarily have the majority and final say in negotiating a restructuring agreement and unsecured creditors who are usually 'out of the money' have little or no knowledge of restructuring and pre-pack proposals. For these creditors, there is limited opportunity to protect their interests.

Additionally, there is concern over the possibility of impartiality of office holders. Although they are bound by statutory obligations and professional guidelines and can exert influence on negotiations to ensure these will be respected in the ultimate transaction, because an office holder is involved so early on, one could argue they are more likely to try and facilitate deal proposals and therefore lose complete impartiality of the wider picture and all stakeholders concerned.

In light of their continued popularity, legislation and guidance continues to evolve to balance the stakes and the Joint Insolvency Committee issued the Statement of Insolvency Practice 16 (SIP 16) to provide some guidance to practitioners on best practices for pre-packs.

[366] Schedule B1, Paragraph 78.

SIP 16:

- recommends that an insolvency practitioner acting in a pre-pack administration should be able to demonstrate that the duties of an administrator under the IA 1986 have been met
- emphasises the need for insolvency practitioners to act as independently as possible in making the decision to effect a pre-packaged sale and in negotiating and arranging the sale
- requires an insolvency practitioner to keep a detailed record of the reasoning behind the pre-pack sale, considered alternatives, marketing strategy and other specific information about the deal, within seven days of the sale transaction.
- SIP 16 also recommends an independent valuation and robust marketing of the business to ensure that the best possible value is obtained for the creditors as a whole.

However, it must be noted that failure to comply with SIP 16 does not invalidate a sale or automatically result in a finding of misconduct by the insolvency practitioner. Insolvency practitioners are separately regulated by recognised bodies who routinely monitor compliance with required standards and can take disciplinary action where appropriate.

The most important development in the pre-pack rulebook has been the introduction of the Administration *(Restrictions on Disposal etc. to Connected Persons)* Regulations 2021 which regulates pre-pack sales to 'connected persons' (i.e., those who have historically been involved in the company's undertaking and business, e.g., shareholders, directors and managers). The key market concern with the definition of 'connected' persons is that it doesn't explicitly exclude secured lenders who may credit bid for, or otherwise fund purchases for the company's assets.

Nevertheless, the regulations don't outright prohibit sales to 'connected persons' but create additional processes to alleviate concerns of unsecured creditors who are locked out of the pre-sale negotiations. Unless prior creditor approval has been obtained, if the company or 'all or substantially all of its assets' are sold within the first 8 weeks of administration to 'connected persons', the proposed buyer must commission an independent 'evaluator' opinion. This opinion should be made available to other creditors (including as a matter of public record at the Companies House).

The 'evaluator' opinion must include the name of the buyer (and their connection to the company), the purchase price and a statement (along with reasons) that the evaluator is (or is not) "*satisfied that the consideration to be provided for the relevant property and the grounds for the substantial disposal are reasonable in the circumstances*"[367].

The evaluator's opinion is not binding on the administrator (i.e., if an undesirable conclusion is reached, the administrator can still go ahead with the sale provided certain steps are followed). Given these regulations are relatively new, it remains to be seen if legislators will give more teeth to the rules in future to achieve the objective of weeding out abuse of process. As with other historic insolvency laws, lawmakers will evaluate how this plays out in practice before forming an opinion on amendments.

The opportunity to challenge pre-packs

Although there is the possibility for trade suppliers, creditors and shareholders to challenge the pre-packaged sale if given an opportunity and the means, in reality, there is very little opportunity or indeed incentive for those parties that disagree to challenge the sale. Furthermore, the courts have sanctioned the practice of selling a company's assets in advance without the approval of creditors and will typically not overturn commercial arrangements unless a case of fraud or undervalue is clearly made out.

Additionally, it is difficult to challenge the conduct of the administrator (where this is a concern or certain stakeholders feel they have been improper or unfair) because under the various rules and legislation the administrator is granted significant discretion to exercise his or her business judgement. These factors, together with the potential high costs of bringing a challenge, serve as a strong disincentive to aggrieved creditors.

Having said that, there has been successful challenges for example, in *Ve Vegas Investors LLC & others v. Henry Shinners, Finbarr O'Connell and others*[368] the applicants were creditors of VE Interactive who brought a claim against the administrators to challenge the pre-packaged sale of the company to the directors for £1.75 million. The creditors requested for the administrator to be replaced. Without determining whether the proposed sale was legitimate or not, the court found that there was a serious issue for investigation by an independent party into whether the proposed sale was in the best interest of the company and whether the administrator had breached his or her duty in agreeing to the terms of the sale.

[367] Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021, Part 2, Chapter 3, 7.
[368] [2018] EWHC 186 (Ch).

English Law Insolvency Procedures: Failed Companies

Winding up or Liquidation: To liquidate or wind up the company are final resort insolvency procedures (though, it could be argued from an unsecured creditor's perspective, these may be the simplest and most effective ways of applying pressure to a distressed company or forcing matters to a head). The procedures require the appointment of a liquidator (who must be an insolvency practitioner) and who will collect in and sell the company's assets and ultimately distribute the resulting cash or proceeds (or sometimes, in solvent situations, may distribute assets without selling them) and, finally once the process is complete, dissolve the company.

The company can also be put into provisional liquidation before a final winding up order is granted. There are two types of liquidation:

- Compulsory: By order of the court. This is commenced by petition, often by a creditor on the grounds that the company is unable to pay its debts.
- Voluntary: By resolution of the company.

Recent UK Insolvency Law Developments - Introduction of Corporate Insolvency and Governance Act 2020 (CIGA 2020)

The introduction of new legislation had been under discussion for decades and CIGA 2020 has been heralded as the single biggest shake up of UK restructuring law since the IA 1986. Although it is still early in its implementation, there have been several companies that have tried to utilise the new restructuring plan including:

- DeepOcean (Re DeepOcean 1 UK Ltd and others [2021] EWHC 138 (Ch))
- Virgin Active (Re Virgin Active Holdings Ltd and others [2021] EWHC 814 (Ch), Re Virgin Active Holdings Ltd and others [2021] EWHC 1246 (Ch))
- Gategroup (Re Gategroup Guarantee Limited [2021] EWHC 304 (Ch), Re Gategroup Guarantee Limited [2021] EWHC 775 (Ch))
- Hurricane Energy (Re Hurricane Energy [2021] EWHC 1759 (Ch))

The introduction of cross class cramdown is one of CIGA 2020's biggest features and can be said to mimic certain features of US Chapter 11 bankruptcy legislation. CIGA 2020 provides a company encountering financial difficulties with a more powerful restructuring tool than the existing scheme of arrangement process in the UK.

It can be said CIGA 2020 has provided an additional tool for restructuring lawyers and practitioners as opposed to replacing the existing insolvency legislation and tools such as the administration and use of pre-packs. It is an interesting space to watch as the law develops and more companies opt to try the new restructuring plan.

Liquidation as Going Concern: Indian Context

Typically, liquidation or winding up is viewed as a process that culminates in the dissolution of the company after piecemeal sale of its assets, where the liquidator has no power to carry on the business of the company except as required for beneficial winding up.[369] However, certain jurisdictions recognise sale of business as a going concern sale of undertaking in liquidation.[370]

The genesis of liquidation on a going concern basis in India, can be traced to *Allahabad Bank v. ARC Holding Limited & Ors*[371], a case under the erstwhile Companies Act, 1956. The Supreme Court, had directed the Official Liquidator to sell the company in liquidation as a going concern, at a reserve price equal to decreed debt plus interest accrued till date of sale. The first instance of sale of corporate debtor on a going-concern basis under the IBC was observed in the Hon'ble National Company Law Tribunal ('**NCLT**'), Kolkata's order in *Gujarat NRE Coke*[372] where the tribunal directed the liquidator to sell the corporate debtor as a going concern, at a reserve price equal to the "total debt amount including interest". In both cases, the court demonstrated concern for the interests of the workmen and employees as one of the key factors behind their decision.

Since the inception of the IBC in 2016, till date, 6 corporate debtors, namely – M/s Emmanuel Engineering Private Limited, M/s KTC Foods Private Limited, M/s Winwind Power Energy Private Limited, M/s Smaat India Private Limited, M/s Southern Online Bio Technologies, and M/s Topworth Pipes & Tubes Private Limited – have been successfully rescued via liquidation on a going concern basis.[373] The aggregate realized value of INR 336.76 crores, as opposed to the liquidation value of INR 290.03 crores, demonstrates the clear advantages that going concern sales hold over other methods of liquidation.

[369] Roy Goode, Principles of Corporate Insolvency Law, Sweet and Maxwell, 4th ed, 2011, at ¶¶ 1-39; Section 54 of IBC, Sections 290(1) and 302 of the Companies Act, 2013.
[370] UNCITRAL Legislative Guide on Insolvency (2005), at page 30, ¶¶ 33 and 34 (e)
[371] AIR 2000 SC 3098, at ¶ 16.
[372] 2018 SCC OnLine NCLT 4072.
[373] IBBI, Insolvency & Bankruptcy Quarterly Newsletter (April to June, 2021), at page 17.

The Scheme of IBC and its Evolution:

The Insolvency Code envisages a two-step process, firstly a corporate insolvency resolution process (‘**CIRP**’) and thereafter liquidation. During the CIRP process an insolvency professional is appointed who has ‘administrative functions’[374] and for certain significant decisions, has to take the approval of the Committee of Creditors (‘**COC**’). On the other hand, during liquidation, the liquidator discharges a quasi-judicial[375] function under the supervision of the NCLT. The COC ceases to exist, and is replaced by a ‘stakeholder’s consultation committee’ (‘**SCC**’) performing recommendatory functions.

If no resolution plan is received or approved by the COC of the corporate debtor, or if the resolution plan is not approved by the NCLT, the corporate debtor is put into liquidation.[376] The COC can, at any time prior to the confirmation of the resolution plan, decide to put the company into liquidation and not wait for the CIRP to run its course if it is of the view that it is not possible to rehabilitate the corporate debtor.[377] The insolvency process is run in a time bound manner and the IBBI has prescribed a detailed set of model timelines for the entire process. The CIRP is to be run in one hundred and eight days which may be extended up to 330 days.[378] The liquidation process, on the other hand, has to be completed within one year.[379] The IBC originally envisaged that liquidation of an enterprise can be by way of sale of its assets collectively/in parcels/ slump sale/ on standalone basis.

As the IBC provides for a resolution process prior to liquidation, it seems to balance the conflicting insolvency objectives of quick and orderly liquidation with value maximisation well, and by its very nature, allows for successful rehabilitation, where possible.

However, the courts have gone a step further and in effect held that all efforts must be made to rehabilitate the enterprise in liquidation also before an asset sale.[380] This has been achieved through two judicial innovations. The first route is through a scheme of restructuring and liquidation under section 230 of the [Indian] Companies Act, 2013[381]. The second, is the concept of liquidation on a going concern basis, wherein the corporate debtor as a whole is sold as part of the liquidation estate, which includes transfer of existing employees to the acquirer.[382]

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374 *Ibid.*
375 *Ibid.*
376 Section 33(1) of IBC.
377 Section 33(2) of IBC.
378 Section 12 IBC read with CoC of Essar Steel India Limited vs. Satish Kumar Gupta, (2020) 8 SCC 531, at ¶ 74.
379 Regulation 44(1) of Liquidation Regulations.
380 ArcelorMittal India Private Limited v. Satish Kumar (2019) 2 SCC 1 at ¶ 83.
381 S.C. Sekaran v. Amit Gupta & Ors. 2019 SCC OnLine NCLAT 517, at ¶ 8.
382 Y. Shivram v. S. Dhanapal & Ors., CA(AT)(Insol.) No. 224 of 2018 (NCLAT New Delhi, decided on 27.02.2019), at ¶ 13.

These modes of liquidation have been incorporated in IBBI (Liquidation Process) Regulations, 2016 (‘**Liquidation Regulations**’) through amendments which now provide for (i) sale of corporate debtor as a going concern; and (ii) sale of its business(es) as a going concern.[383] Under Regulation 39C the of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (‘**CIRP Regulations**’), the COC has to make an assessment and recommend that the liquidator first explore sale as going concern of the corporate debtor or its businesses in liquidation, which then has to be placed on record before the NCLT. The Insolvency Law Committee was of the view that the liquidator is best placed to decide whether sale on a going concern basis should be attempted. [384] Hence, the regulations provide that the liquidator can also form an independent opinion and then endeavour in the first instance to sell the corporate debtor or its businesses as going concern.[385] Only if the liquidator fails to sell the corporate debtor or its businesses as a going concern within ninety days of the liquidation commencement date, shall he adopt other modes of liquidation.[386]

The above changes also flow from a decision of the Hon’ble National Company Law Appellate Tribunal (‘**NCLAT**’) which, in effect, introduced a step-by-step process to liquidation.[387] A liquidator has to first attempt to resolve the liquidation through compromise or arrangement in terms of Section 230 of the Companies Act, 2013. Failing that, the liquidator is required to sell the business of the corporate debtor as going concern in its totality along with the employees. In certain cases, both of the above have been run concurrently. Only upon failure of both of the above processes should the liquidator move forward with liquidation through asset sale.

The liquidator has to ordinarily sell the assets through an auction mechanism, which generally means an e-auction unless NCLT permits a physical auction, as specified in the Liquidation Regulations.[388] The liquidator sets a reserve price which is progressively reduced by up to a predefined percentage in each subsequent round if the auction fails. The highest bidder has to provide the balance consideration within 90 days otherwise sale will be cancelled. On payment of the entire amount a ‘certificate of sale’ or sale deed is executed by the liquidator and the sale is completed.

[383] Regulation 32 of Liquidation Regulations.
[384] Insolvency & Bankruptcy Board of India, Report of the Insolvency Law Committee (February 20, 2020).
[385] Regulation 32A (1) of Liquidation Regulations.
[386] Regulation 32A (4) of Liquidation Regulations
[387] Y. Shivram v. S. Dhanapal & Ors., CA(AT)(Insol.) No. 224 of 2018 (NCLAT New Delhi, decided on 27.02.2019) at ¶ 13.
[388] Regulation 33 read with Schedule 1 of Liquidation Regulations.

Though there have been concerns around the process of going concern liquidation and whether they fit within the scheme of the IBC,[389] they have been followed in various instances and going concern liquidation is likely here to stay.

Issues in Going Concern Sale in Liquidation:

It is submitted that the auction process under the Liquidation Regulations is geared more towards an asset sale, rather than a going concern sale. The original architecture of these regulations only envisaged asset sales and that has continued unmodified, with just the addition of the term 'sale as going concern' under the modes of sale, and under COC and SCC deliberation. However, a going concern sale is much like a resolution plan in liquidation. This gives rise to various issues:

Delays: Since the bidder has to participate in an auction and just feed in a number, diligence assumes greater importance. However, the Liquidation Regulations envisage only 90 days for completion of sale. Thus, the first round of a going concern sale in liquidation seldom attracts bids over the reserve price. This is further complicated by the fact that each subsequent round of sale will happen at a reduced reserve price (by up to a prescribed percentage - twenty-five, at first, and ten percent in each subsequent round as per the regulations) which incentivises bidders to wait out the initial auction process. Liquidation within the initial time frame almost has rarely been achieved.

- Compliances: Since the Liquidation Regulations do not envisage a plan, there is lack of clarity on simple and essential steps such as mode of write off of existing capital, issuance and preferential allotment of shares, updating corporate compliances with Registrar of Companies and tax authorities. The matter acquires more complexity in listed entities where relevant SEBI regulations envisage specific exemptions for resolution plan but not for liquidation as a going concern.

- Ring Fencing of Liability: The Liquidation Regulations do not provide for any ring-fencing of assets against third-party claims or for ring fencing of legacy matters and past liabilities as is the case during CIRP. Normally, unlike an asset sale, sale on a going concern basis involves transfer of assets along with liabilities. While there have been some judicial pronouncements clarifying these issues and holding that past liabilities will get extinguished under Section 53, this issue remains a grey area.

[389] Invest Asset Securitizations & Reconstruction Private Limited v. Mohan Gems & Jewels Private Limited I.A.1490/2020 in Company Petition No. (IB)-590 (PB)/2018 (NCLT New Delhi, decided on 16.09.2019), at ¶¶ 2, 32-34.

- Handover of Assets: In a going-concern sale, it is mandated that a successful bidder shall take possession of the assets of the corporate debtor within a set time-frame from the date of issuance of certificate of sale. The onus of taking possession is placed entirely on the successful bidder without any corresponding clarity on the obligations of the Liquidator. He technically ceases to function on the date of issuance of sale certificate. In many cases, the numerous assets of a corporate debtor may be spread across a vast area, often in possession of, or under occupation by various third parties. This presents a significant problem for a prospective acquirer, as they may not be in a position to recover all the assets of the corporate debtor from third party premises, which would in turn hamper the rehabilitation process of the corporate debtor.

  The NCLTs have risen to the occasion and granted some reliefs to the successful bidder in relation to the above issues. It is also not unusual for the NCLT to provide relaxation in timelines to allow the Liquidator to run a smoother process, but this has resulted in multiple rounds of auctions and delays in liquidation as a going concern.

  However, it has mostly been left to the successful bidder to obtain these reliefs from the NCLT after paying the advance consideration and, in some cases, full consideration. This appears to be counterintuitive, since even if a bidder chooses to participate in such liquidation and pay the full amount, without any certainty of reliefs, the bid pricing will be depressed. Certainty and predictability of the process is key to maximisation of value.

  To address the above issues, the following solutions may be considered:

  - Codify a standardized limited set of reliefs in such cases under the IBC itself. While bidders are being granted reliefs from the NCLT on a case-to-case basis, codification of reliefs will ensure better value and more sensible outcomes from sale as a going concern. This would eliminate the “hidden cost” of a going concern sale in the eyes of a prospective acquirer and allow for faster realization of the value of the corporate debtor.
  - Make corresponding changes in the relevant regulations such as SEBI (Issue of Capital & Disclosure Requirement) Regulations, 2018, SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, and SEBI (Delisting of Equity Shares) Regulations, 2009 recognising liquidation as going concern on the same footing as a resolution plan.
  - Multiple rounds of auction should be avoided in liquidation as going concern. With the two changes suggested above it is hoped that the process of reducing the reserve price in each subsequent round may be discontinued.
  - The Liquidator should be mandated to aid in the completion of the acquisition, and to provide all support and assistance to ensure that the corporate debtor remains a going concern.

Using Schemes of Arrangement in Restructuring and Insolvency

Dhananjay Kumar, Kate Stephenson and Abhishek Mukheerjee

Using Schemes of Arrangement in Restructuring and Insolvency[390]

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Abstract

This article explores the use of English and Indian schemes of arrangement as debt restructuring tools. It considers the relevance of English schemes for the Indian system. It then considers English schemes by reference to their nature, origins and evolution as a debt restructuring tool, into their modern usage. It discusses perceived advantages and disadvantages of English schemes and then takes a deeper dive into certain current hot topics, including how the restructuring market and judiciary have adapted to several potentially problematic issues including the lack of a formal moratorium, adequacy of disclosure and timing (among others).

It then considers Indian schemes of arrangement by reference to their key aspects, origins with foundations inspired from English law framework, extent of judicial scrutiny of schemes, limitations affecting its usage as a debt restructuring tool and discussing recommendations for, and possibilities of, its augmented usage for debt restructuring under the aegis of the new insolvency law framework. It concludes with suggestions of how India might consider reforming elements of its scheme of arrangement.

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[390] The authors' views are personal and confined to their respective jurisdictions.

Part1: Introduction

1.1 Purpose and Scope: This article explores the use of English and Indian schemes of arrangement as debt restructuring tools. It first considers the relevance of English schemes of arrangement for the Indian system. It then considers English schemes of arrangement by reference to:

a) their nature and origins;

b) their evolution as a debt restructuring tool;

c) their modern usage by financially distressed companies (including non-English companies);

d) their perceived advantages and disadvantages; and

e) current hot topics, including how the restructuring market and judiciary have adapted to several potentially problematic issues.

1.2 It then considers Indian schemes of arrangement by reference to:

a) their key features and key procedural aspects;

b) their origins with foundations inspired from English law framework;

c) their evolution into a self-sufficient framework by strengthening elements of transparency, alignment with the changing economic scenario in India to make it more creditor-friendly and to ensure a faster approval process;

d) extent of judicial scrutiny of Schemes to ensure safeguards for minority stakeholders;

e) their limitations affecting usage as a debt restructuring tool; and

f) discussing recommendations for, and possibilities of, its augmented usage for debt restructuring under the aegis of the new insolvency law framework in India.

1.3 It includes suggestions of how India might consider reforming elements of its scheme of arrangement, and also use the new insolvency framework, to position schemes as another debt restructuring tool which would help the Indian banking system and its corporate community to deal with stressed assets in a better fashion.

1.4 This article is confined to matters of English and Indian law as at December 2021.

Relevance of English schemes for the Indian system

1.5 As we navigate through the paper from discussions on the English law framework to Indian law framework for Scheme, it becomes evident that, given the origins of Indian company law are broadly inspired by the English equivalent, the framework for schemes of arrangement are similar. This includes both substantive and procedural aspects.

1.6 The practical issues that both systems face in terms of usage of schemes as a debt restructuring tool are also somewhat similar. However, the English market has been able to deploy certain techniques and need-based practices to circumvent certain issues to accomplish a successful scheme in a timely manner. While adoption of these best practices will be a welcome approach for the Indian jurisdiction, however, it needs to be seen if the techniques can be successfully implemented in the Indian context.

Nature of English Schemes of Arrangement

1.7 The English scheme of arrangement is a formal statutory 'debtor in possession' procedure under Part 26 of the Companies Act 2006 by which a company can bind a dissenting minority of its creditors (and/or members) to a court-sanctioned compromise.

1.8 This article focusses exclusively on creditor schemes given the focus on solutions for insolvency and financial distress; however, member schemes are fairly common, especially in the context of takeovers of listed companies.

1.9 Key aspects of the English scheme of arrangement include:

a) Flexible scope - the legislation does not prescribe the subject matter of a scheme, which permits a wide variety of potential uses (as explored in paragraph 2.1) and schemes are able to bind dissenting secured or preferential creditors.

b) Debtor-led - although a scheme application can be made by any creditor or member, or the company's liquidator or administrator, in addition to the company itself[391], in practice the process is almost invariably originated and led by the company and its advisers, as explored in paragraph 2.2.

C) Voting - creditors vote in classes according to their rights both pre- and post-scheme; a scheme requires the approval of a majority in number representing at least 75% in value of creditors voting, in each class.[392]

[391] Sections 896(2) (application for convening) and 899(2) (application for sanction), Companies Act 2006.

[392] Section 899(1), Companies Act 2006. This contrasts with the restructuring plan procedure under Part 26A of the Companies Act 2006, which contains no requirement for a majority in number to vote in favour (section 901F(1)) and also permits the court to sanction a plan which not every class has approved, subject to certain conditions (section 901G); see further paragraph 2.14(c).

d) Process runs as follows:

(i) a 'convening hearing' at which the court considers whether to convene meeting(s) of the relevant class(es) of creditors;

(ii) voting at the court-convened meeting(s);

(iii)provided the requisite majorities of creditors approve the scheme at the scheme meeting(s), a 'sanction hearing' at which the court considers whether to approve or 'sanction' the scheme; and

(iv)filing the court order with the Companies Registrar, upon which the scheme becomes effective and binds all creditors subject to the scheme.[393]

(e)Selection of creditors - only those creditors compromised by the scheme are entitled to vote; "the ability of a company in financial difficulty to propose a compromise or arrangement with some, but not all, of its groups of creditors is one of the most flexible and valuable features of the scheme jurisdiction under Part 26"[394;] however, the court will be concerned to ensure that the company's selection of whom to include in the scheme was not arbitrary or designed to manipulate the class.

(f) Wide eligibility - any company that is liable to be wound up under the Insolvency Act 1986 is eligible to propose a scheme[395], which includes foreign companies[396]; however, the court will not exercise its jurisdiction unless there is both a "sufficient connection" to the English jurisdiction[397] and a reasonable prospect of the scheme having substantial effect in key jurisdictions.[398]

Origins and Evolution of English Schemes of Arrangement

1.10 A debtor has always been permitted to make arrangements with his or her creditors for the settlement of debts, independent of any formal proceeding - binding only those creditors who consented to the compromise. But such arrangements have historically been fraught with difficulties, mainly in the context of fraud, improper accounting and lack of proper information and notice.

1.11 Statutory provisions were periodically enacted in efforts to provide a formal framework and to reduce abuses. Successive Companies Acts (of 1870, 1908, 1948, 1985 and 2006) and Deeds of Arrangement Acts (of 1887 and 1914) mark the development of the modern-day scheme of arrangement. In the corporate context, these were initially confined to companies in the

[393] Section 899(3)-(4), Companies Act 2006.
[394] Per Snowden J (as he then was), *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2376 (Ch) at [60].
[395] Section 895(2)(b), Companies Act 2006.
[396] Section 221, Insolvency Act 1986.
[397] See e.g. *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch).
[398] See e.g. *Re DTEK Energy B.V.* [2021] EWHC 155 (Ch).

course of winding up and, through evolution, to the stand-alone, non-insolvency, proceeding that the scheme of arrangement remains today.

1.12 Schemes of arrangement have historically been viewed as expensive, complex and cumbersome.[399]

1.13 Following the use of schemes in several insurance company restructurings in the late 1990s, the English market has progressively developed the use of schemes as a debt restructuring tool over the last 20 years or so - particularly in the aftermath of the global financial crisis.

1.14 Several factors drove the emergence of the scheme of arrangement as a key European restructuring tool, including:

(a) the nature of schemes as a non-insolvency proceeding - a key advantage over the frameworks in many European countries, enabling companies to avoid value-destructive insolvency proceedings;

(b) the choice of English law as the governing law in most bank lending in the European market;

(c)schemes' availability to non-English companies with a "sufficient connection" to England (and court judgments finding that English governing law would suffice by way of connection for this purpose[400]);

(d) the strengths of the English judicial system, with its centralised, efficient courts and highly expert judiciary; and

(e)legal and financial expertise in the English restructuring market, which developed over deal after deal.

1.15 The Corporate Insolvency and Governance Act 2020 introduced a new "restructuring plan" procedure as a new Part 26A of the Companies Act 2006 (among other measures). The restructuring plan procedure is modelled on existing schemes of arrangement, but with a few key differences, including:

(a) a financial difficulties eligibility threshold;

(b) the ability for the court to sanction a plan even where not every class has approved it (subject to certain conditions); and

(c)no "numerosity" voting threshold - the approval of at least 75% of creditors (or members) voting within a class is sufficient for that class to approve the plan.

[399] See chapter 7 of the Report of the Insolvency Law Review Committee, *Insolvency Law and Practice* (1982) (known as the Cork Report) and paragraph 43 of the *Report of the Joint DTI/Treasury Review of Company Rescue and Business Reconstruction Mechanisms* (2000).

[400] *Re Drax Holdings Ltd* [2003] EWHC 2743 (Ch); confirmed in subsequent cases e.g. *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch) and extended over subsequent years e.g. to include cases in which the governing law of the debt was contractually amended to English law for the purpose of facilitating a scheme of arrangement: *Re Apcoa Parking Holdings GmbH and others* [2014] EWHC 3849 (Ch).

Part 2: Discussion

Modern Usage of English Schemes in Restructurings

2.1 A scheme must consist of some form of "compromise or arrangement" between a company and its creditors (or any class of them) or members (or any class of them).[401] The terms "compromise or arrangement" have been interpreted broadly by the courts[402], permitting the use of schemes to effect a wide range of transactions in a restructuring context:

(a) debt-for-debt/debt-for-equity swaps (occasionally, in conjunction with a pre-pack administration) - the vast majority of restructuring schemes fall in this category;

(b) "amend and extend" transactions - e.g. the first *Apcoa* scheme;

(c) standstills (to buy breathing space ahead of a substantive restructuring) - e.g. *Metinvest*, *DTEK*;

(d) compromises of litigation claims - e.g. Lehman Brothers International Europe (in administration) and Steinhoff;

(e) compromises of liabilities under leases[403] - e.g. *Instant Cash Loans* and *MAB Leasing* (Malaysia Airlines; aircraft lease arrangements);

(f) compromises of widespread consumer redress claims - e.g. mis-selling liabilities, as in *Instant Cash Loans*, *Amigo*[404] (in which the court declined to sanction the scheme) and *Provident Finance*, or employee claims (e.g., in the asbestosis context, *T&N* and *Cape plc*);

(g) compromises of liabilities under insurance contracts, where the insurance business goes into run-off (widely used in a solvent context); and

(h) takeovers and mergers (widely used in a solvent context).

[401] Section 895(1), Companies Act 2006.
[402] Although a scheme which does no more than expropriate the creditors' interests would not be a "compromise or arrangement": *Re NFU Development Trust* [1972] 1 WLR 1548 - i.e. there needs to be some element of 'give and take'.
[403] However, a scheme of arrangement cannot compel a landlord to accept a surrender of a lease because this would interfere with a landlord's proprietary rights: *Re Instant Cash Loans* [2019] EWHC 2795 (Ch). A scheme can only alter the relationship between tenant and landlord in their capacities as debtor / creditor.
[404] Amigo is authorised by The Financial Conduct Authority ("**FCA**"); the FCA successfully opposed sanction of the scheme. Provident Finance's somewhat-similar consumer redress scheme was subsequently sanctioned by the court; the FCA issued a statement making it clear that it did not support the Provident scheme and listing 10 separate objections, but it did not actively oppose sanction because 1. the alternative was an imminent insolvency in which redress creditors would receive less than under the scheme and 2. Provident's consumer credit division was not continuing its business and there appeared to be no unfair benefit to the Provident group and its stakeholders at the expense of the redress creditors. The FCA intends to consult on guidance regarding the FCA's approach to schemes and other similar restructuring tools, which is expected to include where firms seek to compromise redress through arrangements under company law.

2.2 Schemes can be proposed by the company, a creditor or a shareholder (or administrator or liquidator if the company is in administration or liquidation).[405] However, in practice, schemes are almost invariably proposed by the company itself, both because of disclosure requirements and because the court has no jurisdiction to sanction a scheme which does not have the approval of the company.[406]

Advantages and Disadvantages

2.3 Beauty is in the eye of the beholder; the following high-level summary is presented primarily from the perspective of the scheme applicant.

2.4 Advantages:

(a) Highly flexible in scope - see paragraph 2.1 above.

(b) Highly effective, "tried and tested" mechanism to bind dissenting creditors to a compromise.

(c) As the scheme of arrangement is a Companies Act procedure, and given the absence of any "financial difficulties" eligibility requirement (cf. the new restructuring plan process), a scheme may have less stigma than a formal insolvency process.

(d) Debtor in possession process - existing directors remain in control (though this may be viewed as a disadvantage by creditors in the event they view existing management as culpable for the debtor's financial difficulties).

(e) Ability to bind both secured and unsecured creditors, and for the applicant to select which creditors will be affected by the scheme (subject to safeguards - see further paragraph 1.9(e)).

(f) English courts are extremely highly regarded and include several judges with particular expertise in dealing with schemes of arrangement.

(g) Available for use by non-English companies, provided they have a sufficient connection to the English jurisdiction; this is especially important where the debtor seeks to compromise debt governed by English law, owing to the so-called "rule in *Gibbs*", that a contract can only be discharged or compromised in accordance with its governing law.[407]

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[405] Limited Liability Partnerships can also use the scheme procedure in a slightly modified form.
[406] (Either through the board or a simple majority of the members in general meeting): see *Re Savoy Hotel Ltd* [1981] Ch 351 at [365].
[407] *Antony Gibbs & sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399. The English court cannot recognise or give effect to a foreign insolvency-related judgment under common law principles unless the party against whom the order was made was subject to the relevant foreign proceedings (as a matter of English private international law): *Rubin v Eurofinance SA & others* [2012] UKSC 46.

2.5 Disadvantages:

(a) Requirement for two court hearings in addition to the scheme meetings, with consequent impact on timescale and cost (however, the court plays a critical role in ensuring adequate scrutiny of schemes).
(b) Absence of a formal moratorium to protect the debtor whilst the scheme is in process - see further paragraphs 2.7 and 2.8.
(c) Inability to bind a dissenting class - see further paragraphs 2.13 and 2.14.
(d) Court hearings provide a ready forum for objectors (in contrast to certain other English restructuring and insolvency processes such as a company voluntary arrangement or administration) - on who should bear the costs of an unsuccessful challenge, see further paragraphs 2.36 to 2.38.

Experiences of the English Regime: Evaluation and Solution of Specific Practical Issues

2.6 This section considers a variety of issues which have arisen in practice and explains how the courts, market and/or legislature have attempted to resolve such issues. Many of these remain hot topics in the English restructuring market (although a few, such as voting by ultimate beneficial holders, are now well-settled).

Absence of Formal Moratorium

2.7 There is no formal statutory moratorium on creditors' claims against the company to "hold the ring" whilst it seeks to implement an English scheme. Given the timescale for a scheme (see paragraph 2.15), this creates a long period in which the company is unprotected from creditor enforcement.

2.8 However, the following solutions exist (presented in perceived order of utility and therefore attractiveness):

(a) Contractual standstill arrangements - "lock up agreements" which are almost invariably[408] entered into between the scheme company/group and scheme creditors ahead of launching the scheme;

(b) Reliance on court's case management powers - the scheme company may apply to court seeking a stay of enforcement to enable the company to promote the scheme (by way of the court's discretionary case management powers);[409]

[408] For a notable exception, see *Re Port Finance Investment Ltd*, in which the scheme company launched a scheme of arrangement without first obtaining the support of the ad hoc group of noteholders, and was forced to withdraw its scheme of arrangement following the convening hearing.
[409] As for example in *Sea Assets Ltd v PT Garuda Indonesia (No. 2)* [2001] 6 WLUK 583; *BlueCrest Mercantile BV v Vietnam Shipbuilding Industry Group FMS Wertmanagement AOR v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146 (Comm); and *Riverside CREM 3 Ltd v Virgin Active Health Clubs Ltd* [2021] EWHC 746 (Ch) (in the context of a restructuring plan).

(c) Administration - the company could potentially combine a scheme of arrangement with administration, given that a statutory moratorium exists whilst a company is in administration; it is also possible for directors to be left in control of day-to-day operations by pursuing a “light touch administration”. However, entry into administration remains a significant, potentially value-destructive step and is not to be undertaken lightly; or

(d) New standalone moratorium - the Corporate Insolvency and Governance Act 2020 introduced a new standalone moratorium procedure[410], which can potentially be utilised in parallel to a scheme of arrangement. However, the utility of this moratorium is limited owing to various factors, including:

(i) broad capital markets exceptions to eligibility render most bond issuers / guarantors ineligible for the moratorium altogether;

(ii) there is no payment holiday in respect of bank facilities (or other debts or liabilities arising under a contract involving financial services)[411]

(iii) the initial duration of the moratorium - 20 business days - is too short to achieve protection for the period in which it takes to promulgate a scheme (although there are various routes by which the moratorium period can be extended); and

(iv) acceleration is permitted during the moratorium, and in practice would likely require termination of the moratorium.

Class Constitution

2.9 At the convening hearing, the court will consider whether more than one meeting of creditors (and/or members) is required, and if so what is the appropriate composition of those meetings.[412]

2.10 The long-established principle for class constitution is that a class must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.[413] “In each case the answer to that question will depend upon analysis (i) of the rights which are to be released or varied under the scheme and (ii) of the new rights (if any) which the scheme gives, by way of compromise or arrangement, to those whose rights are to be released or

[410] Section 1 of the Corporate Insolvency and Governance Act 2020 inserted a new Part A1 into the Insolvency Act 1986.
[411] Section A18(3)(f) of the Insolvency Act 1986 (as amended).
[412] Paragraph 11 of the Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006.
[413] See *Sovereign Life Assurance v Dodd* [1892] 2 QB 573 at [583] and *Re UDL Holdings Ltd* [2002] 1 HKC 172 at [27] per Lord Millett NPJ).

varied."[414] In carrying out that exercise, it is the legal rights of creditors, not their separate commercial or other interests, which determine the appropriate constitution of a class.[415] (Interests may instead be taken into account at sanction stage.)

2.11 The authorities also caution against unnecessary proliferation of classes, given the risk of giving an unwarranted right of veto to a minority group. Where rights are "sufficiently similar" to the rights of others that they can properly consult together, then they should be required to do so.[416] Where a scheme is proposed as an alternative to winding up, the right approach is to consider the position on the basis that the relevant rights are those which creditors would have in a winding up.[417]

2.12 There is very extensive case law on class constitution issues, a detailed exposition of which lies beyond the scope of this article. For present purposes, it suffices to note that the courts have historically been slow to "fracture the class" and, on occasion, have entertained pragmatic solutions to resolve prospective class issues.[418]

Inability to Bind a Dissenting Class

2.13 As noted, the requisite majorities in **every** class must approve an English scheme of arrangement, before the court is asked to sanction it. Schemes alone cannot achieve the "cramdown" of "out of the money" junior stakeholders; this includes a non-consensual change of control or equity dilution (because shareholders usually have pre-emption rights in respect of new share issuances, which may be required to engineer a debt-for-equity swap, and the shareholder class would have a power of veto if included in the scheme).

2.14 Accordingly, existing shareholder consent or some other workaround may be needed, such as:

(a) twinning a scheme of arrangement (to any bind dissenting senior creditors) with a pre-packaged administration sale of Oldco's assets / shares

[414] Per Chadwick LJ in *Re Hawk Insurance Company Ltd* [2002] BCC 300 at [30].
[415] *Re BTR plc* [1999] 2 BCLC 675, *Re Hawk Insurance Co Ltd* [2001] 2 BCLC 480, *Re UDL Holdings Ltd* [2002] 1 HKC 172 at 184-185 per Lord Millett NPJ.
[416] *Re Hawk Insurance Company Ltd* [2002] BCC 300 at [32] and [33].
[417] *Ibid.* at [42].
[418] For example, in *Re Stemcor Trade Finance Ltd* [2015] EWHC 2662 (Ch) at [21]-[22], permitting the company to adjust its proposed class constitution in order to avoid potential concerns that an "anchor shareholder" with certain different post-restructuring rights ought to constitute a separate class (and thereby avoid any argument at sanction by an opposing creditor that their vote had been outweighed by the inappropriate inclusion of the anchor shareholder within that class).

in its subsidiaries to a Newco, often majority-owned by senior creditors, thereby leaving "out of the money" junior creditors and/or equity behind in Oldco (which effectively becomes a valueless shell); Newco pays for the transferred assets by "credit bidding" the claims of the senior creditors. This technique was used in e.g. *MyTravel*[419], *IMO Carwash*[420], *McCarthy & Stone*[421], *WIND Hellas*[422] and more recently *Swissport*[423];

(b) achieving a similar result via receivership or share pledge enforcement; or

(c) use of the new restructuring plan procedure, by which the court may sanction a plan which not every class has approved (subject to certain conditions). The mere possibility that dissenting classes may be bound naturally influences negotiations. Cases in which the court has exercised its power to bind a dissenting class to date are *DeepOcean*[424], *Smile Telecoms*[425], *Virgin Active*[426] and *Amicus Finance*[427].

Timing

2.15 The legislation does not expressly provide a timeline for schemes of arrangement. A recent judicial Practice Statement[428] states that the applicant for a scheme of arrangement (or restructuring plan) should, prior to the convening hearing, "take all steps reasonably open to it to notify any person affected by the scheme" of various matters relating to the scheme. Unless there are good reasons otherwise, such notice "should be given to persons affected by the scheme in sufficient time to enable them to consider what is proposed, to take appropriate advice and, if so advised, to attend the convening hearing. What is adequate notice will depend on all the circumstances".

[419] *Re Mytravel Group plc* [2004] EWHC 2741 (Ch) (convening); [2005] 1 WLR 2365 (sanction)
[420] *Re Bluebrook Ltd and others* [2009] EWHC 2114 (Ch) (sanction)
[421] *Re McCarthy & Stone plc and another* [2009] EWHC 712 (Ch) (convening); [2009] EWHC 1116 (Ch) (sanction)
[422] *Re Hellas Telecommunications (Luxembourg) II SCA* [2009] EWHC 3199 (Ch) (administration application)
[423] *Re Swissport Fuelling Ltd* [2020] EWHC 1499 (Ch) (convening); [2020] EWHC 1773 (Ch) (sanction)
[424] *Re DeepOcean I UK Ltd and others* [2021] EWHC 138 (Ch) (sanction)
[425] *Re Smile Telecoms Holdings Ltd* [2021] EWHC 685 (Ch) (sanction)
[426] *Re Virgin Active Holdings Ltd and others* [2021] EWHC 1246 (Ch) (sanction)
[427] *Re Amicus Finance plc (in administration)* [2021] EWHC 3036 (Ch) (sanction)
[428] Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006, effective 30 June 2020.

2.16 This reflects an inherent tension between (a) permitting financially-distressed debtors to restructure their debt swiftly and efficiently and (b) ensuring affected creditors receive adequate notice of the debtor's plans so as to have an effective opportunity to appear in court.

2.17 Attempting to strike a balance, the English court has held that:

(a) "What is adequate notice will depend on all the circumstances. The more complex or novel the scheme, and the less consultation that has taken place with creditors as a whole before the scheme is launched, the longer the notice should generally be.

(b) That said, if the scheme is being put forward as a matter of great urgency when the company is in real financial distress, there may not be time to give very much notice to creditors if a default is to be avoided. In such a case the scheme company may well be able to persuade the court that there is good reason to shorten the period of notice or depart altogether from the Practice Statement; and in such a case, any opposing creditor would have a good reason why he had been unable to raise a class or jurisdictional question prior to the sanction hearing.

(c) But in the absence of evidence of real urgency, the Practice Statement should be followed and a sufficient period of notice given of the convening hearing to enable scheme creditors to consider the matter, take advice and, if desired, participate at the hearing ... The court must be astute to detect any attempt to "bounce" creditors into a convening hearing in relation to a complex or novel scheme on inadequate notice."[429]

(d) "The extent of any prior engagement with creditors, the relevant sophistication of the creditors and the extent of any financial distress of the company and, thus, the urgency of the restructuring are all factors relevant to the appropriate time period."[430] Less notice may be required where investors are reasonably sophisticated (especially where the debtor faces imminent financial difficulties). The vast majority of distressed schemes have involved sophisticated financial creditors.[431] (This raises an interesting contrast with restructuring plans, as the ability to bind dissenting class(es) opens the possibility of including a wider range of creditors within the restructuring plan.)

[429] *Re Indah Kiat International Finance Co BV* [2016] BCC 418 at [28]-[30] per Snowden J (as he then was).

[430] *Re MAB Leasing Ltd* [2021] EWHC 152 (Ch) per Zacaroli J; see also *Re NN2 Newco Ltd* [2019] EWHC 1917 (Ch) at [22]-[23] per Norris J.

[431] Notable exceptions include schemes of consumer redress creditors (e.g. Amigo Loans, *Re ALL Scheme Ltd* [2021] EWHC 1002 (Ch) (convening) and [2021] EWHC 1401 (Ch) (sanction) and Provident Finance, *Re Provident SPV Ltd* [2021] EWHC 1341 (convening) and [2021] EWHC 2217 (Ch) (sanction)).

(e) Where an ad hoc group of creditors have negotiated restructuring terms with the debtor before any proposal is put to creditors more generally, the court will remain concerned to ensure adequate notice is given to the wider body of affected creditors. "The requirement to give adequate notice to creditors of the convening hearing has in practice nothing to do with giving notice to the creditors who have already been closely involved in negotiating a scheme and/or who have already locked up to support the scheme. The requirement to give notice of the convening hearing is part of the court's essential role to ensure the fairness of the process and to provide appropriate protection to the minority from the use of majority power which a scheme of arrangement necessarily involves. … [T]he question of the adequacy of notice of the convening hearing is therefore not affected by the level of support for the scheme from the creditors who have already locked up. It falls to be judged by reference to the position of those who have not locked up and who might wish to oppose the formulation of classes proposed by the company."[432]

2.18 Where the court is not satisfied that scheme creditors have been given sufficient time (to enable them to consider what is proposed, to take appropriate advice and, if so advised, to attend and participate effectively in the convening hearing), the court's practical response may vary. It may:

(a) give the scheme creditors liberty to apply to vary or set aside the convening order;[433]

(b) direct that the scheme creditors be entitled to raise any relevant issues at the sanction hearing;[434] or

(c) most drastically (and therefore highly unusually), decline to convene the scheme meetings at the convening hearing.[435]

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[432] *Re ColourOz Investment 2 LLC and others* [2020] EWHC 1864 (Ch) at [46]-[47], per Snowden J (as he then was).

[433] As in *Re ColourOz Investment 2 LLC* [2020] EWHC 1864 (Ch).

[434] I.e. the scheme creditors would not be subject to the restrictions identified in paragraph 10 of the Practice Statement, under which a scheme creditor which raises objections at the sanction hearing based on grounds which would ordinarily be determined at the convening hearing will be expected to show good reason why it did not raise the issue at an earlier stage. This was the approach adopted in *Re Swissport Fuelling Ltd* [2020] EWHC 1499 (Ch), *Re HEMA UK I Ltd* [2020] EWHC 2219 (Ch) and *Re Port Finance Investment Ltd* [2021] EWHC 378 (Ch), among others.

[435] As in *Re Indah Kiat International Finance Company B.V.* [2016] EWHC 246 (Ch), in which the convening hearing was adjourned on grounds of inadequate notice, inadequate disclosure and other issues with the proposed scheme.

Adequacy of Disclosure

2.19 There may be a tension between (a) ensuring scheme creditors receive a sufficient level of information regarding the proposed scheme and (b) avoiding imposing overly-onerous disclosure obligations on financially-distressed debtors (with the consequent impact on implementation costs and timing).

2.20 The Practice Statement provides that explanatory statements should be "in a form and style appropriate to the circumstances of the case, including the nature of the member and/or creditor constituency, and should be as concise as the circumstances admit. … [T]he commercial impact of the scheme must be explained and members and/or creditors must be provided with such information as is reasonably necessary to enable them to make an informed decision as to whether or not the scheme is in their interests, and on how to vote on the scheme. The court will consider the adequacy of the explanatory statement at the convening hearing. The court may refuse to make a meetings order if it considers that the explanatory statement is not in an appropriate form. However, the court will not approve the explanatory statement at the convening hearing, and it will remain open to any person affected by the scheme to raise issues as to its adequacy at the sanction hearing."[436]

2.21 For examples of where an explanatory statement was considered deficient, see *Indah Kiat*[437], *Sunbird*[438] and *Amigo Loans*.[439]

2.22 A further tension arises where relevant information is highly commercially sensitive. "There will be cases in which there is a difficult balance to be struck between the provision of information with which it is reasonably necessary for creditors to be provided, and the disclosure of confidential information which might have a material adverse impact on the business."[440]

2.23 A pragmatic solution to this issue - which avoids the flow of information being unreasonably impaired - is entry into a simple written confidentiality undertaking by scheme creditors[441] or their advisors.[442]

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[436] Paragraphs 14 and 15 of the Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006.

[437] *Re Indah Kiat International Finance Company BV* [2016] EWHC 246 (Ch), in which Snowden J (as he then was) declined to convene scheme meetings.

[438] *Re Sunbird Business Services Ltd* [2020] EWHC 2493 (Ch), in which Snowden J (as he then was) declined to sanction the scheme on the basis that he was not satisfied that a reasonable creditor could have taken an informed decision as to whether the scheme was in its interests. (The company did however succeed in its second attempt at a scheme: [2020] EWHC 3459 (Ch).)

[439] See *Re ALL Scheme Ltd* [2021] EWHC 1401 (Ch) at [132-136], in which Miles J held that the scheme explanatory statement was insufficient to inform scheme creditors about the scheme and the realistic alternatives to it, in presenting a binary choice to scheme creditors and not explaining the basis on which shareholders were to retain their full equity interest (while the scheme creditors - consumer redress claimants - were taking a 90% haircut).

[440] *Re Smile Telecoms Holdings Ltd* [2021] EWHC 395 (Ch) at [49], per Trower J, in the context of a restructuring plan.

[441] As in *Re Smile Telecoms Holdings Ltd* [2021] EWHC 395 (Ch) at [50]-[51], in the context of a restructuring plan.

[442] As in *Virgin Active Holdings Ltd and others* [2021] EWHC 814 (Ch), in the context of a restructuring plan.

Use by SMEs

2.24 Schemes of arrangement are notoriously considered complex and expensive for use by small or medium sized enterprises (especially in light of the requirement for two court hearings and the possibility that the scheme company may be required to pay some or all of the costs of any challenge - see paragraphs 2.36 to 2.38 below).

2.25 Accordingly, use of schemes by SMEs is rare; for notable exceptions, see *Sunbird*[443] (noting that the company was unsuccessful in its first attempt at a scheme) and, in the context of a restructuring plan, *Amicus Finance*.[444]

2.26 There have been some efforts to facilitate access to schemes (and, even more so, the new restructuring plan) by SMEs. For example, the Practice Statement extract cited at paragraph 2.15 above acknowledges the possibility that "lighter touch" documentation may be appropriate for simpler cases involving sophisticated scheme creditors, though this must be approached with caution. Efforts are also underway to produce template restructuring plan documentation to be made available for use by SMEs.

Third Party Releases

2.27 It is common for schemes of arrangement to release scheme creditors' claims against third parties. Relevant third parties potentially include parties related to the debtor (e.g. group entities, shareholders, directors and officers or insolvency officeholders) and also non-affiliates (e.g. legal and financial advisors, auditors or insurers). Claims to be released may be contractual or tortious claims and may be secured or unsecured.

2.28 The court has held it has jurisdiction to approve a scheme of arrangement which releases creditors' claims against third parties that are designed to recover the same loss as creditors' claims against the company - such that the release is "merely ancillary" to the arrangement between the company and its own creditors, and/or the release is "necessary" in order to

[443] *Re Sunbird Business Services Ltd* [2020] EWHC 2493 (Ch) (sanction declined) and [2020] EWHC 3459 (Ch) (sanction granted).
[444] *Re Amicus Finance plc (in administration)* [2021] EWHC 2255 (Ch) (convening) and [2021] EWHC 3036 (Ch) (sanction).

give effect to the arrangement.[445] That test is most clearly satisfied where the scheme/plan compromises debts which are guaranteed and where, absent such a release, pursuit of the guarantor by a scheme/plan creditor (a so-called "ricochet claim") would undermine the compromise between the creditor and the company.

2.29 The court has also found it has jurisdiction to approve a scheme of arrangement which releases claims against parties involved in the preparation, negotiation or implementation of the scheme/restructuring plan and their legal advisors. The court has held that such clauses can be justified by a need not to allow scheme creditors to undermine the terms of the scheme itself, and have become a regular feature of schemes.[446]

2.30 In contrast, the court has held it does *not* have jurisdiction to approve a scheme of arrangement which releases creditors' claims against third parties in the following circumstances:

(a) more tangential claims against third parties - to take a hypothetical example given by the court[447]: a claim by a scheme creditor in negligence against an independent financial adviser who had not cautioned against him buying the investment in the first place, aimed at recouping the difference between the original amount paid for the investment and the consideration provided under the scheme; and

(b) creditors' proprietary rights over assets held on trust by the debtor on their behalf, because that is not a claim in respect of a debt or liability of the debtor.[448]2.31 Accordingly, in practice, if the court considers the issue of third party releases at all, it is likely to focus on:

a) whether the releases are "necessary" in order to give effect to the arrangement;

(b) whether the releases are "merely ancillary" to the arrangement between the company and its creditors;

(c) whether the claims against third parties are "closely connected" to the core claims against the debtor to be compromised under the scheme/plan; and

(d) whether not granting the releases would permit scheme/plan creditors to undermine the terms of the scheme/plan.

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[445] *Re Lehman Brothers International (Europe) (in administration)* [2009] EWCA Civ 1161 at [63] and [65]; see also *Re Noble Group Ltd* [2018] EWHC 3092 (Ch) at [24] and *Re Instant Cash Loans Ltd* [2019] EWHC 2795 (Ch) at [24]]. There is some debate as to whether it is necessary for the release to be both "merely ancillary" and *also* "necessary", or whether it can be either "merely ancillary" *or* "necessary". This was raised in *Re gategroup Guarantee Ltd* [2021] EWHC 304 (Ch), in the context of a restructuring plan, but not ultimately tested.
[446] *Re Far East Capital SA* [2017] EWHC 2878 (Ch) at [14]; *Re Noble Group Ltd* [2018] EWHC 3092 (Ch) at [25]
[447] *Re Noble Group Ltd* [2018] EWHC 3092 (Ch) at [26]
[448] *Re Lehman Brothers International (Europe) (in administration)* [2009] EWCA Civ 1161

2.32 Such releases do not *automatically* alter creditors' rights against third parties. Instead, the scheme must include a legal mechanism for effecting the relevant third party releases and enabling the third party to benefit from them, such as:

(a) the appointment, as a term of the scheme, of an attorney on behalf of the creditors to do the thing that the scheme obliges them to do; or
(b) a covenant by the creditor in favour of the company, to release or alter rights as against a third party, which is enforceable by the company against its creditors, including non-assenting creditors, following sanction of the scheme.[449]

Voting by Ultimate Beneficial Holders

2.33 Scheme debt commonly includes notes issued in global form, where legal ownership of the notes passes by registration and the legal owner is the nominee of a common depositary. A question, therefore, arises over whether the legal owner of the global note is the only creditor which should be entitled to vote, or whether the underlying beneficial noteholders should have this entitlement.

2.34 This issue has arisen in a number of schemes. The courts consider that a scheme "ought obviously to be considered by those who have an economic interest in the debt, that is to say, by the ultimate beneficial owner or principal".[450] It is now well-established that if the relevant instruments provide that beneficial noteholders can acquire direct rights against the issuer in certain (even remote) circumstances[451], then the underlying beneficial noteholders can properly be classified as "contingent creditors" of the company[452], and arrangements should be made to enable them to vote so as to enfranchise those with the ultimate economic interest in the debt.[453]

2.35 Related practical points (illustrated in *Noble*[454] and other cases) include:

(a) notes trustees may undertake not to vote at the scheme meetings, to ensure that there is no double counting;

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[449]See *Re gategroup Guarantee Ltd* [2021] EWHC 304 (Ch) at [36-38], in the context of a restructuring plan.
[450]*Re Castle Holdco 4 Ltd and others* [2009] EWHC 3919 (Ch) at [23].
[451]I.e. by calling for the issue of a definitive note, since a definitive note would represent a direct payment obligation owing by the issuer to the ultimate beneficial owner, which would effectively have exchanged its beneficial interest for legal title.
[452]Contingent creditors are included within the definition of creditors for the purposes of a scheme: see *Re T&N Ltd and others* [2005] EWHC 2870 (Ch).
[453]Approach adopted in numerous cases including e.g. *Re The Co-operative Bank plc* [2013] EWHC 4072 (Ch) at [36]-[40], *Re Noble Group Ltd* [2018] EWHC 2911 (Ch) at [161]-[164], *Re Petra Diamonds US$ Treasury plc* [2020] EWHC 3565 (Ch) at [16] and *Re Castle Trust Direct plc & others* [2020] EWHC 969 (Ch) at [20]-[23].
[454]*Re Noble Group Ltd* [2018] EWHC 2911 (Ch) at [161]-[164].

(b) in the event of a vote being cast by more than one creditor in respect of the same debt, the Chair of the meeting may be authorised to count only the votes of the person with the ultimate economic interest in that debt; and

(c) where an account participant holds interests in the notes on its own account and/or on behalf of one or more ultimate beneficial owners, the votes of the account participant may be split to reflect the votes of the underlying beneficial owners of the notes.

Who Should Bear the Costs of an Unsuccessful Challenge?

2.36 In the last couple of years, there has been a marked increase in the proportion of schemes which face a formal challenge. Successful challenges nonetheless remain rare.[455]

2.37 The ordinary rule in English litigation is that costs usually follow the event, i.e. "loser pays". However, the award of parties' costs remains a matter for the discretion of the court. In a scheme context, the tension is obvious: the financially distressed scheme company has usually "succeeded" and will argue it should not be required to pay the costs of the usually "unsuccessful" opponent, yet the opponent's arguments may have been genuine and assisted the court in ensuring proper scrutiny of the scheme (and the court may well have ordered some adjustment to the scheme terms in light of the objections).

2.38 As ever, the courts have sought to strike a fair balance. Snowden J (as he then was) recently reviewed the authorities as to costs in relation to schemes and stated the following principles[456]:

(a) In all cases the issue of costs is in the discretion of the court.

(b) The general rule in relation to costs [under rule 44.2 of the UK Civil Procedure Rules] will ordinarily have no application to an application … seeking an order convening scheme meetings or sanctioning a scheme, because the company seeks the approval of the court, not a remedy or relief against another party.

(c) That is not necessarily the case (and hence the general rule under the CPR may apply) in respect of individual applications made within scheme proceedings.

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[455] For a notable exception, see *Amigo Loans*: *Re ALL Scheme Ltd* [2021] EWHC 1002 (Ch) (convening) and [2021] EWHC 1401 (Ch) (sanction).

[456] *Re Virgin Active Holdings Ltd & others* [2021] EWHC 991 (Ch) at [29]; Norris J in *Re William Hill plc* [2021] EWHC 1347 (Ch) at [3] described Snowden J's "careful summary" as "now the starting point for deciding costs issues" in relation to both creditors' and members' schemes of arrangement.

(d) In determining the appropriate order to make in relation to costs in scheme proceedings, relevant considerations may include,

i. that members or creditors should not be deterred from raising genuine issues relating to a scheme in a timely and appropriate manner by concerns over exposure to adverse costs orders;

ii. that ordering the company to pay the reasonable costs of members or creditors who appear may enable matters of proper concern to be fully ventilated before the court, thereby assisting the court in its scrutiny of the proposals; and

iii. that the court should not encourage members or creditors to object in the belief that the costs of objecting will be defrayed by someone else.

(e) The court does not generally make adverse costs orders against objecting members or creditors when their objections (though unsuccessful) are not frivolous and have been of assistance to the court in its scrutiny of the scheme. But the court may make such an adverse costs order if the circumstances justify that order.

(f) There is no principle or presumption that the court will order the scheme company to pay the costs of an opposing member or creditor whose objections to a scheme have been unsuccessful. It may do so if the objections have not been frivolous and have assisted the court; or it may make no order as to costs. The decision in each case will depend on all the circumstances."

INDIA

Part 1: INTRODUCTION

Nature of Schemes of Arrangement

1.1 Chapter XV of the Indian Companies Act, 2013 ("**CA 2013**") contains provisions pertaining to Schemes of compromises, arrangements and amalgamations ("**the Scheme(s)**"), wherein an application for any corporate reorganisation (in form of amalgamation, demerger, etc.) and also for corporate debt restructuring can be made by creditors (or class thereof) / members (or class thereof)/ liquidator of the company and be submitted to the bench(es) of the National Company Law Tribunal ("**NCLT**") (having jurisdiction over the company and any transferee company involved as part of the Scheme) for approval.

1.2 This article focusses on the framework of Schemes under the CA 2013 and its usage as a restructuring tool for companies experiencing financial stress. Similar to the English law on scheme of arrangement, the Scheme under the CA 2013 sets out a debtor-in-possession rescue model wherein the incumbent management is not displaced during the rescue process.

1.3 Key aspects of the Scheme under the CA 2013 include the following (each of which mirrors the position in English law) –

(a) No Limitation on Scope – The Scheme can be proposed by any creditor (or class thereof) / member (or class thereof) of the company without any qualifying threshold, or by the company itself, in any circumstance, including the zone of the insolvency or financial distress, and for any purpose, including reorganisation or debt restructuring.

(b) Stage-wise Approval – The Scheme is primarily a three-stage process, with the *first stage,* being the submission of application to the NCLT, *second stage* involving meeting of the stakeholders to vote on the proposed Scheme, and the *third stage,* where the Scheme is submitted to NCLT for its approval. A detailed process is set out in subsequent paras of this article.

(c) Debtor in possession – During the entire procedure, the incumbent management is not displaced at any stage, and continues to be in charge of the company, even though the fate of the Scheme depends on the approval of creditors/members, as the case may be.

(d) Binding Effect – Once the Scheme is approved by the NCLT, its terms become binding on all the creditors (including dissenting), members and the company.

History of the Scheme of Arrangement in India

1.4 The company law legislation in India has been extensively modelled on the company law in the United Kingdom ("**UK**"), with the first company law legislation enacted in India i.e. the Joint Stock Companies Act, 1850, being based on the English Companies Act, 1844. This legislation did not contain provisions relating to any compromise/arrangement with members/creditors.[457] However, the statutes of 1866 and 1882 incorporated certain provisions allowing a company to enter into arrangement with creditors, but only when it was about to be or in the course of being wound up voluntarily.[458]

[457] India Company Law Problems in 1850, *by RS Rungta,* The American Journal of Legal History, Volume 6, No. 3, July, 1962, at page 302. Also note that the Joint Stock Companies Act of 1857 did not allow the company to enter into a scheme of arrangement with creditors, although section 89 permitted the liquidator to compromise the debts/claims of the creditors.

[458] Note that Section 152 of the Companies Act, 1866 stated that a company, which is about to be or in the course of being wound up voluntarily, may enter into an arrangement with creditors, which shall be binding on the company, if the same has been sanctioned by an extraordinary resolution and consented to by three-fourth in number and value of creditors. Section 180 of the Companies Act, 1882 also incorporated similar provisions to this effect.

1.5 Subsequent changes to the legislative framework vide the Companies Act of 1913 (with extensive amendments in 1936[459]) permitted both creditors and shareholders/ members to enter into an arrangement/ compromise, albeit during winding up, which had to be approved by a simple majority in number and three-fourth in value of creditors/ members before sanction of the court.[460] Also, various procedural safeguards were inserted to strengthen the enforceability[461] and workability of schemes of arrangement.[462]

1.6 Thereafter, pursuant to the recommendations in the Justice Cohen Committee Report in 1943[463] and subsequently the Bhabha Committee Report in 1952[464], the Companies Act, 1956 ("**CA 1956**") was introduced (with further amendments in 1965) whereby elements of transparency in a Scheme submission and approval process were strengthened. For example, section 393 provided for a statement to be sent to all the attendees of the Scheme meeting, explaining the effect of the Scheme of arrangement/compromise and particularly on the material interests of the directors, managing director, secretaries, manager etc. of the company.[465] Also, it became mandatory for the company to disclose to the court all material facts, such as its latest financial position, auditor's report on its accounts of the company, pendency of any investigation proceedings, etc.[466]

1.7 Subsequently, with a view to simplify the corporate law structure and bring it in line with the liberalised Indian economic landscape, the Company Law Committee Report under Dr. JJ Irani[467] ("**Irani Committee**") was accepted to give way to the enactment of the CA 2013.[468] Apart from overhauling of the provisions, the CA 2013 marked a new shift in the regime concerning scheme of arrangement/ compromise, with the major change being that the Scheme could be entered into, even without the company being in the course of winding up.[469] Further, certain new provisions were introduced to make the process creditor friendly and secure, such as power of the sanctioning authority/ court to dispense with the creditor meetings upon filing of an affidavit supporting the Scheme[470], specification of threshold for raising objections to the Scheme[471] etc. However, surprisingly, the provision relating to moratorium was kept out from the CA 2013, even though Section 391(6) of the CA 1956 empowered the court to impose a moratorium, once an application was filed (refer to paragraph 2.3(a) below).

[459] Company Law and Practice, *by Dr. Sanjay Kapoor and Dr. Sanjay Dhamija,* Taxmann,August, 2019, at Page 1.
[460] Companies Act, 1913, Section 153 (Original Act of 1913).
[461] Note that Section 153 of the Companies Act, 1913 [Amended by Companies (Amendment) Act, XXII of 1936] provided for filing a copy of the court's order sanctioning arrangement/ compromise with the registrar and granted powers to courts to stay the continuation/commencement of any other suit against the company.
[462] Note that Section 153A of the Companies Act, 1913 [Amended by Companies (Amendment) Act, XXII of 1936] provided for transfer of whole or part of undertaking of a company to another through a scheme of arrangement.
[463] Report of the Committee on Company Law Amendment, June 1945, Her Majesty's Stationery Office, at page 89.
[464] Report of the Company Law Committee, 1952, Bhabha Committee Report, at page 170.
[465] Companies Act, 1956, Section 393.
[466] Companies Act, 1956, Proviso to Section 391(2).
[467] Report of the Expert Committee on Company Law, Ministry of Corporate Affairs, May, 2005, at page 2.

1.8 Furthermore, a specialised court i.e. NCLT was established in 2016, after facing legal hurdles in relation to its constitution,[472] replacing the Hon'ble High Court as the jurisdictional authority for sanctioning Schemes under the CA 2013 to ensure a faster approval process. This development was also supplemented with the enactment of the Insolvency and Bankruptcy Code, 2016 ("**IBC**"), with many of its provisions coming into effect in late 2017. The interplay of IBC with the schemes under the CA 2013 has also been discussed in the later sections of this article.

Part 2: DISCUSSION

Procedure of Schemes under the Companies Act as a Debt Restructuring Mechanism

2.1 Similar to the English law, an application in respect of the Scheme may be made under Section 230(1) of the CA 2013 by creditors (or class thereof)/members (or class thereof) of the company, or by the company itself ("**Applicant**"), before the jurisdictional NCLT (i.e. the NCLT's bench within whose jurisdiction the company is incorporated). The NCLT may, on the application of the company or of any creditor or member of the company, order a meeting of the creditors (or class thereof), or of the members (or class thereof), as the case may be, to be called, held and conducted in such manner as the NCLT directs.

2.2 The process for sanction and implementation of the Scheme (being broadly similar to the English law process) would involve three stages, as set out below:

(a) First Stage: The Applicant, while filing the application under Section 230(1) of the CA 2013, is also required to disclose under an affidavit, amongst others:

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[468] See "The Scheme of Arrangement as a Debt Restructuring Tool in India: Problems and Prospects", *by Umakanth Varottil,* NUS Working Paper 2017/005, NUS Centre for Law & Business Working Paper 17/02, March, 2017, at page 23.

[469] Note that a similar construct was there in the CA 1956, however, the courts in India, on many occasions, have interpreted the terms "liable to be wound up" under the provisions of CA 1956 as not being equivalent to the fact that the company should be wound up. Accordingly, there are conflicting judgments on this aspect; see Guide to the Companies Act, *by A Ramaiya*, 19th Edition - Volume 2, Chapter 15, at page 64.

[470] Companies Act, 2013, Section 230(9).

[471] Note that the proviso to Section 230(4) of the Companies Act, 2013 stipulates that objections against the Scheme can be made only by persons holding not less than ten per cent. of the shareholding or having outstanding debt amounting to not less than five per cent. of the total outstanding debt.

[472] *Madras Bar Association v. Union of India*, MANU/SC/0610/2015 (SC); Ministry of Corporate Affairs, Government of India, Notification Nos. S.O. 1934(E) and S.O. 1935(E) dated 1 June 2016.

i. Financial Position of the Company

All material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company are required to be disclosed in the application.

ii. Consent Requirements

A. If the Scheme proposes to restructure / vary the debt obligations of the company towards its creditors, as a precondition for making an application before the NCLT, the Scheme requires the approval by at least 75% of the secured creditors by value.[473] However, where the Scheme does not involve debt restructuring and the creditors (or any class) are not identified in the Scheme as an affected class, then their prior approval will not be required[474], unless there are consent requirements under the relevant loan documentation[475]. In such cases, only the approval of the members (or the relevant affected class) will be taken.

B. The Applicant is also required to disclose to the NCLT, the classification of creditors/ members and the basis on which each class of creditors/ members has been identified for the purposes of the approval of the Scheme.[476] It is pertinent to note that the CA 2013 does not prescribe specific "classes" of creditors for this purpose (e.g. financial creditor or operational creditor as classified under IBC). However, if separate classes of creditors are identified (being affected/impaired class under the Scheme[477]), then approval of such Scheme at a meeting of each class of creditors is required. The established practice for the Indian Schemes has been to classify creditors as 'secured creditors' and 'unsecured creditors'.

[473] Companies Act, 2013, Section 230(2)(c).
[474] Note that the Bombay High Court in the case of *ICICI Ltd. Re*, (2002) 36 SCL 682, held that "Creditors meeting not necessary where scheme is only between members…. The Court said that though the court is bound to take care of the interests of creditors, it is not bound to call a meeting of the creditors where the proposed arrangement is only between members, and the creditors are not likely to be adversely affected."; See Guide to the Companies Act, *by A Ramaiya*, 19th Edition - Volume 2, Chapter 15, at pages 41 and 48.
[475] Note that, in the case of *Ramco Super Leathers Ltd. v Dhanlakshmi Bank Ltd.,* (2009) 152 Com Cases 937, the order of sanction of the Scheme was modified to make it subject to approval of the creditors as the fact regarding requirement of a consent under the relevant loan documentation was not brought to the notice of the NCLT earlier.
[476] Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, Rule 3(4).
[477] See *Supra Note* at 85; Also, the Supreme Court in the *Miheer Mafatlal case* drew support from the concept of a 'class' from Palmer's Company Law, 24th Edition and noted various judgments therein which inter alia held that "*..if rights of ordinary shareholders are to be altered, but those of preference shares are not touched, a meeting of ordinary shareholders will be necessary but not of preference shareholders.*"

In the case of *In Re: Arvind Mills Ltd.*[478], which was a scheme for debt restructuring, the Court declined to accept an objection from some of the foreign creditors that a separate class for them was not required to be constituted considering the absence of commonality of interest and the conflict of interest, in light of an existing litigation with some of the Indian banks. The Court, relying on the ratio of the landmark judgment of the Hon'ble Supreme Court in *Miheer H. Mafatlal* v. *Mafatlal Industries Ltd*[479] (the "***Miheer Mafatlal* case**") held that "…*no separate classification is required until a group is treated differently under the scheme..*" and "…*objectors would not be entitled to be treated as a different class of secured creditors, a class within the class, as there is no conflict of commercial interest between objectors and other secured creditors, especially when the same scheme with same terms has been offered to all the secured creditors and there is no distinction made in the scheme between the objectors and other secured creditors*".

iii. Other Requirements

A. The provisions of the CA 2013 prescribe several other requirements to ensure that the interests of all stakeholders are safeguarded and to avoid prejudice to any minority stakeholder. These include inter alia the following:

   a) The Scheme must include a Creditor Responsibility Statement[480], wherein the consenting secured creditor would be required to make certain representations, such as (I) it has read and understood the proposed restructuring scheme, (II) it is in its best interest to concur with the same, and (III) the Scheme does not give any fraudulent preference to the relevant secured creditor at the cost of any secured/unsecured creditor etc. This puts a responsibility on the consenting creditors to ensure fair play.

   b) The Scheme must also be accompanied by a report by the auditor that the fund requirements of the company, after the Scheme restructuring, shall conform to the liquidity test based upon the estimates provided to such auditors by the board of directors of the company.[481]

[478] *In Re: Arvind Mills Ltd.* [2002] 111CompCas118(Guj), at paras 13 and 15. Also, the High Court of Gujarat has, in the case of *Maneckchowk and Ahmedabad Manufacturing Co. Ltd., In re* (1970) 40 Comp Cas 819 (Guj), observed that a class "*must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult each together with a view to their common interest.*"
[479] *Miheer H. Mafatlal* v. *Mafatlal Industries Ltd*., (1997) 1 SCC 579.
[480] Companies Act, 2013, Section 230(2)(c)(i) read with Rule 4 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.
[481] Companies Act, 2013, Section 230(2)(c)(iii).

c) The NCLT also has the power to pass an order providing for exit offer to dissenting shareholders, if it thinks that it is necessary to effectively implement the terms of the Scheme (i.e. to not only protect their interests but also to prevent any holdouts).[482] Also, the Scheme can involve a takeover offer, wherein any member of the company holding not less than three-fourth of the shares can make an application to the NCLT to acquire the remaining shares with a valuation report from a registered valuer.[483] In such a case, if the company is a listed company, then it has to comply with the regulations framed by the Securities and Exchange Board of India. No similar provision for takeover of debt of a dissenting creditor is available under Section 230.

i. A valuation report, in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer must be submitted, along with the Scheme. The aspect of valuation is important because the commercial viability of the Scheme will be assessed by the creditors who approve the filing of the application and the NCLT will assume that the creditors have examined the viability of the Scheme before approving the same.[484] As has been held in the *Miheer Mafatlal* case[485]:

"The Court has neither the expertise nor the jurisdiction to delve deep into the commercial wisdom exercised by the creditors and members of the company who have ratified the Scheme by the requisite majority. Consequently, the Company Court's jurisdiction to that extent is peripheral and supervisory and not appellate."

It is to be noted, while the English courts will carefully evaluate valuation evidence where necessary,[486] the Indian courts have usually avoided scrutinising the same, holding this to be a commercial aspect which does not fall within the remit of the courts while examining a Scheme for approval.[487] Having said that, the courts may look at the valuation evidence if the issue is germane to the determination of the fairness and reasonableness of a

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[482] Companies Act, 2013, Section 230(7)(e).
[483] Companies Act, 2013, Section 230(11) read with Rule 3(5) and Rule 3(6) of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.
[484] *N.A.P. Alagiri Raja and Company vs N. Guruswamy and Ors.,* 1989 65 CompCas 758 MAD.
[485] See *Miheer Mafatlal case* at para 29.
[486] The starting point for the English courts is to consider the scheme from a counterfactual perspective i.e. what would happen if the scheme is unsuccessful. Historically, scheme companies have most frequently asserted that the only alternative to the scheme is liquidation, and consequently a liquidation valuation is applied to the company to determine whether the junior creditors (and shareholders) have any remaining economic interest. *See* 'The Role of the Court in Debt Restructuring' by *Jennifer Payne*, 77 Cambridge L.J. 124 (2018). The relevant alternative - and valuations - are now being considered more closely in light of the introduction of the new restructuring plan procedure (in part, because the two threshold conditions for the court to have jurisdiction to sanction a plan which not every class has approved are framed by reference to the that (no member of a dissenting class be any worse off under the plan than they would in the relevant alternative).
[487] See *Miheer Mafatlal* case, at para 40.

scheme, and to ensure that it is not a fraudulent scheme (refer to the Ankit Mittal case as referred to in paragraph 2.3(c) below).

Second Stage

Upon the application being heard by the NCLT, the Scheme would be put to vote in the meeting of each class of members and creditors, convened as per the directions of the NCLT. The NCLT may dispense with calling of a meeting of creditor or class of creditors where such creditors or class of creditors, having at least 90% by value, agree and confirm, by way of affidavit, to the Scheme.[488]

Furthermore, after the notices for the meeting has been sent to the creditors, objections may be made to the Scheme by such recipients which hold not less than 10% of shareholding or have outstanding debt amounting to not less than 5% of the total outstanding debt.[489] The notice is also required to be sent to the statutory authorities such as income tax authorities, the Reserve Bank of India, the Securities and Exchange Board of India, the registrar of companies, stock exchanges, official liquidator, the Competition Commission of India etc.,[490] which may register their objection, if any, with the Scheme within 30 days of receipt of notice and if no representation is received within the period of 30 days, it will be presumed that the relevant authorities have no objection.

An important aspect of the second stage pertains to voting on the Scheme, for which the provisions of Section 230(6) of the CA 2013 expressly specify the requirement of approval by majority of persons representing three-fourth by value in each class of creditors and in each class of members,[491] as the case may be, in the meetings convened with respect to such class.

Third Stage

Once the Scheme has been approved at each of the meetings, by the majority of stakeholders representing at least three-fourth in value, an application in respect of the Scheme is to be submitted to the NCLT seeking its approval.[492] Upon being sanctioned by the NCLT, the Scheme will become binding on inter alia the company, all the creditors, or class of creditors or

488 Companies Act, 2013, Section 230(9).
489 Companies Act, 2013, Proviso to Section 230(4).
490 Companies Act, 2013, Section 230(5) read with Rule 8 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.
491 *In Re: Auto Steering India P. Ltd.*, [1977] 47 Comp Cas 257 (Delhi); *K. Sudhakar Gupta vs. Electro Thermics (Pvt) Limited*, [2004] 122 Comp Cas 625 (AP).
492 Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, Rule 15.

members or class of members and the contributories of the company.[493] However, it is pertinent to note that the NCLT has the power to make modifications to the Scheme, either at the time of sanctioning of the Scheme and/or any time thereafter[494], only for the purposes of its proper implementation without changing the basic fabric or commercial arrangement of the Scheme.[495]

The provisions of the Scheme under CA 2013 do not explicitly define any contours or design of the Scheme including any restrictions on the structure or arrangement for the same. Therefore, a Scheme can provide for *inter alia* a demerger of all the undertakings (or a division/undertaking[496]) of a company(s) with amalgamation of the transferor company(s) into a single unit (with a view to optimise synergy of operations)[497] or to issue shares to the transferor company in lieu of the demerger/transfer, and may also provide for extinguishment of all or certain liabilities of the company, provided the requisite approval of the affected class has been duly taken. A Scheme can also provide for a simple merger, including a cross border merger subject to compliance with the applicable law in the foreign country[498].

In the case of *Apurva J. Parekh v. Essen Computers Ltd.,*[499] where the scheme was proposed merely with a view to dispose of the assets of the company and extinguish the personal liabilities of promoters and former directors, without following the due procedure and obtaining of requisite consents from affected classes, the court refused to grant approval to such Scheme. Further, regardless of the structure of the Scheme, what is necessary for the proposer of the Scheme is to specify the treatment of existing liabilities. For example, in the case of *Hemakuta Sugar & Allied Industries Ltd. v Salar Jung Sugar Mills Ltd.,*[500] the NCLT found the scheme as unviable, since it did not specify how the funds will be mobilised to discharge the existing liabilities to the workmen and creditors. Also, a scheme which does not contain any proposal or provision with reference to the claim of the workers and also proposes to make 20% payment of the dues of the unsecured creditors in instalments has been held as not being a *bona fide* scheme, and instead a façade.[501]

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[493] Companies Act, 2013, Section 230(6).
[494] Companies Act, 2013, Section 231(1).
[495] *Unique Delta Force Security Private Ltd. v. Sumeet Facilities Pvt. Ltd*., [2012] 175 CompCas 318 (Bom); *Meghal homes (P) Ltd. v. Shree Niwas Girni K.K. Samiti and Ors.*, (2007) 7 SCC 753.
[496] *Jindal Pipes Ltd., Re,* (2008) 88 SCL 48 (All), *Arvind Mills Ltd., Re*, (2010) 155 Com Cases 449.
[497] *Dynasty Developers P. Ltd.,Re,* (2010) 98 SCL 268 (Kar); See Guide to the Companies Act, *by A Ramaiya*, 19th Edition - Volume 2, Chapter 15, at page 129.
[498] Note that the provisions relating to the amalgamation of a foreign company with an Indian company and vice-versa have been provided under Section 234 of the CA 2013. Also, see *Supra Note* at 80, at page 130.
[499] (2006) 3 Comp LJ 321.
[500] (2010) 99 CLJ 347 (Kar).
[501] *Madhu Fabrics Ltd. v Regional Director* [2013] 176 Com Cases 368 (Guj).

Key Practical Issues and Recommendations

2.3 Historically, the Scheme process has been marred with various practical difficulties, which is the reason why, even under the CA 1956, there were not many instances of the companies entering into Schemes, let alone for the purposes of stressed debt restructuring.[502] Even under the present CA 2013, the procedure has certain shortcomings, which have been emphasised below, along with possible transformations which can optimise the efficiency of the framework.

(a) Absence of Moratorium
In debt restructuring, moratorium refers to the stay or prohibition on commencement/ continuation of proceedings or enforcement of security by any creditor against the company for debt recovery. Moratorium is a standard feature in the insolvency laws across jurisdictions, which ensures that the debt resolution proposal/plan for the company can be implemented smoothly without the company or concerned creditors being saddled with recovery proceedings by individual creditors and a uniform approach for the default resolution can be followed. For example, in the IBC framework, once the NCLT admits the application for initiation of insolvency, it also imposes a moratorium inter alia on any proceedings to be initiated against the corporate debtor.[503]

Despite the apparent benefits of a moratorium for the purposes of Schemes, CA 2013 does not explicitly contain any provision which empowers the NCLT to impose the moratorium, once the application is filed under Section 230 of the CA 2013. However, the Hon'ble National Company Law Appellate Tribunal ("**NCLAT**"), in the case of *Union of India v. Infrastructure Leasing & Financial Services & ors.,*[504] exercised its power under Section 242(4) of the CA, 2013[505] and imposed a moratorium in order to avoid multiplicity of cases and preserve the time of the tribunals that would otherwise had been spent in adjudication of several individual applications. Here, the NCLAT acknowledged the fact that the moratorium available under the provisions of IBC is not present in CA 2013 but the same power can regardless be exercised under Section 242(4) of the CA, 2013 by way of an interim order.

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[502] Interim Report of The Bankruptcy Law Reform Committee, February, 2015 at page 78.
[503] The Insolvency & Bankruptcy Code, 2016, Section 14. The Report of The Bankruptcy Law Reforms Committee, November, 2015, pursuant to which the IBC was enacted, notes (at pages 78 and 118 respectively) that "*One of the goals of having an insolvency law is to ensure the suspension of debt collection actions by the creditors, and provide time for the debtors and creditors to re-negotiate their contract. This requires a moratorium period in which there is no collection or other action by creditors against debtors.*"…… "*The motivation behind the moratorium is that it is value maximising for the entity to continue operations even as viability is being assessed during the IRP. There should be no additional stress on the business after the public announcement of the IRP. The order for the moratorium during the IRP imposes a stay not just on debt recovery actions, but also any claims or expected claims from old lawsuits, or on new lawsuits, for any manner of recovery from the entity.*"
[504] Company Appeal (AT) No. 346 of 2018 along with Company Appeal (AT) No. 347 of 2018.
[505] Note that Section 242(4) of the Companies Act, 2013 allows the tribunal to make any interim order which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as appear to it to be just and equitable.

It is relevant to note here even though Section 391(6) of the CA 1956 empowered the court to impose a moratorium[506] once the application under the provisions have been filed, the courts were very cautious in exercising their discretion to impose a moratorium.[507] Surprisingly, this provision was not included in CA 2013, owing to which the discretionary imposition of moratorium/stay by the NCLT remains out of question. The absence of moratorium/stay provisions keeps alive the fear of enforcement action against security by individual creditors, which essentially makes it difficult for the company to be able to enter into an arrangement with creditors.[508]

If not an automatic stay, then certain provisions must be incorporated, similar to the CA 1956, wherein NCLT has authority in imposing stay on individual enforcement actions, coupled with adequate guidance on the way NCLT must exercise this authority. Notably, the English statutory framework also does not provide for a moratorium; practical workarounds for this are covered in paragraph 2.8 of the English part of this article. It needs to be seen if these workarounds (especially the 'lock-up arrangements' and implementing a Scheme as part of Administration proceeding) can be implemented in the Indian context. Please refer to paragraph 2.7 onwards in relation to usage of Schemes under an IBC proceeding.

(b) No fixed timelines
The entire procedure of the approval of the Scheme is devoid of prescribed timelines for various milestones.

Although there is no formal timeline in English schemes of arrangement either, the English market tends to focus on getting deals done as quickly as possible, especially where there is some "burning platform" e.g. a liquidity crisis, which creates a deadline by which the scheme must be implemented. The focus of the English case law on timing (and a recent judicial Practice Statement[509]) has therefore been on ensuring the process is not so rushed that stakeholders are not given proper opportunity to consider the proposals (see paragraphs 2.15 to 2.17 of the English part of this article).

In contrast, in India, the absence of timelines gives rise to the issue of delay, which also existed in the erstwhile CA 1956 and resultantly reduced the usage of such procedures in the past.[510] Even the Irani Committee, while laying down recommendations on the issues of restructuring and liquidation, emphasised that a definite time frame must exist for the rehabilitation

[506] *Alps Industries Limited, Re,* (2012) 107 CLA 25 (All).
[507] *Supra note 79*, at page 9.
[508] *Ibid,* at page 30.
[509] Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006, effective 30 June 2020.
[510] *Supra note 113.*

process, as opposed to the then existing time frame, which was too long and substantially depleted the value of the assets.[511]

It is worthwhile to note that the legislature found it suitable to prescribe a detailed timeline at each stage (including timeline for admission of an insolvency application by the NCLT, being the adjudicating authority under IBC), apart from an overall mandatory timeline, for the completion of Corporate Insolvency Resolution Process ("**CIRP**") under the IBC[512] so as to ensure a time bound resolution. Similarly, the Scheme procedure must also be equipped with certain timelines, especially for NCLT to allow the meeting of creditors/shareholders and also at the sanction stage, which will ensure that the procedure is not marred by unnecessary delays or holdouts and the stakeholder confidence in the process is maintained.

(c) Excessive Scope for NCLT's interference

The provisions of the CA 2013 broadly authorise the NCLT to look into the legitimacy of the Scheme at two stages – first, at the stage of filing of the application and second, at the final sanction/rejection of the Scheme. Overall, the NCLT has the broad ambit to look at the fairness of the Scheme,[513] in order to justify the protection of all classes of creditors. Furthermore, the NCLT must also be convinced that the persons attending the meeting are fair representatives of the respective classes and have not been coerced by the statutory majority to promote their interests. To this end, the NCLT can also review the manner in which the meeting was held and can reject the Scheme if there is any evidence of irregular conduct in the meeting. In *Birla VXL Ltd., In re*[514]*,* the NCLT ordered for the inclusion of an unsecured creditor in a meeting and rejected the plea for its exclusion, on the grounds that he/she was a creditor for another unit of the same company. The NCLT has, in the past, also pierced the *veil of apparent corporate purpose* to look into the intended purpose of the Scheme which, if found to be fraudulent, will be rejected by the NCLT at the outset.[515]

Additionally, the proviso to Section 230(4) of the CA 2013, which specifies a threshold for a creditor/shareholder to be able to object to the Scheme, was intended to serve as a safeguard to avoid holdouts by shareholders/creditors having miniscule amount of shares or lending.[516] While, on one hand, the NCLT has refused creditors having less than 5% of the outstanding debt from

[511] *Supra Note 78*, at page 144.
[512] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Regulation 44A.
[513] *Sistema Shyam Teleservices Ltd.,* In re [2016] 74 taxmann.com 261.
[514] *Birla VXL Ltd., In re*, [2006] 66 SCL 69 (Guj.).
[515] *Bedrock Ltd., In re* [2000] 101 Comp Cas 343 (Bom.), at paras 22A and 23. Also see *St. Mary's Finance Ltd. v. R.G. Jaya Prakash* [1999] 22 SCL 337 (Ker.) and *Integrated Finance Company Ltd. v. Reserve Bank of India and ors.,* (2015) 13 SCC 772, at para 43.
[516] *Supra Note 80*, at page 26.

objecting to the Scheme,[517] but on the other hand, the NCLAT has, in the *Ankit Mittal* case, surprisingly relaxed the statutory criterion to reject a Scheme stating that if an objection has come then even though the prescribed threshold is not met, the NCLT is bound to see if the Scheme is just, fair, conscionable and reasonable from the perspective of reasonable prudent men of business taking a commercial decision.[518] In the said judgment, the NCLAT (vide para 38) also ordered for reworking of the valuation/exchange ratio on the basis that the initial scheme did not provide payment for the shareholders whose shares were cancelled in terms of the scheme and such payment was offered only upon the intervention of the NCLT, thereby raising questions on the manner in which the valuation was carried out.

Further, the NCLT, at the stage of filing, has to assess that the Scheme application is approved by 75% of secured creditors, along with necessary disclosures, which is again accompanied with another hearing of sanctioning, wherein the consent of the requisite threshold of each class of creditors is required to be seen, along with its fairness. The two stages of screening the Scheme adds another redundant layer of scrutiny[519].

It is significant to note that, on one hand, the presence of statutory safeguards is required to avoid abuse in the process, but on the other hand, it is also important to define the ambit of the usage of such safeguard provisions, in order to avoid misinterpretation of provisions or divergence in case laws and to avoid the delays in the approval process. This was the reason why the Apex Court, in the *Miheer Mafatlal* case, laid down the contours of court's supervisory jurisdiction in sanctioning the scheme stating that the scheme must be fair and reasonable but that does not permit the courts to question the commercial wisdom of the creditors.[520] Hence, it is pertinent that the NCLT and subsequent appellate authorities, as the case may be, carefully exercise judicial discretion, while sanctioning/rejecting the Scheme, which will resultantly increase the confidence of the stakeholders to use this route as a debt restructuring mechanism frequently.

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[517] *Reliance Communications Limited,* CSP 376A to CSP 381 of 2017, decided on 14 August 2017 (NCLT Mumbai Bench).

[518] *Ankit Mittal v Ankita Pratistan Limited*, [2020] 218 Comp Cases 79 (NCLAT), at para 33. Also see Guide to the Companies Act, by A Ramaiya, 19th Edition - Volume 2, Chapter 15, at pages 26 and 27

[519] *Supra note 113*, at page 77.

[520] The ratio has been followed in various judgments including the case of *Meghal Homes Pvt Ltd v. Shri Niwas Girni K.K. Samiti and ors.*, [2007] 139 Comp Cas 418 (SC), wherein the Apex Court held that "*While the Court will not sit in appeal over the commercial wisdom of the shareholders of a company, it would certainly consider whether there is a genuine attempt to revive the company that has gone into liquidation and whether such revival is in public interest and conforms to commercial morality*." Also see *Integrated Finance Company Ltd. v. Reserve Bank of India and ors.,* (2015) 13 SCC 772, at para 43.

(d) Limited usage of Schemes in debt restructuring cases

Notably, Schemes have been seldom used solely as a debt restructuring tool and the usage has been more for corporate reorganisation/restructuring with debt restructuring being a small part of such corporate reorganisation/restructuring[521]. This reluctance is mainly attributable to the costs, uncertainties and delays in getting a Scheme approved and also reliance of the Indian banks on various debt restructuring tools proposed by the Reserve Bank of India (RBI) from time to time.

Adequacy Of Disclosure

2.4 As mentioned previously, one of the major reasons stated by the Bhabha Committee Report, to amend the schemes of arrangement regime, was regarding the transparency about the Scheme and its disclosure to the stakeholders and the court. Not only the CA 1956 emphasise the disclosure of material facts, but also CA 2013 prescribes mandatory disclosure at filing stage.

2.5 Non-disclosure of the relevant facts has led to rejection of applications by the NCLT. In *Morepen Laboratories Ltd., In re*,[522] (upheld in *Morepen Laboratories v Regional Director*)[523] the applicant did not disclose investigation by Serious Fraud Investigation Office or pendency of various criminal proceedings against it and hence, the proposed scheme of arrangement with fixed deposit holders was dismissed. The absence of valuation report, which is required to be disclosed as per the CA 2013, has also led the NCLT to dismiss the Scheme, as being in violation of statutory provisions.[524]

2.6 On the other hand, objections to the Scheme on the grounds of disclosure of facts have been carefully considered by the courts. The Gujarat High Court, in *Gujarat Lease Financing Ltd. Re*[525], approved a scheme for part payment to debenture holders, even though it was opposed by 2% of debenture holders on the grounds of inadequate disclosure, because the objectors could not show the violation of any statutory provisions. Furthermore, the possibility of violation of accounting standards cannot be the basis for straightaway rejection of a scheme of arrangement. In *Hindalco Industries Ltd., In re*,[526] the Bombay High Court allowed the scheme of arrangement involving equity shareholders and financial restructuring, subject to disclosure of deviation from applicable accounting standard in the final accounts of the company.

[521] *Supra note 79*, at pages 2, 28 and 31.
[522] [2018] 92 taxmann.com 296 (NCLT - Chd.).
[523] 2019 SCC OnLine NCLAT 426.
[524] *Anuroop Builders & Developers Private Limited with Dome Builders & Developers Private Limited,* CA/295(PB)/2017 in CA(CAA)/26(PB)/2017, decided on 3 November 2017 (NCLT New Delhi)
[525] (2002) 36 SCL 838 (Guj).
[526] [2009] 94 SCL 1; *Reliance Communications Ltd., In re* [2009] 94 SCL 219 (Bom.).

Contemporary Usage of Schemes in the IBC era

2.7 The enactment of IBC, as the crucial insolvency law legislation, has added another interesting puzzle regarding usage of Schemes under the CA 2013 for the purposes of implementing a resolution plan ("**Plan**") under IBC. Under IBC, an entity emerges as a successful resolution applicant of the corporate debtor, when the Plan proposed by it, is accepted by at least 66% of the Committee of Creditors and is subsequently approved by the NCLT.[527] It has been frequently seen that such Plans contain provisions for scheme of merger/amalgamation/demerger (of business undertaking) of the corporate debtor with another company of the resolution applicant. This is in line with Regulation 37(c) of the Insolvency and Bankruptcy Board Of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("**CIRP Regulations**") which states that a Plan may, as a measure for insolvency resolution of a corporate debtor, provide for *merger or consolidation of the corporate debtor with one or more persons*.

2.8 In such a situation, a question arises whether the process for approval of a Scheme (as set out under sections 230-232 of the CA 2013), being proposed under a Plan (which is a feature of IBC), also needs to be followed for implementing the Plan in light of the fact that the IBC is being considered as a self-contained legislation for insolvency resolution[528] and has an overriding effect on all other existing legislations in case of any inconsistency[529].

2.9 The Mumbai Bench of NCLT, in the recent case of *State Bank of India v Videocon Industries Ltd.*[530]*,* granted an in-principle approval to the scheme of merger as part of the resolution plan, without requiring recourse to the applicable provisions of CA 2013, stating that IBC is an exhaustive code on the subject matter of insolvency in relation to corporate entities and is complete in itself. The NCLT also relied on the judgment of NCLAT in the case of *Edelweiss Asset Construction Company Ltd. v. Synergies Dooray Automative Ltd. and Ors.,*[531] wherein the Hon'ble NCLAT, while referring to

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[527] The Insolvency & Bankruptcy Code, 2016, Section 30 read with Section 31.
[528] *Laxmi Pat Surana v. Union Bank of India*, (2020) SCC OnLine SC 1187. Similar ruling was given by the Hon'ble Supreme Court in *Swiss Ribbons Pvt. Ltd. v. Union of India*, 2019 SCC OnLine SC 73 and *Ebix Singapore Pvt Ltd v. CoC of Educomp Solutions Ltd and Anr., Judgment dated 13 September 2021 in C.A. no. 3224 of 2020*
[529] The Insolvency & Bankruptcy Code, 2016, Section 238.
[530] MANU/NC/1501/2021.
[531] 2018 SCC Online NCLAT 1005.

the Explanation to Section 30(2)(e) of IBC,[532] held that the contention of the appellant thereto (regarding non-compliance with provisions of sections 230-232 of the CA 2013 while filing Plan for NCLT's approval, to be held as being violative of section 30(2) of the IBC)[533], cannot be accepted as the Plan merely proposes merger which is as per Regulation 37 of the CIRP Regulations and the IBC has an overriding effect over the provisions of other legislations on account of its Section 238. Accordingly, the NCLAT held that the approval of the Plan, providing for a scheme of merger, is in accordance with the applicable provisions of law and can be given effect to. 2.10 The NCLAT, in another case of *Y. Shivram Prasad v S. Dhanapal,*[534] has held that the NCLT, while dealing with any schemes being implemented as part of a liquidation process under the IBC, can play a dual role, i.e., of an Adjudicating Authority under IBC and as a tribunal for passing orders under section 230 of CA 2013. Accordingly, it can hear objections to the Scheme and also approve/reject a Scheme as part of the IBC process after evaluating if the Scheme is in consonance with the objectives of the IBC[535] and is also beneficial for revival of the corporate debtor. In this regard, Regulation 2B[536] was introduced in the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 permitting Schemes to be entered into during liquidation under the provisions of IBC as per the requisite timelines.

2.11 Accordingly, it has been seen that the NCLT (acting as the Adjudicating Authority under IBC) plays this dual role of passing deemed approval orders for Schemes proposed as part of the Plan, being the jurisdictional tribunal for the corporate debtor under Section 230 of the CA 2013 in light of the dispensation of shareholders' approval provided under the Explanation to Section 30(2)(e) of IBC.[537] Also, the requirement of a separate creditors' approval is not required for the corporate debtor as the Plan is being approved by the requisite majority of 66% of the financial creditors of the corporate debtor, which is binding on all the other creditors (including operational and dissenting) of the corporate debtor.[538]

2.12 It is to be noted that the dispensation from shareholders' and creditors' consent can be said to be available only to the corporate debtor (the same being under the CIRP), however, the same cannot be said for the resolution applicant which has filed the Plan as it may need to comply with the process set out under sections 230-232 of the CA 2013 and obtain its shareholders' and creditors' approval. Having said that, a separate approval from the NCLT may not be required if the resolution applicant comes under the same jurisdictional NCLT as that of the corporate debtor entity.

[532] Note that the explanation to Section 30(2)(e) reads as follows — *For the purposes of clause (e), if any approval of shareholders is required under the Companies Act, 2013(18 of 2013) or any other law for the time being in*

2.13 A further level of complexity arises in the situation where the jurisdictional NCLT is not same for the corporate debtor and the resolution applicant/transferee company. In such a case, in all likelihood, the resolution applicant/transferee may have to take separate approval (or waiver thereto) for the Scheme proposed under the Plan from its own jurisdictional NCLT bench. In the judgment of the NCLAT in *Anatanium Holdings* case[539], the Bench confirmed the position enunciated by the NCLT that "… *the Resolution Plan approved shall not construe any waiver to any statutory obligations/liabilities arising out of the approved Resolution Plan and same shall be dealt in accordance with the appropriate Authorities as per relevant Laws. This Adjudicating Authority is of the considered view that if any waiver is sought in the Resolution Plan, the same shall be subject to approval by the concerned Authorities*". A similar view was taken by the Principal Bench of NCLT in the case of *Parveen Bansal vs. Amit Spinning Industries Ltd.*[540] Though these cases didn't specifically deal with a Scheme proposed under the Plan, but the legal principle laid down by these cases will equally apply to Schemes and compliance with requirements under sections 230-232 of CA 2013 which is a separate legislation, and there being no inconsistency with IBC, the argument of overriding effect of IBC may not be available.

2.14 Another issue which gained traction was the applicability of Section 29A of the IBC to the Schemes proposed for corporate debtors undergoing liquidation under IBC. According to Section 29A of IBC, certain persons (such as promoters, persons in control of the corporate debtor, etc.) are barred from submitting a resolution plan under the CIRP. However, this was clarified through an amendment to the Insolvency and Bankruptcy Board Of India (Liquidation Process) Regulations, 2016, in January, 2020, after which Regulation 2B specifically ensured the application of Section 29A of IBC to any Schemes proposed even during liquidation of the corporate debtor. The aforementioned amendment also went through an unsuccessful constitutional challenge, where the Supreme Court upheld the constitutionality of the amendment.[541]

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force for the implementation of actions under the resolution plan, such approval shall be deemed to have been given and it shall not be a contravention of that Act or law.

[533] Note that, according to section 30(2) (e) of the Insolvency & Bankruptcy Code, 2016, a Plan has to be in compliance with the provisions of applicable law.

[534] 2019 SCC Online NCLAT 172.

[535] Note that the objectives of the Insolvency & Bankruptcy Code, 2016 include inter alia 'maximisation of value of assets', and 'balancing of interests of all creditors.'

[536] Inserted by Notification No. IBBI/2019-20/GN/REG047, dated 25th July, 2019 (w.e.f. 25-07-2019).

[537] *Supra note* 143.

[538] The Insolvency & Bankruptcy Code, 2016, Section 31 (1).

[539] *Anatanium Holdings Pte Ltd. v. M/s.Sujana Universal Industries Limited and ors*., Company Appeal (AT) (CH) (Ins) No.07 of 2021.

[540] CA No.360 (PB) 2018 in CP No.(IB) 131 (PB)/2017. Note further that the NCLT held that the reliefs and concessions sought for in the Plan, which lie with jurisdiction of some other authorities, can be only sought from the relevant authorities.

[541] *Arun Kumar Jagatramka v. Jindal Steel and Power Ltd. & Anr.* (Civil Appeal No. 9664 of 2019).

Part 3: Closing Remarks

The Scheme framework under the CA 2013 remains the only formal debtor-in-possession model in India which provides a lot of flexibility to achieve corporate and debt restructuring. However, the inclination/reliance of the creditor community towards RBI's restructuring tools (to avail asset classification forbearance) and recently the IBC (being a creditor-driven process) have made the Scheme framework take a backseat for a while now. This is also on account of the various issues in the current framework (as discussed earlier) which need attention of the Indian lawmakers.

It is important to strengthen this framework so that we can have a robust mechanism for solvent/insolvent debt restructuring before getting into the insolvency twilight zone and without the need to take away the control from the promoters by forcing the insolvency pill down their throat. In fact, with certain tweaks (such as imposition of a moratorium upon filing of application for convening a meeting, prescribing a timeline for completion of the process including approval by NCLT), this framework can become the best possible tool for all stakeholders for value maximisation and would bolster the confidence of the Indian corporate community and also boost entrepreneurship.

Even in its current form, the Scheme framework can act in tandem with the IBC by way of implementing a Scheme through pre-packs which would not only protect a Scheme from holdouts but also help in faster implementation. However, for that to happen, the legislature would need to make the pre-pack framework applicable to all corporate debtors.

About the Authors

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