Insolvency and Bankruptcy Regime in India

A NARRATIVE

World Bank’s Resolving Insolvency
India’s Rising Ranking

2017 136
2018 103
2019 108
2020 59

India’s Insolvency
Resolving Regime

Insolvency and Bankruptcy Board of India
The Insolvency and Bankruptcy Code, 2016 (Code) has been hailed as a paradigm shift from the erstwhile insolvency regime in India in terms of its design and architecture and professionalisation of insolvency services. The efficiency and efficacy of the Code in terms of outcomes has been inspiring. The role of the Code has been lauded by the leaders of the country, including the Hon'ble President of India and the Hon'ble Prime Minister of India at various fora. The World Bank, in its annual Ease of Doing Business rankings, has also commended India’s performance in resolving insolvency since enactment of the Code.

This is, thus, truly a journey worthy of being penned down and narrated to generations to come, much like other series of economic reforms rolled out by the government to foster efficiency and transparency under the mantra 'Reform, Perform, and Transform'. This publication, the second Annual publication of the Insolvency and Bankruptcy Board of India, being released on its Fourth Annual Day, is a contribution towards presenting some thoughts and viewpoints of various stakeholders in the insolvency ecosystem in terms of its passage so far and road ahead.

The theme of this year’s publication is a ‘narration’ of the path the law has taken; where it stands today and what lies ahead. Practitioners, policymakers, lawyers, subject experts, and academicians have graciously shared their thoughts in the publication around this theme.

The selection of articles put together aim to keep the readers abreast with the developments in the evolving area of insolvency and bankruptcy laws in the country and inspire them to know more and research further in this area.
On the fourth Annual Day of the Insolvency and Bankruptcy Board of India (IBBI), we look back at the journey of the Insolvency and Bankruptcy Code, 2016 (Code) and that of the IBBI with a sense of pride. It was not easy to break from the shackles of the past insolvency and bankruptcy regime in the country and come thus far. Almost every provision in the Code and every amendment to the Code in respect of corporate insolvency has been challenged on grounds of constitutional validity. The Code, judged by the generality of its provisions and not by so-called crudities and inequities, has passed the constitutional muster. In a short span of time, the Code has delivered as the best facilitator of business, which has been recognised domestically and internationally.

This annual publication of the IBBI, very appropriately, reflects on the trail of the past, assesses the present and charts out the journey for the future of the Code, in the spirit of the famous quote of Anette Thomas: ‘Appreciate the lessons of the past and enjoy the newness of the future, yet remember the present is today’. This, in essence, is the theme of this year’s publication, that is ‘a narrative’.

We sincerely thank all the contributors who have graciously aided in the efforts of IBBI to pen down their thoughts around the theme of the publication. They have all been part of the journey of the law in one manner or another and hence, are best placed to offer their reflections. We thank them for enriching this publication.

This publication has been an effort of a small team at IBBI comprising Mr. Sudhaker Shukla, Dr. Anuradha Guru, Mr. Sushanta Kumar Das, Dr. Kokila Jayaram, Ms. Medha Shekar, Mr. Santosh Saram and Ms. Pihu Mishra. We appreciate their efforts. We are thankful to Ms. Harini Srinivasan, Founder and Director, Lekhana Communications Consulting Pvt. Ltd., for guidance and help in the editing of this publication. We thank the printers Thinking Cap Creatives Pvt. Ltd. for designing and printing this publication with quality and finesse of our expectations.

Bernard Baruch said, ‘Millions saw the apple fall, but Newton was the one who asked why’. We are hopeful that readers will ask questions and seek to find answers on how and why the insolvency and bankruptcy regime changed dramatically, what we did right and what could have been done differently.

Dr. M. S. Sahoo
Chairperson
Insolvency and Bankruptcy Board of India
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The year 2020 has highlighted the role of uncertainty in the global economy with the COVID-19 pandemic unfolding into a crisis straining every household, firm, industry, village and city and causing unprecedented distress. So has been the challenge to the Government and its institutions, all of which continue to fight valiantly with an ‘all hands-on deck’ zeal. Backed by the strong ‘Atma Nirbhar Bharat’ initiative of the Government, India has been able to stem the economic nosedive. Proactive and timely measures taken under the Insolvency and Bankruptcy Code, 2016 (Code), have prevented eruption of pandemic induced insolvencies. This, in turn, has attempted to minimise the erosion of real assets and resultant financial sector distress during this crisis.

The Code has been heralded as a game changing legislation and rightly so. It put in place a comprehensive legislative framework to deal with the insolvency in corporate businesses. It provides for re-organisation of businesses in a time bound process, as the primary objective, in order to preserve value. It protects creditor’s rights while balancing the interests of all stakeholders and enables equitable distribution of the harnessed value. It has helped banks with recovering significant amounts of the loans by resolving the large accounts that were designated non-performing assets make substantial recoveries. The Economic Survey of 2018-19 presented in detail the outcomes of the Code and how it stood the financial and corporate sectors in good stead.

Insolvency/bankruptcy laws help in improving efficiency in resource allocation, which lies at the heart of a market economy. It is crucial amongst the economic laws that govern markets because it enables the freedom of exit. With the pandemic and consequent lockdown measures contracting business activity and economic growth, the Code and its operation may seem to be a double-edged sword. Operation of the Code has been suspended to the limited extent of disallowing firms being brought under insolvency resolution proceedings for COVID-19 related debts. This has led to a wide debate on whether the market driven process of the Code should be stopped specially when the market may see an increasing number of businesses that are unable to service their debts and are unsustainable. It is also true that the financial stress is almost universal to all businesses so that the market may not also be able to find rescuers for these distressed companies, forcing otherwise viable businesses to liquidate. The pandemic situation can be seen as an instance of a ‘market failure’, where market forces need to be supplemented by Government intervention. On balance, the suspension of provisions that enable initiation of insolvency proceedings is a positive in the long term as it provides immediate relief leaving the businesses alive so that they can live to fight another day.

The contribution that the enactment and operationalisation of the Code made to the Ease of Doing business ranking of India has been the most talked about. However, it is important to recognise the contribution of the Code to a positive behavioral change in the creditor-debtor relationship and the systemic strengthening of the credit markets. In the long run, the Code driven incentives will be internalised by stakeholders providing certainty and predictability to creditor – debtor contracts. This vital element will strengthen the market economy and hence would be the lasting achievement of the Code.
The other significant achievement is the establishment of the Insolvency and Bankruptcy Board of India (IBBI) as the regulator. As an institution, IBBI has come a long way in a short span of time, considering the challenges the Code and the regulator continue to face. The Board has established itself as a pillar of strength and can take pride in facilitating the creation of a bankruptcy ecosystem, complete with regulated insolvency professionals and valuers, their frontline regulators and an information utility, for corporate insolvency and bankruptcy in India.

My association with the IBBI as a part-time member of its Governing Board began in June, 2019. It has been an engaging journey given the challenging times that the country and economy face. The Board, through its efforts, has encouraged discussion and research in these areas of increasing importance. The first annual publication of the IBBI, brought out in 2019 was an insightful compilation of work in the domain of insolvency and bankruptcy. Similarly, I am sure that this year’s publication will add to the repository of knowledge in this evolving area.

My best wishes to the Board to continue being a strong pillar amongst economic institutions that help India’s markets grow and thrive.

Dr. Krishnamurthy V. Subramanian
Chief Economic Adviser
Government of India
Preface

Only a crisis - actual or perceived - produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is our basic function: to develop alternatives to existing policies, to keep them alive and available until the politically impossible becomes the politically inevitable.

- Milton Friedman

The COVID-19 pandemic and its aftermath have led doomsday predictors to opine sneeringly that when sustaining life on earth itself is a growing concern, the least said about saving the day for companies and entrepreneurs as a going concern the better. With possibilities of rise in defaults triggered primarily by disruption of cash-flows across economic sectors, human endurance, economic resilience, and zeal for innovative policy - all are being put to test. In moving forward, the key measures from a resolution perspective can be tailor-made in relation to potential phases of the current crisis. In the Indian context, policy options have been triaged and consolidated in the form of ‘Atma Nirbhar Bharat’ initiative as announced on May 17, 2020, which inter-alia highlighted the key steps, including reforms in the Insolvency and Bankruptcy Code, 2016 (IBC/Code), for further enhancement in ‘Ease of Doing Business’.

In March, 2020, the threshold amount of default required to initiate an insolvency proceeding was increased from Rs.1 lakh to Rs.1 crore, with intent to prevent MSMEs from being pushed into insolvency for their inability to meet repayment obligations caused due to business disruptions. In June, 2020, promulgation of Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 suspended initiation of insolvency proceedings against corporate debtors (CDs) in respect of any default arising during the period the COVID-19 pandemic holds sway. The said Ordinance is applicable for the period starting from March 25, 2020, when national lockdown commenced and will continue for six months or such further period, not exceeding one year, as would be decided by the Government depending on the situation on the ground. The Ordinance also provides that such defaults shall not be the basis for initiation of insolvency proceeding at any time in future. This will prevent corporate persons, which are experiencing distress largely on account of the unprecedented situation caused by the pandemic, from being pushed into insolvency proceedings, particularly when it is difficult to find adequate number of resolution applicants to rescue them.

The pandemic has nudged us to devise out of box solutions to deal with the extra-ordinary circumstances in a swift and effective manner. In the wake of COVID-19, there are apprehensions about possible glut in the insolvency regime with supply in terms of increase in insolvencies expected to far outweigh the demand for stressed assets; as prospective resolution applicants may possibly shy away from the market due to liquidity crunch. Vulnerability in terms of corporate enterprises not being able to find a market determined value maximisation resolution exists across the spectrum. Some studies, however,
suggest that MSMEs in comparison to larger enterprises are more vulnerable as they have little capacity to absorb shocks. For the MSME sector, the suspension of sections 7, 9 or 10 of the IBC would only give a temporary relief to CD and postpone the stress but may fail to address their stress per se. Therefore, major reforms for providing special dispensation for MSMEs including introduction of prepacks and devising an administrative approach for resolving individual insolvency under fresh start process are some of the initiatives on which stakeholders' discussions have already commenced.

To deal with the extraordinary circumstances posed by the pandemic, suspension of certain provisions of IBC, such as by way of plugging exit routes, may defer the demise of a corporate person temporarily. But for how long and at what cost such dispensation may be pursued are some relevant questions which need answers while moving forward. Characteristic barriers to exit include high fixed exit costs such as compensation to employees, cost of writing off assets and closure of business by cancelation of contracts with suppliers, etc. Highly specialised assets may be difficult to sell or relocate. The Government itself could act as one of the barriers to exit if the business is operating in a highly regulated environment or it is engaged in offering a public good. Such exit barriers do not allow distressed firms to exit thereby impeding efficient allocation of limited resources. This also hinders technological progress precluding new technologies to replace the old. Easy exit procedures are imperative to encourage entrepreneurship. Laws which trap businesses in lengthy court proceedings or impose penal provisions muzzle the risk-taking zeal of entrepreneurs. Fresh wave of barriers being erected through policy pronouncement must be keep in mind the associated transaction costs and therefore, in the context of conducive market signaling have to be accompanied with a credible sunset clause.

Due caution is being accorded in designing the special interventions and also the sunset clauses associated with them, keeping in view the fact that the basic features of insolvency regime have been tested over a period of time and they have effectively passed the rigorous scrutiny of evolving jurisprudence. Aided by the fact that it has extraordinary results to showcase, the IBC has been heralded as a game changing law providing a market directed and time bound mechanism for resolution of insolvency, wherever possible, or exit, wherever required, and thereby ensuring freedom to exit.

As the regime is gearing up to innovative responses, it is instructive to recapitulate the basic features and outcomes associated with the IBC. The objective of the IBC is time bound reorganisation and insolvency resolution of firms for maximisation of value of assets of the firm concerned, to promote entrepreneurship and availability of credit and thereby balance the interests of all stakeholders. The first order objective is resolution. The second order objective is maximisation of value of assets of the firm and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests. The Code has proved to be an efficient, effective, and efficacious legislation based on its outcomes so far.

The corporate insolvency resolution process (CIRP), as provided under IBC, has successfully managed to address financial distress in the economy. As on June 30, 2020, 250 CIRPs have been resolved and creditors have recovered Rs. 1.94 lakh crore as against the sum owed of Rs. 4.97 lakh crore. In comparison to liquidation value, realisable value of disposed CDs has been 192 per cent. During this short span, the dispensation under IBC has evolved to fructify into a well-defined market driven process to resolve corporate insolvency. One of the reasons behind its success has been that, unlike other mechanisms, existing or past, the Code has been organic in nature and that has allowed it to evolve rapidly with the new challenges faced by the market and its players. From Synergy Dooray, the first company resolved through a resolution plan to the most protracted resolution of Essar Steel, the story has been compelling.
The journey of this path breaking reform, thus far, has been a roller coaster ride. Though criticised for frequent changes in the statute, it would not be wrong to say that we are continuously ‘learning-on-the-go’ at each step, akin to being pushed into deep waters and learning to swim to survive. The law survived; all stakeholders learned to stay afloat; determined to see the law succeed. The highest Court of the country proactively settled the jurisprudence on various aspects of this new law at an unprecedented pace and with passion. Almost every provision of the law has been challenged in the Courts and it has come out unscathed through the acid test of judicial scrutiny.

The Code has been a potent cure for the banking system infested with non-performing assets (NPAs). The recovery rate for banks (amount recovered/amount involved) in 2018-19, according to RBI data, through existing channels of SARFAESI (14.5 per cent), DRT (3.54 per cent) and Lok Adalats (5.3 per cent) were insignificant in comparison to phenomenal recovery rate achieved through the Code (42.5 per cent). Adding IBC to the existing arsenal of the creditor has provided more than just a recovery route. It has triggered a systemic response to the underlying attitudinal problems in the creditor-debtor relationship and it is acting as a prophylactic for an acute condition. The need for a banker to explain not using the IBC option is expected to have a deterrent effect on any unholy ties between lender and borrower, consequently reducing the chances of high value defaults and frauds. A deeper, healthier and much required change for banks is the obligation they now feel towards more responsible and clean lending to begin with. For the business debtor, the threat of a resolution process shifting control of the firm away from the promoters is real and it is serving as a deterrent. They have every incentive to not default or operate at below optimal levels leading to insolvent conditions.

The IBC is also enabling latent opportunities. The ‘twin balance sheet’ or ‘four balance sheets’ problem has left the economy with a large inventory of stressed assets. According to a report from Credit Suisse, total impaired assets of the banking sector were Rs 16,88,600 crore (15.7 per cent of total advances of banks) as of December, 2019. This continuing challenge to the economy is one such latent opportunity that can be harnessed by leveraging the IBC to push for better allocation of productive resources and making space for fresh lending. This has become possible because of investor confidence in the effectiveness of the law which has brought in certainty of process, outcome, and time. The amendment to the IBC allowing for mergers, de-mergers and amalgamations to be part of resolution plans further strengthens the incentive for strategic investors.

India made a giant leap in the ‘resolving insolvency’ parameter of the World Banks’ Ease of Doing Business Survey for the year 2019, improving 56 places to reach 52 from 108 last year among 190 countries. It is yet another recognition that the IBC has put in place effective tools for creditors to successfully negotiate and effectuated greater chances for creditors to realise their dues (71 cents to a dollar) with significantly reduced timeframe (1.6 years) and substantially lower costs as compared to the earlier insolvency regime. Also, more than just adding points to the Ease of Doing Business in India, the IBC has essentially provided a credible exit route. By June, 2020, 684 businesses have opted to take this route to exit their business efforts voluntarily and 234 have been successful.

Thanks to IBC, failure being seen as a taboo and the associated ‘fear of failure’ will gradually change. This is extremely important for India, which has the third largest start-up ecosystem in the world; it is expected to witness YoY growth of 12-15 per cent with at least 2-3 tech start-ups born every day and their average rate of failure is close to 90 per cent. In Silicon Valley, seen as the global center of entrepreneurialism, the notion of ‘failing is succeeding’ has ingrained itself so that entrepreneurs who may have gone through one or more business bankruptcies, are looked up to with honor. Similarly, by
providing a clean and dignified exit, the IBC is aiming to inculcate an entrepreneurial culture, releasing
the animal spirit of entrepreneurs in India.

In January, 2020, Essar Steel, which was reeling under insolvency, was restored back to health. Banks
recovered Rs.42,000 crore and the company's loan accounts were reclassified as 'standard account' in
view of timely and higher repayments. The steel producer saw fresh infusion of capital to bring into use
its under-utilised productive resources. A slew of value chain partners and service providers received
their overdue payments. They were able to repay their debts to banks and move forward. Rs. 1214 crore
was distributed to 1946 creditors which included small business vendors, employees, and workmen.
This revival of a virtuous cycle of business activities was made possible under the framework of the
Code.

The Code has come a long way since 2016, meandering through myriad challenges and in the process, it
has won many accolades. In the short period of its operation, the consolidation of the statute was closely
synchronised with the development of the ecosystem. The speed with which the entire ecosystem was
gear ed up has been astounding. The Code has been instrumental in building a cadre of 3122 Insolvency
Professional, 3 Insolvency Professional Agencies, 73 Insolvency Professional Entities, 3038 Registered
Valuers, 14 Registered Valuers’ Organisations and one Information Utility. It has expanded the scope
of services of Advocates, Accountants, and other professionals. The Code has also created markets for
education and capacity building of these professionals.

This annual publication, to document the progress of the Code, is the second in the series. Views
of distinguished contributors, with diverse persuasions, have been put together in the interest of
disseminating knowledge and experience sharing. The gracious contribution on their part will enhance
its appeal. Views expressed in the articles, however, are those of individual authors and not of IBBI.

Dr. M. S. Sahoo, who has been at the helm of affairs, as Chairperson of IBBI since its inception, has
contributed an overview article. He presents the journey of the IBBI so far in terms of the legal trajectory
traversed, amendments made as course correction and its impact and outcomes. He also provides a
glimpse into future course of action required to complete the reform agenda with which the IBC was
enacted.

The publication is divided into five Parts. Part I, titled 'Progression', provides an overview of how the IBC
has evolved as a law providing for an exit mechanism for businesses and reallocating scare economic
resources to best possible use. Authors also touch upon the role of this law in improving the investment
climate in the country and transforming the credit culture. Dr. Rajiv Kumar and Mr. Desh Gaurav Sekhri
talk about the role of IBC in improving the ease of doing business in India. They express hope that in the
country's endeavour to break into the top 25 position in the World Bank's Doing Business rankings, the
contribution of IBC will undoubtedly be significant. Dr. Poorinima Advani and Ms. Madhvi Goradia Divan
are other significant contributors in fortifying this section.

Dr. Bibek Debroy and Ms. Aparajita Gupta, aptly compare the life of a company to Olympics, noting that
'The Olympic motto of Citius, Altius, Fortius resonates with the life of a living organism that evolves,
adapts and self-learns as it grows to survive in the external environment. This is akin to the life of a
company that also evolves, adapts and self-learns with the objective to innovate and compete, and
ultimately survive.' They present the role of the IBC in the context of saving the life of companies.

Part II named 'Processes', charts out the course taken by IBC in a short span of four years, where
authors provide their perspective on various aspects of the law. Some interesting anecdotes and
viewpoints are presented to inform readers about the story behind the reform in the form of the Code. Mr. Injeti Srinivas, former Secretary, Ministry of Corporate Affairs, gives a firsthand account of how the now famous section 29A was inserted in the Code. Mr. B. Sriram, in his piece, presents various proactive steps taken, both legislatively and judicially, to enhance the insolvency regime, and makes certain suggestions to further assist in effective resolution under the Code. Dr. S. K. Gupta presents a case study of the Bhushan Steel Limited, prior to and post insolvency process of the company under IBC. Other articles in this section touch upon certain finer legal aspects of the Code, enriched by the invaluable contributions from Mr. Unnikrishnan A., Mr. Anurag Das, Mr. Balvinder Singh, Mr. Vinod Kothari and Ms. Sikha Bansal, Dr. Aparna Ravi, Mr. Nikhil Shah et. al.; Mr. Shubham Jain, Prof. M. P. Ram Mohan and Ms. Vishakha Raj.

Part III regarding 'Providers of services', presents articles on the insolvency and valuation profession which the Code has endeavored to build and nurture. Mr. Akash Chandra Jauhari and Ms. Manmayi Sharma present the development of valuation profession in India and lay down the background in which Government constituted Committee of Experts to Examine the Need for an Institutional Framework for Regulation and Development of Valuation Professionals, made its recommendations to the Government recently.

Part IV, titled 'Pandemic', dwells upon challenges posed to the insolvency law by COVID-19 and informs about actions taken by various jurisdictions to ameliorate the pain of the stakeholders in the insolvency space, for example the article by Mr. U. K. Sinha and Ms. Saparya Sood. Authors also make some specific suggestions on what can be done to further address the consequences of economic upheaval being caused by the pandemic, such as papers by Mr. Sumant Batra and Mr. Somasekhar Sundaresan. Mr. Mahesh Uttamchandani et. al. and Dr. Ajit Ranade make a case for addressing debt crisis faced by the MSME sector in the wake of the pandemic and suggest some measures in this regard. Dr. Shubhashis Gangopadhyay evaluates various policy options available to the Government to address the impact of COVID-19 on credit markets involving a role of IBC. Ms. Bhargavi Zaveri critically analyses certain policy actions taken in India in terms of standstills and forbearance during the pandemic.

The journey of the insolvency reforms in the country has been very encouraging till now. Many milestones have been crossed. However, as Robert Frost puts it, ‘The woods are lovely, dark and deep, but I have promises to keep, and miles to go before I sleep, and miles to go before I sleep’. There are many more goals to be achieved and more accolades to be won. Part V, named 'Path Ahead', presents the views of authors on path ahead for the IBC. Thoughts around special insolvency regime for MSMEs have been presented by Dr. K. P. Krishnan et. al; building a personal insolvency regime in India, has been articulated by Dr. Shashank Saksena and by Prof Adam Feibelman and Dr. Renuka Sane; introducing mediation in insolvency matters has been noted by Dr. Rajiv Mani and varied suggestions on how to move forward on making provisions to deal with matters relating to cross border insolvency, have been touched upon by Dr. Neeti Shikha and Dr. Mamata Biswal. Ms. Surbhi Jain and Ms. Sonali Chowdhry narrate the achievements of the Code.

I take this opportunity to place on record the insightful knowledge pieces coming from officers of the IBBI, Dr. Anuradha Guru, Dr. Kokila Jayaram, Mr. Sushanta Kumar Das, Mr. Abhishek Mittapally, Ms. Medha Shekar, Ms. Pihu Mishra and Ms. Surbhi Kapur. We are hopeful that the articles presented here will add to our collective understanding of the philosophy, the processes, the outcomes, and the long-term impact of the landmark reform in the insolvency and bankruptcy space in the country. It would also provide us with pointers to the future course of this reform, as evidently, the journey has just begun.
The publication is sprinkled with quotes from the upper most echelons of political and academic visionaries who have, at various occasions, applauded the reforms ushered in the insolvency and bankruptcy space by the IBC and its outcomes. These capture well the journey of the law and its achievements, in the spirit of the title of the publication which appropriately reads as, 'Insolvency and Bankruptcy Regime in India- A Narrative'.

Sudhaker Shukla
Whole Time Member
Insolvency and Bankruptcy Board of India
The life of a company is as precious as that of a human. The Insolvency and Bankruptcy Code, 2016 provides a new lifeline to rescue a company when it experiences a serious threat to its life. It has an added responsibility to complement every endeavour to rescue the companies who are victims of the COVID-19 pandemic.

JOURNEY SO FAR

Insolvency reforms in India took a concrete shape with the enactment of the Insolvency and Bankruptcy Code, 2016 (Code) on May 28, 2016. In no time, it became a reform by the stakeholders, of the stakeholders and for the stakeholders. Four years into the reforms, the outcomes speak for themselves.

(a) India did not have any prior experience of a modern insolvency regime that is proactive, incentive-compliant, market-led, and time-bound. The Code and the underlying reform, in many ways, was a journey into unchartered territory - a leap into the unknown and a leap of faith. Many institutions required for implementation of a modern insolvency regime did not exist. The law had to be laid down; infrastructure had to be created; capacity had to be built; professions had to be developed, the markets and practices had to develop; and stakeholders had to be aware of the Code, accept the change and learn how to use it. Yet, the entire regulatory framework in respect of service providers and corporate insolvency, and the entire ecosystem for corporate insolvency was put in place to enable commencement of corporate insolvency proceedings by December 1, 2016.

(b) Implementation of a law of such significance usually throws up several challenges. All concerned took the challenges head on and resolved them expeditiously. The Code and regulatory framework underwent several amendments and refinements in sync with the emerging market realities. The Central Government made several changes in laws relating to banking, revenue, companies, etc., to facilitate the smooth implementation of the processes under the Code. It referred large corporates with high non-performing assets (NPAs) into insolvency resolution process in the early days of distress. The Adjudicating Authority (AA), the Appellate Authority, High Courts, and the Supreme Court delivered numerous landmark orders to explain several conceptual issues and settle contentious issues and resolve grey areas, with alacrity. The Code passed the constitutional muster. A standing committee, the Insolvency Law Committee (ILC) continuously reviews the implementation of the Code to identify issues and make recommendations to address them.
(c) At the end of June, 2020, the AA has presence in 15 cities. The Appellate Authority, the Insolvency and Bankruptcy Board of India (IBBI), 3122 Insolvency Professionals (IPs), three Insolvency Professional Agencies (IPAs), 73 Insolvency Professional Entities, one Information Utility (IU), 3130 registered valuers and 14 registered valuer organisations are in place. Debtors and creditors alike are undertaking corporate insolvency processes. About 4000 firms, some of them having large NPAs, have been admitted into corporate insolvency resolution process (CIRP). 45 per cent of them have exited the process with resolution plans, withdrawals, or orders for liquidation, while the rest are under process. Another 700 firms have commenced voluntary liquidation and one third of them have concluded the process.

(d) The primary objective of the Code is rescuing lives of firms in distress. Till June, 2020, the Code has rescued about 250 such firms through resolution plans, one third of which were in deep distress. However, it has referred 955 firms for liquidation. The firms rescued had assets valued at Rs. 1.01 lakh crore, while the firms referred for liquidation had assets valued at Rs. 0.38 lakh crore when they were admitted to CIRP. Thus, in value terms, around three fourth of distressed assets were rescued. Of the firms sent for liquidation, three-fourth were either sick or defunct and of the firms rescued, one-third were either sick or defunct.

(e) The realisable value of the assets available with the firms rescued, when they entered the CIRP, was only Rs. 1.01 lakh crore. The resolution plans recovered Rs. 1.94 lakh crore, which is about 192 per cent of the realisable value of these firms. Any other option of recovery or liquidation would have recovered at best Rs. 100 minus the cost of recovery/liquidation, while the creditors recovered Rs. 192 under the Code. The excess recovery of Rs. 92 is a bonus because of the Code. Though recovery is incidental under the Code, the financial creditors (FCs) recovered 45 per cent of their claims, which is the highest among all options available to creditors for recovery.

(f) Beyond revival of firms and realisations for creditors, the credible threat of the Code, that a firm may change hands, redefined debtor-creditor relationship prompting resolutions in the shadow of the Code and substantial recoveries for creditors outside the Code, while improving performance of firms. It seems that defaulters’ paradise is lost. Many debtors today prefer to resolve stress at early stages and making best effort to avoid consequences of CIRP. Most firms are rescued at these stages. Only a few firms, who fail to address the distress in any of the earlier stages, pass through the entire resolution process. At this stage, the value of the firm is substantially eroded, and hence some of them are rescued, and others liquidated.

(g) The Code has established the supremacy of markets, while balancing the powers of suppliers of capital - debt and equity. It enables the stakeholders themselves to decide the matters for them instead of accepting a solution worked out by the State. Where the equity suppliers have failed to address the distress of a firm, the Code gives an opportunity to creditors to do so. The right of the promoters to cling on to the firm, irrespective of its conduct, is no more divine with several firms changing hands, despite valiant battles by some of them up to the Supreme Court.

(h) The 250 CIRPs, which have yielded resolution plans by the end of June, 2020, took, on average 380 days (after excluding the time excluded by the AA), for conclusion. Similarly, the 955 CIRPs, which ended in orders for liquidation, took, on average 312 days, for conclusion. Further, 88 liquidation processes, which have closed by submission of final reports till June 30, 2020, took on average 296 days for closure. Similarly, 250 voluntary liquidation processes, which have closed by submission of final reports, took on average 336 days for closure. The cost of a CIRP yielding resolution plan works out on average 0.75 per cent of liquidation value and 0.38 per cent of resolution value.
(i) The implementation of the Code got reflected in Ease of Doing Business. In the World Bank Group’s Doing Business Reports, India’s rank moved up from 136 to 52 in terms of ‘resolving insolvency’ in the last three years. In terms of the World Bank’s data, the overall recovery rate for creditors jumped from 26.0 to 71.6 cents on the dollar and the time taken for resolving insolvency also came down significantly from 4.3 years to 1.6 years. India is now, by far, the best performer in South Asia on the resolving insolvency component and does better than the average for Organisation for Economic Co-operation and Development (OECD) high-income economies in terms of recovery rate, time taken and cost of a CIRP. In the Global Innovation Index, India’s rank improved from 111 in 2017 to 47 in 2020 in ‘Ease of Resolving Insolvency’.

LIVES OF COMPANIES

Life is precious. While preserving and rescuing our lives, we created artificial persons, namely companies, which would live forever. *Kongo Gumi*, a Japanese construction company, lived 1,428 years before it succumbed to debt in 2006. Though there are a few thousand-year young companies around, the life of a company is in danger today than any time before. The average life of S&P 500 companies has reportedly reduced from 90 years to 18 years over the last century. A research conducted in 2015 reveals that the average life of a publicly traded company, considering acquisitions, mergers, and bankruptcy, is about 10 years. A company having indefinite life now lives shorter than a human!

The life of a company has three enemies. First is the enemy within. A company is an amalgam of many stakeholders. Each stakeholder has a unique objective function, with a distinct set of rights, interests, and level of engagement with the company. The interests of one stakeholder may conflict with those of another and/or of the company. Stakeholders may work at cross-purposes, and even against the interest of the company. Some leave the company at the earliest sign of distress. Departure of a major shareholder may orphan the company. In their drive to maximise the upside for them while enjoying limited liability, shareholders may expose the company and other stakeholders to unlimited liabilities. The society bears the brunt of unlimited liability such as those arising from Bhopal gas tragedy, Satyam fiasco, etc.

Such conduct of stakeholders benefits a set of stakeholders, often at the cost of another, the company, and the society. Persistent uneven sharing of losses and gains endangers the life of the company. Independent directors, key managerial personnel, regulation of related-party transactions, protection of minority interest, financial and secretarial audit, timely and accurate disclosures about material matters, taxes and subsidies, corporate social responsibility - collectively referred to as corporate governance - endeavour to synchronise and balance the interests of stakeholders, subordinate the interests of immediate stakeholders to those of the company, and balance the interests of the society *vis-à-vis* those of the company. Many jurisdictions have consolidated these norms through codes for corporate governance to protect companies.

The second enemy is unfair battles at the marketplace. For example, a company that does not have financial muscle to sell its product below cost, cannot survive in a market where a dominant company sells its product below cost. The competition law prohibits predatory pricing. A company cannot survive if its cost of capital is high as compared to another company that manipulates market for its securities. Securities laws regulate the capital market to prevent any kind of manipulation. A company that dutifully pays corporate tax on its profits, cannot survive if another company in the same business dodges taxes. The rule of law ensures that all companies get a similar tax treatment. Generally, the State protects a company from such unfair battles.
The third and the most fatal enemy is competition and innovation. This is a fair battle because it is the State policy to stimulate competition and innovation, and eliminate anticompetitive conduct at marketplace, for higher growth. A company loses life when it fails to compete with its peers in the industry for reasons such as poor organisation, inefficient management, malfeasance, etc. It also loses life when its business becomes unviable for reasons such as innovation. Creative destruction often destroys more companies than it creates! Resilience and adaptation, research and development, risk management, sustainable business model, visionary leadership, preparedness for unknowns, etc., minimise threat to life. There is, however, no governance norm to have such strategies, though many companies have these on their own volition. To add salt to injury, with demand dwindling and supply chains hit around the globe in the wake of the COVID-19 pandemic, many companies, which were doing well earlier, are reeling under stress. Some of them are at the brink of default, not because of market pressures, but because of force majeure circumstances.

Companies are modern engines of growth. They are the hope of prosperity for posterity. They often have organisational capital over and above their liquidation values. Closure of a company destroys the hope and the organisational capital. It takes years of efforts to bring up a company, which can replace an existing one. The law provides for layers of security to protect the life of a company. A board of directors appoints and supervises the executive management and replaces it in accordance with contractual arrangements, in case of failure. Shareholders elect directors to the board, monitor their performance and replace them in accordance with the provisions of the Companies Act, 2013, if they fail to perform. A promising set of shareholders may even replace the existing set through the market for corporate control. The creditors step in to rescue the company in accordance with the provisions of the Code when shareholders fail to protect its life.

The Code recognises that insolvency is an outcome of market forces. It incentivises, facilitates, enables, and empowers market participants to resolve insolvency. The first order objective of the Code is resolution. The second order objective is maximisation of value of assets of the firm and the third order objectives are promoting entrepreneurship, availability of credit and balancing the interests of stakeholders. This order of objectives is sacrosanct. In sync with these objectives, the Code enables the stakeholders to rescue the life of a company in distress, and while doing so, they maximise value and share the value equitably.

**Rescuing life**

The Code empowers creditors, represented by a committee of creditors (CoC), to rescue a company, when it experiences a serious threat to its life. For this, the CoC has a *trishul*: (a) it can take or cause a haircut of any amount to any or all stakeholders for rescuing the company; (b) it seeks the best resolution from the market (unlike earlier mechanisms that allowed creditors to find a resolution only from existing promoters); and (c) the resolution plan can provide for any measure that rescues the company. It may entail a change of management, technology, or product portfolio; acquisition or disposal of assets, businesses or undertakings; restructuring of organisation, business model, ownership, or balance sheet; strategies of turn-around, buy-out, merger, amalgamation, acquisition, or takeover; etc. The Code provides a competitive, transparent market process, which identifies the person, who is best placed to rescue the company and selects the resolution plan, which is the most sustainable under the circumstances.

**Maximising value**

The Code safeguards and maximises the value of the company and consequently, value for all its
stakeholders. It enables initiation of resolution process at the earliest to preserve the value. It mandates resolution in a time-bound manner to prevent decline in the value.

The Code facilitates resolution as a going concern to capture going concern surplus. It makes an IP run the company as a going concern, prohibits suspension or termination of supply of critical services, mandates continuation of licences, permits and grants; stays execution of individual claims, enables raising interim finances for running the company, insulates the resolution applicants (RAs) from the misdeeds of the company under the erstwhile management, etc. It provides for a market mechanism where the world at large competes to give the best value for the company through a resolution plan.

Where value has been lost on account of avoidance transactions, the Code enables claw back of such value. It even mandates retrieval of value lost due to the failure of directors to exercise due diligence. There is a twilight zone which begins from the time when a director knew or ought to have known that there was no reasonable prospect of avoiding the commencement of CIRP and actual commencement. During this period, a director has an additional responsibility to exercise due diligence to minimise the potential loss to the creditors and he is liable to make good such loss. There is thus strong deterrence to prevent directors and promoters from causing loss of value to the company in the run-up to insolvency.

**Balancing interests**

The Code endeavours to balance the rights of debtors and creditors. It believes that a company has two main sets of immediate stakeholders: shareholders and creditors. If debt is serviced, shareholders have complete control of the company. When the company fails to service the debt, the Code shifts control of the company to the creditors for resolving insolvency. By moving from debtor-in-possession to creditor-in-control, the Code balances the rights and powers of shareholders and creditors vis-à-vis a company. Further, the Code balances the interests of all stakeholders, including Government. It does not envisage recovery, which maximises the value of the creditors on first-cum-first-serve basis. It does not allow direct liquidation, which maximises the value for stakeholders who rank higher in the waterfall, while destroying going concern value. Liquidation process commences only on failure of resolution process to revive the company. The Code provides for a waterfall which specifies the priority of various stakeholders for payment from the liquidation proceeds. Stakeholders placed higher in priority get paid first, and the claims of stakeholders placed next in priority are considered only if there is any surplus after fully satisfying the claims of the prior set of stakeholders. It also provides minimum entitlements for operational creditors and dissenting FCs in resolution plan.

**DYNAMIC CODE**

An economic law is essentially empiric and it evolves continuously through experimentation. The Code is no exception; it has been a road under construction for good reasons. It envisaged standard, plain vanilla processes to start with, but anticipated prompt course corrections to continue to remain in the service of the business and economy. Such corrections arose from difficulties encountered while implementing the provisions of the Code and from the changes in the economic environment. The Code has witnessed five legislative interventions since its enactment to strengthen the processes and further its objectives, in sync with the emerging market realities. Each of the five amendment Acts are milestones on the road of insolvency reforms, reinforcing the primary objective of the Code, namely, rescuing lives of companies. They aim at preventing danger to life of a company, rescuing the company when it is in danger, and ensuring sustained life, post rescue.
The Code provides for resolution of stress of a company through a resolution plan. It, however, did not anticipate that a company may, through a resolution plan, land up in the hands of undesirable persons, risking its life, post resolution. The first amendment to the Code, which came through an Ordinance on November 23, 2017, mandates consideration of only feasible and viable resolution plans, that too, from capable and credible persons, to ensure sustained life of the company. It inserted section 29A that prohibits persons, who do not have credible antecedents, from submitting resolution plans or taking over companies in stress. This prevents certain persons, including promoters, having specified ineligibilities from submitting resolution plans. Even if one is eligible, it may not submit the most competitive plan or the CoC may opt for liquidation. In such cases, existing promoters and management may lose the company forever. The credible threat of a resolution process that may shift control and management of the company away from existing promoters and managers, most probably, forever, deters them from operating below the optimum potential and motivates them to make the best efforts to avoid stress.

The second amendment to the Code, which came through an Ordinance on June 6, 2018, provides a lower voting threshold of 66 per cent down from 75 per cent for approval of resolution plan to encourage resolution as against liquidation. It also provides the voting threshold of 51 per cent for routine decisions to facilitate the CD to continue as a going concern during the CIRP. It allows closure of CIRP with the approval of 90 per cent of voting share of the CoC. It streamlines section 29A to avoid unintended exclusions and thereby enlarges the universe of RAs. It provides for one-year grace period for the successful RA to fulfil various statutory obligations required under different laws.

The third amendment to the Code, which came into force on August 16, 2019, clarifies that a resolution plan may provide for restructuring of the CD, including by way of merger, amalgamation, and demerger to enable the market to come up with innovative resolution plans for rescuing the lives of companies. To deal with voting impasse in case of creditors in a class, the amendment provides that the decision by the creditors in a class shall be taken with the approval of more than 50 per cent voting share of FCs, who have cast their votes and the authorised representative of the class shall vote for the class of FCs he represents in accordance with the decisions taken by the class. To avoid disputes, it clarifies that the CoC may approve a resolution plan after considering its feasibility and viability, and the manner of distribution of realisation under the plan, keeping in view priority of the creditors and their security interests as laid down in the waterfall. In the interest of certainty, it provides that resolution plan shall be binding on Central Government, any State Government, and any local authority to whom the CD owes debt under any law. In cases where running the entire CIRP is an empty formality, it clarifies that CoC may decide to liquidate a CD at any time during CIRP, even before preparation of the information memorandum (IM).

The fourth amendment came through an Ordinance on December 28, 2019. In order to facilitate continuation of a CD as a going concern during CIRP, which is essential for its rescue, the amendment clarifies that a license, permit, registration, quota, concession, clearance or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law, shall not be suspended or terminated on the grounds of insolvency. Further, it provides for continuation of supply of goods and services which the IP considers ‘critical’ to protect and preserve the value of the CD and manage its operations as a going concern. It provides that the liability of a CD for an offence committed prior to the commencement of the CIRP shall cease, and the CD shall not be prosecuted for such an offence from the date the resolution plan is approved by the AA, if the resolution plan results in the change in the management or control of the CD. Similarly, no action shall be taken against the property of the CD in relation to an offence committed prior to the commencement of the CIRP of the CD, where such property is covered under a
resolution plan approved by the AA, which results in change in control of the CD. These would encourage prospective RAs applicants to submit resolution plans undeterred by uncertainties surrounding the offence committed by the CD prior to CIRP.

The fifth amendment to the Code came through the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, which is discussed in the next section.

Every amendment to the Code, including the fifth one, and almost every provision in the Code in respect of corporate insolvency has been challenged on grounds of constitutional validity. While upholding various provisions in the Code, the Supreme Court accorded certain degree of deference to the legislative judgment in economic choices, apart from the presumption of constitutionality in economic legislations. Every order and judgement delivered by the AA and other Courts of law, has paved the road of insolvency reforms.

**COVID-19 PANDEMIC**

The world is in the grip of the coronavirus disease (COVID-19). What makes it a rare of the rarest event is the great amount of uncertainty surrounding it, making it almost impossible to think ahead. It is fast snowballing into an economic crisis of dimensions being compared to those of the Great Depression. With many countries having passed through long periods of lockdown to contain the spread of the virus, the economic activity across the world had come to a standstill till about end of May, 2020 and is now limping back to a ‘new normal’, albeit at a snail’s pace. According to the IMF’s World Economic Outlook of June, 2020, the global economy is projected to contract sharply by 4.9 per cent in 2020. Similar shocks of a comparatively lower intensity in the past witnessed a sharp increase in corporate and personal insolvencies all over the world. For example, the number of corporate bankruptcies increased in the United States by 40 per cent in the wake of the 2008 global financial crisis.

The unprecedented misery required a matching response to save ‘lives’, that required saving ‘livelihood’, which in turn required saving lives of firms. Governments around the world adopted an accommodative stance and acted swiftly to prevent corporates and individuals from being forced into insolvency and bankruptcy. Many bought time to prepare a comprehensive plan to rescue the economy by suspending some provisions of their insolvency legislations. New Zealand placed all the debts of businesses in hibernation till the market starts to function normally. Germany deferred all payments due between April 1, 2020 and June 30, 2020, for three months. France extended performing of insolvency test by three months while Italy provided six months extension to debt restructuring agreements and composition of creditor’s proceedings. Some countries, such as Australia and France conferred temporary power on the Government to amend the provisions of relevant insolvency laws to provide relief from specific obligations or to modify obligations to enable compliance with legal requirements, as required, to deal with the economic and financial impact of the COVID-19.

The World Bank and IMF have listed out the challenges and key responses required to meet those challenges to prevent the economies from facing a fate like the Great Depression. They suggest the implementation of those responses in a three-phased approach to help the economy transition smoothly towards the positive side of the graph. In the first phase, copious interim measures need to be taken to halt insolvency and debt enforcement activities. In the second phase, when a huge wave of insolvencies is anticipated, it may be addressed by transitional measures, such as special out-of-court workouts, to ‘flatten the curve’ of insolvencies. The third phase calls for regular debt resolution tools to address the remaining debt overhang and support economic growth in the medium term. Governments
have responded with measures such as moratorium on loan repayments, sector specific forbearance, infusion of liquidity into the banking system to provide credit to financially distressed firms, relief in asset classification banking norms, flexibility in director’s obligations to initiate insolvency proceeding, relief from compliance with specific legal obligations, etc. The table below presents the key challenges and responses in three phases by select jurisdictions in the wake of COVID-19 outbreak.

As around the world, in India as well, the impact of COVID-19 on the economy has been severe. In its June 2020 report, the ADB estimates that India is expected to contract by 4.0 per cent in fiscal 2020. According to IMF’s World Economic Outlook, June 2020, India’s economy is projected to contract by 4.5 per cent following a longer period of lockdown and slower recovery than anticipated in April. RBI’s Financial Stability Report released in July 2020 highlights that nominal sales and net profits of 1,640 listed private non-financial companies declined (y-o-y) by 3.4 per cent (10.2 per cent in Q4:2019-20) and 19.3 per cent (65.4 per cent in Q4:2019-20), respectively. As per provisional data released by Government, GDP at constant (2011-12) prices in Q1 of 2020-21 shows a contraction of 23.9 per cent as compared to 5.2 per cent growth in Q1 2019-20. Several measurers have been taken to ameliorate the pains emanating from COVID-19. For example, Government increased the threshold of default for filing of an insolvency application from Rs. 1 lakh to Rs. 1 crore to prevent MSMEs from being pushed into insolvency proceedings. RBI permitted lending institutions to extend the moratorium on term loan instalments by six months and time for resolution under prudential framework by 180 days.

INSOLVENCY AND BANKRUPTCY CODE (AMENDMENT) ORDINANCE, 2020

In normal times, the Code enables market forces to pursue twin complementary remedies in respect of failing firms: (a) rescue a viable firm, and (b) liquidate an unviable one. It searches for a white knight, who rescues a failing firm. When every firm, every industry and every economy is reeling under stress, the likelihood of finding a white knight to rescue a failing firm is remote. If all failing firms were to undergo insolvency proceeding, most of them may end up with liquidation for want of saviours to rescue them. Upon such liquidation, the firms would have a premature death, while the assets would have distress sale, realising abysmally little. Rescuing lives of firms being the prime objective of the Code, it could not be used to take away their lives prematurely at these unusual times.

The unprecedented situation called for another experimentation requiring a choice between two competing policy options, namely, suspend the operations of the Code or continue its operations as usual. If the first option is exercised, the market would fail to liquidate an unviable firm. This is not good for an economy, but this can be rectified in the following quarter or the following year. If the second option is exercised, the market would liquidate a viable firm forever, which can never be undone. Rescuing a viable firm is, therefore, far more important than failing to liquidate an unviable one. Further, firms, which are failing solely on account of COVID-19, may bounce back on their own as soon as normalcy restores. Alternatively, they would at least recalibrate their operations and businesses to an ‘all-new normal’. The choice, therefore, fell on the first option, which provides breathing time for firms, in furthance of the objectives of the Code.

The first option has two sub-options, namely, suspend the Code in its entirety or suspend some elements, as may be warranted. The first sub-option would not allow liquidation of a failing firm, whether it was unviable before COVID-19 or became unviable on account of it. It would also not allow rescue of a failing firm even if it were viable before the COVID-19 or remains viable despite it. A delay in rescue of a viable firm may make its rescue impossible. The policy should, therefore, protect those firms which are victims of pandemic, and not protect the undeserving. The choice, therefore, fell on the second sub-
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<th>Key Challenges</th>
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<td><strong>Phase 1</strong></td>
<td>Implementing one or more extraordinary measures for a limited period</td>
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<td>Preventing viable firms from prematurely being pushed into insolvency</td>
<td>Increasing the barriers to creditor-initiated insolvency filings</td>
<td>• Australia increased Statutory demand on a company for an unpaid debt from AUD 2,000 to AUD 20,000.</td>
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<td>• USA increased debt threshold to trigger insolvency proceedings for a small business to USD 7.5 million for cases filed on or before March 27, 2021, from earlier threshold of USD 2,725,625.</td>
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<td>Suspending the director's duty to file and associated liability</td>
<td>• Australia amended law to make directors not liable for incurring debts while insolvent (insolvent trading) in relation to any debt incurred by the company in the initial six-month period commencing on March 25, 2020.</td>
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<td>• Germany suspended the duty to file and to limit the directors' and managers' liability in case of an insolvency caused by the COVID-19 pandemic for the period March 1, 2020 to September 30, 2020 with a possibility of further extension until March 31, 2021.</td>
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<td>• Italy provided that the directors would not be obliged to immediately start pre-insolvency or insolvency proceedings with a view to avoid personal (and criminal) liabilities.</td>
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<td>Ensuring complementarities with debt repayment emergency measures</td>
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<td>• New Zealand provided safe harbour to directors facing liquidity problems from insolvency duties.</td>
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<td>• Australia extended time for a company to respond to a statutory demand from 21 days to six months.</td>
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<td>• USA provided that a resolution plan may be approved without complying with the absolute priority rule – the owner of the debtor may retain its equity without paying all creditors in full or contributing 'new value' – and administrative claims may be paid over time, rather than on the confirmation date as is required to confirm a plan in Chapter 11.</td>
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<td><strong>Phase 2</strong></td>
<td>Ensuring the smooth functioning of workouts and debt restructuring mechanisms</td>
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<td>Responding to the increased number of firms that will not survive this crisis without going through insolvency</td>
<td>Establishing informal out-of-court or hybrid workout frameworks</td>
<td>• Spain granted the debtor a three-month term to agree to a refinancing agreement with its creditors.</td>
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<td>• Italy provided a flexible approach to insolvency initiation in favour of out-of-court solutions.</td>
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<td>• Brazil is encouraging parties to renegotiate their obligations in COVID situations.</td>
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<td>Facilitating business rescue through bridge financing</td>
<td>• New Zealand put all the existing debts into hibernation till COVID prevails.</td>
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<td>• France simplified liquidation procedure and extended payment of employees' claims by the Employees' Claims Payment Guarantee Institution; businesses may apply for loans from banks during COVID situation.</td>
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<td>Extending procedural deadlines for a limited period</td>
<td>• Banks in USA are providing 90 days forbearance to debtors.</td>
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<td>• New Zealand extended deadlines for companies, incorporated societies, charitable trusts, and other entities under the legislation.</td>
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<td>• Germany extended the deadline for three months.</td>
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<td>• France extended insolvency test for three months.</td>
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option which suspends only such provisions of the Code, for such purposes and for such period, as are necessary under the circumstances, avoiding any unintended consequences.

Contrary to general belief that the Code has been suspended for a year, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 is a keyhole surgery that suspends a minute part of the Code. It suspends filing of applications for initiation of insolvency proceeding against a company for any default arising during COVID-19 period, which is six months commencing on March 25, 2020 to start with, but can be extended up to a year, if warranted. It insulates a company, which did not have a default as on March 25, 2020, but commits a default during the COVID-19 period, from being pushed into an insolvency proceeding.

<table>
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<th>Key Challenges</th>
<th>Critical Responses</th>
<th>Examples of action taken by various countries</th>
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| Suspending the requirement to proceed to liquidation if the business activity of the debtor has stopped while undergoing reorganisation | • Spain suspended directors’ duty to convene a shareholders’ meeting to wind up a company.  
• Brazil suspended all in-court and out-of-court foreclosure measures, pending hearings, trials, and all deadlines.  
• USA suspended commencement of eviction or foreclosure proceedings for 90 days.  
• Australia restricted the use of bankruptcy notices by creditors.  
• Italy postponed all hearings and judicial proceedings except for those proceedings unaffected by the emergency legislation, after April 15, 2020. |                                                                                                                                                                                                                                                                                                                                                                               |
| Encouraging e-filings, virtual court hearings and out-of-court solutions in insolvency cases | • Most countries are promoting virtual hearings and e-filings. Courts in Australia, Canada, USA, France, and Italy have devised e-filing procedure and are promoting hearing over video calls.  
• France implemented conciliation procedures under its Insolvency Act. |                                                                                                                                                                                                                                                                                                                                                                               |
| Phase 3  
Addressing individual financial distress resulting from the crisis | Implementing modern consumer bankruptcy frameworks                                                                                                                                                                                                                                 | • Hong Kong announced its intention to implement insolvency proceedings on the lines of ‘Chapter 11’ proceedings in the USA by early 2021.   
• Australia allowed businesses with total business loans of up to USD10 million to defer their loan repayments for up to six months.  
• Italy suspended pending debt-restructuring agreements and composition with creditors for a six-month period.  
• New Zealand reduced the period of vulnerability from two years to six months for voidable transaction regime.  
• Brazil allowed payment of debts in up to 60 monthly instalments for reorganisation plans for small and micro companies. |                                                                                                                                                                                                                                                                                                                                                                               |
| Enabling a debt forgiveness mechanism or discharge is important for facilitating a fresh start | Ensuring there are flexible options for debt rescheduling and repayment plans                                                                                                                                                                                                    |                                                                                                                                                                                                                                                                                                                                                                               |
|                                                                                       |                                                                                                                                                                                                                      |                                                                                                                                                                                                                                                                                                                                                                               |

The Ordinance does not absolve the company of COVID-19 default. It does not even exclude such default from the ambit of default under the Code. Such default remains a default for all purposes under the Code, except for the purpose of initiating insolvency proceeding against the company. For example, such default can be the basis for submission of claim in an insolvency proceeding or initiation of insolvency proceeding against a personal guarantor.

The Ordinance clarifies that an application can be filed for initiating insolvency proceeding against a company for defaults committed before March 25, 2020. It does not suspend the applications already filed before the AA for initiation of insolvency proceeding and pending for admission, and ongoing corporate insolvency proceedings - resolution and liquidation, including voluntary liquidation. Nor does it suspend provisions relating to and ongoing insolvency proceedings against personal guarantors and financial service providers (FSPs).

Though the broad rationale of the Ordinance is well understood, the rationale for some of its finer aspects are not obvious. Since the objective is to insulate companies which are victims of the pandemic, why should a company, which defaults during COVID-19 period, but not on account of COVID-19, have protection? There is hardly any company which is not impacted by the pandemic. There may be a handful of companies which did not default earlier but defaults during COVID-19 period for reasons other than COVID-19. Identification of such handful of companies would require determination in each case whether the default during the COVID-19 period is on account of COVID-19, or for any other reason, or for a mix of COVID-19 and other reasons. From practical considerations, it makes sense to allow such rare cases have the protection rather than be theoretically correct and waste years in legal battles.

A question arises, if the objective of the Ordinance is not to push certain companies into insolvency proceedings, why should such a company not have option to commence insolvency proceedings on its own volition? A key design feature of the Code is that it balances the rights and interests of all stakeholders, particularly of the equity and debt suppliers. It creates imbalance if only debtor has the right to initiate insolvency proceeding, while a creditor does not have, and vice versa. Further, irrespective of whether the debtor initiates or a creditor initiates the proceeding, the outcome is the same, which is not acceptable in present times when saving economically viable companies is of paramount importance. In any case, the data indicates that only 2 per cent of the insolvency proceedings that commenced during 2019-20 were self-initiated.

The non-availability of RAs is the basis for suspension. Should it not apply to all companies whether they defaulted before or during COVID-19 period? The Ordinance distinguishes failures on account of the COVID-19 and for market pressures (competition and innovation). It is only fair that they are treated differently. The Ordinance prohibits resort to insolvency proceeding where a company, which withstands market pressures, but defaults on account of COVID-19. It enables resort to insolvency proceeding where a company defaults on account of market pressures, should the stakeholders wish, as in such cases, the stress is unlikely to disappear on the other side of the pandemic.

Why should COVID-19 default be kept out of insolvency proceedings forever? A company, which was viable before the onset of COVID-19, may earn normal profits from current operations and become viable again, after the impact of pandemic subsides. It would, however, take years to wipe off the deep stress that arose during COVID-19 period. Depending on the nature of the industry and specific strength of a company, one may recoup the loss in one year while another may take years, or even decades. If the company is pushed into insolvency when it is recouping the loss, the objective of the
Ordinance would be frustrated.

A fear has been expressed that a company may deliberately default taking undue advantage of the Ordinance. This is very unlikely because the Ordinance has not suspended the liabilities in respect of COVID-19 default under various other laws. It has not even suspended COVID-19 default for all purposes under the Code. There are several checks and balances to discourage wilful default, including liability under section 29A. Further, it may not be fair to assume that a company would default even when it can repay. A slim possibility of misuse should not deter a policy which benefits everyone.

With the Ordinance in place, have the stakeholders lost an effective avenue for resolution of stress? It is important to note that the Code is available for resolution for all defaults, except default arising during COVID-19 period. Further, there are several credible options for resolutions outside the Code. The stakeholders may use statutory, Court supervised compromise or an arrangement under the Companies Act, 2013. They may use the RBI’s prudential framework for resolution of stressed assets. They may sit across a table and work out a resolution without the involvement of Court or outside any formal framework. The concern that the Ordinance has taken away an effective avenue for recovery of dues has no basis as recovery of dues is not an objective of the Code. The menu available for creditors for recovery of dues is quite long.

There is an apprehension that there will be a surge of insolvency proceedings on the other side of the pandemic. This is very unlikely given that the stakeholders have many options during the COVID-19 period for recovery of loan as well as for resolution of stress. They may even explore innovative options for resolution in these challenging times. The number could be less as the companies have normal business operations after the pandemic subsides, higher threshold of default for initiation of insolvency proceedings keeps many smaller default out of the reach, and COVID-19 period defaults remain outside insolvency proceedings.

Some have misconstrued insertion of sub-section (3) to section 66 to mean that it provides undue protection to the directors of a company for any fraudulent transaction during the COVID-19 period. It provides protection to directors in respect of liability under sub-section (2), which deals with exercise of due diligence to minimise the potential loss to creditors. It is necessary to limit the liability before the insolvency commencement date, as insolvency process cannot commence in respect of COVID-19 defaults. It has not touched sub-section (1), which deals with fraud. Further, section 166 of the Companies Act, 2013, which requires a director to discharge his duties with due and reasonable care, skill, and diligence, remains intact. Thus, there is no protection from fraud.

There is a misgiving in some circles that the suspension of the Code is a setback to insolvency reforms. As mentioned earlier, only a tiny part of the Code has been suspended, that too, for a short period. This suspension not only reinforces the prime objective of the Code, that is, to rescue the lives of companies from market pressures, but also endeavours to rescue companies having stress from force majeure circumstances. A study of our 30-year history of economic reforms indicates that some reforms have, at times, changed gears, moved one step back and two steps ahead, moved sideways, and even stood still, yet ultimately reached the destination.

There have been concerns about work opportunities for professionals. There are thousands of applications for CIRPs at the admission stage, thousands of ongoing CIRPs, and thousands of ongoing corporate liquidations and voluntary liquidations. Fresh applications in respect of defaults that have occurred before March 25, 2020 would continue to be filed. Applications for insolvency proceedings against personal guarantors and financial service providers can be filed. Special insolvency resolution
framework for MSMEs is on the way. Work has begun on development of a prepack insolvency framework. Thus, what professionals have on table is much more than what they can take.

ROAD AHEAD

While the journey of insolvency reforms passes through COVID-19, construction of the road must continue unabated. The following three sets of developments are likely to pave the road in short and medium term matching the increasing traffic.

Building institutions

Institutions do matter and make a difference. Given their role in insolvency processes, the institutions of insolvency and bankruptcy will get strengthened further.

(a) Insolvency profession: Insolvency proceedings require high-end, sophisticated professional services. The Code casts, unlike many advanced jurisdictions, strenuous responsibilities on an IP to run the affairs of the firm in distress as a going concern, protect and preserve the value of its property, comply with all applicable laws on its behalf, conduct the entire resolution process with fairness and equity, retrieve value lost through avoidance transactions, etc. The promising professionals from disciplines of law, management, accountancy, etc., with ten years of experience have joined the insolvency profession after undergoing pre-registration training and passing the Limited Insolvency Examination. They have performed admirably well. To take the insolvency profession to the next level, the IBBI has conceived a two-year Graduate Insolvency Programme (GIP) for young and bright minds having a professional qualification or a degree in a relevant discipline but with no experience. GIP aims to groom tailor-made IPs and inculcate all that an IP needs, including the soft skills such as people management, entrepreneurship, emotional quotient, and deep-rooted ethics and integrity. On completion of GIP, one would be eligible for registration as an IP. GIP is the first of its kind in the world and is an endeavour to create insolvency as a discipline of knowledge. The first batch of GIP with 37 students had commenced on July 1, 2019 at the Indian Institute of Corporate Affairs (IICA). After completing coursework at campus, the students have proceeded for one year of internship. They should be ready for registration as IPs in July, 2021. The next batch of GIP with 41 students commenced on July 1, 2020. In addition, several measures, such as advanced training in niche areas, continuing professional education, are being undertaken to build the capacity of insolvency profession.

(b) Valuation profession: A key objective of the Code is maximisation of the value of assets of the persons in distress. One needs transparent and credible determination of value of the assets to facilitate comparison and informed decision making. The valuations serve as reference for evaluation of choices, including liquidation, and selection of the choices that decides the fate of a firm undergoing CIRP. If valuation is not right, a viable firm could be liquidated and an unviable one could be rehabilitated, which could be unfortunate for an economy. The decisions arising from use of inappropriate values, in addition to causing unfair gain or loss to parties, has the potential to distort market and misallocate resources which may impinge upon economic growth in a market economy. An interim framework has been put in place under the Companies Act, 2013. A Committee of Experts has recently recommended enactment of an exclusive statute to provide for the establishment of the National Institute of Valuers to protect the interests of users of valuation services in India and to promote the development of, and to regulate the valuation profession and market for valuation services. This should ensure that valuers enjoy an enviable reputation of the stakeholders while being accountable for their services. Here also, the endeavour is
novel and aims to create the subject of valuation as an independent discipline of knowledge.

(c) **Information Utility**: The resolution process is information intensive. Value depends on availability of quality information with the stakeholders. The Code provides for a competitive industry of interoperable IUs to store financial information that helps to establish defaults, verify claims, constitute CoC based on claims, and generate IM expeditiously and thereby facilitates completion of insolvency processes in a time bound manner. To ensure that IUs capture the information necessary for the resolution of insolvency and bankruptcy, the Code makes data submission mandatory for FCs and imposes an obligation on IUs to accept such data. To ensure accuracy and preclude disputes, the Code mandates that such records be co-verified with all concerned parties. An IU has come up and is gathering a critical mass of information for use by the concerned stakeholders. This is also first of its kind in the world to address information asymmetry in the insolvency space. It will get a push if creditors extending credit above a threshold to any person are mandated to submit financial information to an IU and borrowers taking a credit above a threshold from any person are mandated to authenticate financial information with an IU.

(d) **Committee of creditors**: The CoC, which comprises FCs, has responsibility to decide the fate of the firm in distress, whether to rescue or liquidate it. The decisions of the CoC are not generally open to any analysis, evaluation, or judicial review by the AA. The stakeholders, including the Government, are bound by the resolution plan, which is a commercial decision of the CoC. A wrong decision can destroy an otherwise viable firm or place the firm in the hands of wrong people. The CoC deciphers whether the firm is in economic distress and if so, it may release the resources of the firm to other competing uses and the entrepreneur to pursue emerging opportunities. If the firm is in financial distress, the CoC rescues the firm from the clutches of current management and puts it in the hands of a credible and capable management to avoid liquidation. It creates the visibility of the underlying value of the firm and a market for competing, feasible and viable resolution plans from capable and credible people. It assesses feasibility and viability of resolution plans and capability and credibility of RAs. These decisions are not amenable to a mathematical equation and require tremendous business acumen. Given the consequences of such decisions are grave, all round efforts are being made to strengthen the institution of the CoC to match its responsibilities.

(e) **Adjudicating Authority**: The National Company Law Tribunal was created under the Companies Act, 2013 to discharge the responsibilities under the said Act. However, it has been entrusted with the responsibilities of the AA under the Code. The bench capacity needs to increase commensurate with the responsibilities under both the enactments. The capacity of a member to dispose of matters can be enhanced by provision of a quality research support. The AA should have strong administrative support that scrutinises the applications / filings for accuracy, completeness, and compliance with the requirements, and manages information technology to manage the cases and scheduling, that releases members to focus on adjudication.

In the long run, a separate AA may be created under the Code to deal with all kinds of insolvency, liquidation and bankruptcy processes of corporates and individuals. Since market participants take commercial decisions, and insolvency proceedings are not adversarial, one member of the AA, instead of two, may dispose of matters. The members of the AA may have similar terms as Judges of the High Court, which would attract right talent and build institutional capacity. Simultaneously efforts need to be made to resolve stress by mediation and conciliation or through processes such as pre-pack, which do not use or make minimum use of the AA.
Process improvements

The second set of developments relates to process improvements for certainty, efficiency, and efficacy.

(a) Responsive regulation: As a regulator, IBBI has no parallel elsewhere in the world. It makes, among others, regulations for corporate and individual insolvency, liquidation, and bankruptcy processes. Regulation, however, is not an unmixed blessing. Nor is there a regulation for every market failure. A responsive regulator designs and modifies regulations, proactively with changing needs of the market, without unduly restricting freedom of the participants and with the least unintended consequences. IBBI has standardised the regulation making process to ensure that the regulations are effective as well as responsive, and not excessive. The IBBI (Mechanism for Issuing Regulations) Regulations, 2018 govern the process of making regulations, which includes cost benefit analysis and consulting the public. It is imparting training to its employees on regulatory impact assessment to ensure that the regulations factor in ground reality, secures ownership of regulations and makes regulations robust and precise, relevant to the time and for the purpose.

(b) Resolvability: The Code has shifted the focus of creditors from the possibility of recovery to the possibility of resolution, in case of default. The market now prefers to deal with a company which is resolvable. A resolvable company obtains a competitive advantage vis-à-vis non-resolvable companies through reduced cost of debt. Where the value of a company lies in informal, off-the record arrangements or personal relationships among promoters or their family members, prospective RAs may find it hard to trace and harness the value, making resolution of the company remote. A company would focus on creating and maintaining value, which is visible and readily transferable to RAs. Similarly, a company would keep an updated IM ready to enable expeditious conclusion of the resolution process, if initiated. It would be the endeavour of every company to keep itself resolvable all the time, should a need arise, along with a restoration plan. In a sense, it would be having a sort of ‘living will’ for the benefit of the firm as well as the society at large.

(c) Market for distressed assets: India is the fastest-growing, trillion-dollar economy and the fifth largest in the world. The average growth rate over the last three decades has been about seven per cent. All vital statistics such as index for competitiveness and index for innovation have been improving over the years. In the face of competition and innovation, it is natural that some firms will have distress. Given the size of the economy and its growth potential, there will be a continuous flow of distressed assets into market. They would need to be resolved, not necessarily through a CIRP. They could be bought even in early days of distress. Regulations could facilitate the development of a secondary market for corporate loans. Several platforms provide the details of such distress assets. As the participation increases, there would be electronic platforms which would provide every detail of every company undergoing CIRP and enable prospective RAs to submit resolution plans, making the market liquid in the days ahead.

(d) Automation of contracts: It often takes time and effort for an IU to receive the information from one of the parties to a loan agreement and then seek verification from the other party before the information is usable. Automation of loan contracts (standardisation of loan agreements, dematerialisation of loan agreements and their online execution) will make the process of contracting efficient and obviate the need for explicit authentication. This will facilitate seamless insolvency proceedings, like such automation has revolutionised the securities markets. An IU or some other repository could facilitate automation of loan contracts and serve as a ‘one stop shop’ for all the information about the loans and required for insolvency proceedings. The National e-Governance Services Limited, an IU registered with IBBI, has set up a digital document execution platform to facilitate documentation remotely through e-signing and digital e-stamping.
(e) **Best practices**: The law does not and cannot provide solutions to every problem. Best practices evolve to provide solutions to many problems. Such best practices acquire full force of law over time and become customs. For example, regulations require an IM in respect of a distressed firm to provide details of assets and liabilities with such description, as on the insolvency commencement date, as are generally necessary for ascertaining their values. ‘Description’ includes the details such as date of acquisition, cost of acquisition, remaining useful life, identification number, depreciation charged, book value, and any other relevant details. The market would figure out the relevant details in respect of different kinds of assets, which would serve as the best practice for description of an asset. The IPAs are working to develop best practices for avoidance transactions.

**Missing elements**

The third set is implementation of the missing elements of insolvency regime.

(a) **Individual insolvency**: After having passed several milestones in corporate insolvency, it is time now to focus on the next big thing, viz. individual insolvency. The Code classifies individuals into three classes, namely, personal guarantors (PGs) to CDs, partnership firms and proprietorship firms and other individuals, to enable implementation of individual insolvency in a phased manner considering the wider impact of these provisions. The learning from the implementation of the earlier phases would help facilitate a smoother roll out of the later phases. Individual insolvency in respect of PGs to CDs is in operation. Insolvency and bankruptcy in respect of other individuals should commence as the ecosystem for the same is put in place.

(b) **Fresh Start Process**: Part III of the Code provides for a fresh start process (FS Process) that allows debtors, who have an annual income ≤ Rs.60,000, assets ≤ Rs.20,000, debts ≤ Rs.35,000 and do not have a dwelling unit, to seek discharge of debt and thereby protects them from coercive actions of creditors. The chances of recovery in such cases is so low that the cost of resolving insolvency becomes an additional burden to the debtor, creditor, or the State. Implementation of these provisions, which use Tribunals and IPs, may pose difficulty for such debtors. The ILC has recommended redesigning the FS process to make it accessible, simple, quicker and cost effective. It has recommended three major changes: (a) shift from quasi-judicial process to an administrative one, whereby dedicated debt relief officers oversee the process and issue debt relief orders at low-cost, (b) shift from IPs to less costly insolvency advisers to assist and guide eligible debtors, and (c) implementation of the FS Process on an online platform accessible from anywhere. This will require changes in the Code along with development of a dedicated administrative mechanism, a cadre of insolvency advisers and a technology enabled platform.

(c) **Financial Service Providers**: Presently, India does not have a specialised comprehensive legal framework for resolution of FSPs. However, financial distress and liquidity crunch in certain FSPs recently called for an insolvency framework for them. Using the powers under section 227 of the Code, Government has notified a generic framework for resolution of FSPs as an interim arrangement pending introduction of an enactment to deal with financial resolution of banks and other systemically important FSPs. Following the notification, RBI has initiated CIRP against Dewan Housing Finance Ltd. Subsequently, by an amendment, section 227 has been modified to enable the Government to apply insolvency processes under the Code with modifications for insolvency resolution of FSPs. This fills up a vacuum and would enable resolution of FSPs till a specialised framework is put in place.

(d) **Cross border insolvency**: The Code enables the Government to enter into bilateral agreements with foreign countries for applying the provisions of the Code. There are obvious limitations of such a bilateral approach. The ILC has proposed to add a Chapter to the Code to introduce a globally accepted and well
recognised cross border insolvency framework, the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, considering the fact that some corporates transact businesses in more than one jurisdiction and have assets across many jurisdictions. It has also recommended a few carve outs to ensure that there is no inconsistency between the domestic insolvency framework and the proposed cross border insolvency framework. A committee constituted by the Government to propose the rules and regulatory framework that would enable the implementation of provisions relating to cross border insolvency submitted its report recently. It is now working on rules for cross border group insolvency.

(e) Group insolvency: There is an increasing preference to organise business in a group of companies to harness synergies among them. It may be useful to deal with the insolvency of a group of companies together, in certain circumstances, to preserve synergies among the group companies for value maximisation. It may be advisable to provide for an optional framework to enable some degree of synchronisation of insolvency proceedings of group companies where it promotes the objective of value maximisation. It may start with procedural coordination, while cross-border group insolvency and substantive consolidation could be considered at a later stage, depending on the experience of implementing the earlier phases of the framework, and the felt need at the relevant time.

(f) Special framework for MSMEs: MSMEs are unique in many ways and the typical CIRP style resolution is not conducive for resolution of their insolvencies. Most MSMEs are entrepreneurial ventures, where value often lies in informal arrangements, which a third party may not be able to harness through a resolution plan. The market for resolution plans for them is local, while the entire globe is the market for bigger firms. Most of them have loans from informal sources and have no access to frameworks for resolution as available for banks. In recognition of their uniqueness, most countries have a special dispensation for their resolution.

Based on recommendation of the ILC, the Code was amended in 2018 to enable the Central Government, in public interest, to provide a modified framework for resolution of insolvency of MSMEs. As part of the ‘Atma Nirbhar Bharat, Part V: Government Reforms and Enablers’ announced on May 17, 2020, it has been proposed to notify a special insolvency resolution framework for MSMEs. The framework is likely to be a blend of CIRP and individual insolvency as some MSMES are corporates while others are individuals.

(g) Pre-pack: The market has been advocating and anticipating a resolution framework which is a hybrid between the court supervised insolvency framework and out-of-court restructuring schemes that harnesses the best of both the worlds sans their demerits and provides a formal framework for resolutions that are happening today in the shadow or on account of the Code. Most pre-packs across the globe start with an informal understanding, engage the stakeholders in between, and end with a judicial blessing of its outcome, though the nuances differ from one jurisdiction to another. Sometimes even within a jurisdiction, there may exist more than one variant of a pre-pack. Government has constituted a sub-committee of the ILC recently to recommend the regulatory framework for pre-pack insolvency resolution process. Likely, this would, require an amendment to the Code.

CELEBRATE FAILURE

Though the Code endeavours to rescue lives of companies, rescue may be neither desirable nor feasible where creative destruction is driving out failing,uviable firms from the market. The Code, therefore, provides a mechanism whereby a failing, unviable firm exits with the least disruption and cost and
liberates the entrepreneur from failure and releases idle resources in an orderly manner for fresh allocation to efficient uses. Growth needs entrepreneurs. The Code aims to promote entrepreneurship by providing an effective mechanism to liberate entrepreneurs from honest failure instead of penalising them. Hon'ble Prime Minister of India in his address at the Centenary Celebrations of Kirloskar Group on January 6, 2020, underscored its importance:

“The insolvency journey must continue till it reaches ultimate destination when India celebrates honest business failures.”
Part I

Progression
This (The Insolvency and Bankruptcy Code, 2016) is considered as the biggest economic reform next only to GST.

INTRODUCTION

Insolvency reform has been attempted in India since the early 1990s. It remained mostly unsuccessful until the passing of the Insolvency and Bankruptcy Code, 2016 (IBC). A plethora of laws made bankruptcy resolution in India extremely difficult. Laws including the Sick Industrial Companies Act, 1985, the Recovery of Debts and Bankruptcy Act, 1993, among others resulted in a confusing structure for the resolution and insolvency process. IBC represents a major structural reform that has the potential to completely revolutionise insolvency resolution process in India. It replaced what was earlier a fractionalised framework for insolvency laws and processes in India, which resulted in unacceptable and costly delays and inefficiencies. With a focus on reducing the time taken, and a resolution rather than liquidation first approach, the IBC has been an empowering tool. It has instilled confidence in the corporate resolution methodology and on recovery possibilities for businesses. The IBC is an effort at a comprehensive reform of the fragmented regime of corporate insolvency framework. This has allowed credit to flow more freely in India through speedy disposal of struggling ventures and by instilling faith among the investors that their interests will be protected without inordinate delays. At the same time, it has also helped to transform the investment eco-system by making promoters bear the responsibility of their investment decisions and not perpetually pass on the downside risks to the creditors as had been the practice in the past. The IBC has thus purported to radically improve the investment climate in India.

The IBC has and will also help in liquidating the serious backlog presently extant in our judicial system. Nearly four crore matters are pending final judgment in various courts. The enforceability of contracts is limited, and on average it takes 1445 days for a contract to be enforced, and that too at a cost of nearly 31 per cent of the claim value. India thus suffers from weak contract enforceability. This is reflected in India’s position in the World Bank’s Doing Business Report (DBR), for contract enforcement languishing at an unacceptable 163. The IBC has the potential to improve this on a sustained basis.

IBC’S ROLE IN EASING THE DOING OF BUSINESS

Any landmark Act or legislation that serves as a watershed reform must have the ability to be flexible and dynamic. The IBC has these twin features. It goes beyond other similar legislations across the world, and through the Insolvency and Bankruptcy Board of India (IBBI), it has established an unprecedented organisation that both regulates and develops insolvency policy and assesses market realities. The IBBI provides the IBC with means to remain robust by responding effectively to emerging challenges.

The Ministry of Corporate Affairs (MCA), in its year end summary press release set the context of India’s rapid rise in the DBR rankings, and the role of the IBC in making India an attractive destination for
investment. According to the report, in the ‘Resolving Insolvency’ parameter, India's ranking improved to 52 in 2019 from 108 in 2018, a leap of 56 places. Further, the recovery rate improved nearly threefold from 26.5 per cent in 2018 to 71.6 per cent in 2019. The overall time taken in recovery also improved nearly three times, coming down from 4.3 years in 2018 to 1.6 years in 2019. These are all major improvements to which the IBC has contribute in ample measure.

As per official estimates, in resolution matters, out of 21,136 applications filed, 9,653 cases involving a total approximate amount of Rs. 3.75 lakh crore had been disposed of at the pre-admission stage of IBC. According to data from the IBBI, as of March, 2020, of the 2838 cases admitted into corporate insolvency resolution process (CIRP), 306 cases were closed by either appeal, review, or were withdrawn. From the 161 resolved cases, the realisable amount was upwards of Rs. 1.56 lakh crore.

Dr. M. S. Sahoo, Chairperson, IBBI in an opinion piece published in Indian Express on March 14, 2020 stated that 200 companies had been rescued till December, 2019 through resolution plans, owing Rs. 4 lakh crore to creditors. On the flip side, the realisable value of the assets available with them at the time of entering the IBC process was Rs. 0.8 lakh crore. Dr. Sahoo rightly emphasised that the IBC maximises the value of the existing assets, not of the assets which do not exist, enabling the creditors to recover Rs. 1.6 lakh crore or approximately 200 per cent of the realisable value of those companies. This he compared to alternate options which would have hypothetically yielded half of that value. He also pointed out how compared to other options, banks are recovering their dues more speedily and in larger volumes thanks to the IBC.

By allowing viable companies to continue operating as going concerns, the amendments to the insolvency law aim to support entrepreneurial risk-taking and at the same time protecting the interests of the investors and creditors in such ventures. Introducing insolvency is difficult at first. Finding expertise to prepare reorganisation plans has proven challenging across the world and through history. It is therefore imperative to give the IBC ample time to establish itself and iron out any initial obstacles.

Four years in the life of a game-changing legislation is clearly negligible. Despite that, IBC has metamorphosed insolvency resolutions in India. The goal is for the distressed company to survive the insolvency procedure. This goal is better achieved if transparent rules are in place for the management of the debtor's assets during insolvency proceedings. Such rules prevent debtors from distributing and dissipating assets that should legitimately be used to pay off the creditors or to preserve the viability of the business as a going concern. The IBC again has played an important role in providing that transparency and clarity and preventing avoidable losses to the creditors.

It is, therefore, clear that the IBC, enforced and enabled in accordance with legislative intent, is an unprecedented reform, acting as much a deterrent for lags and delays as an actual cure for a previously unsolved problem.

**International Experience**

Chapter 11 of the Bankruptcy Code in the United States (US) can be said to the origin of the corporate resolution and reorganisation process. It is justifiably considered extremely company friendly, especially because of its automatic stay provision. The US bankruptcy laws, in fact, are said to help companies continue to the furthest extent possible during the process. The United Kingdom's insolvency laws, on the other hand are, for the most part considered to be creditor friendly.

An advisory on World Bank’s Doing Business website provides an inter-jurisdictional analysis of research conducted on insolvency resolution across the world, and mentions how ‘Economy-specific research
has shown that insolvency reforms that encourage debt restructuring and reorganisation reduce both failure rates among small and medium-size enterprises and the liquidation of profitable businesses. Using Italy as an example, it postulates how ‘the reform that accelerated the liquidation procedure not only decreased firms’ cost of finance but also relaxed credit constraints. Research has also shown that bankruptcy reform can aid in the quick recovery of an economy during a recession.’

Concluding that procedure matters along with the laws, it stipulates how,

even when bankruptcy laws are similar across economies, the use of bankruptcy procedures can vary because of differences in the efficiency of debt enforcement. If courts cannot be used effectively in a case of default, creditors and debtors are likely to engage in informal negotiations outside of court, which often enhance uncertainty in the resolution process and would be expectedly biased in favor of the relatively ‘stronger party’, thereby discouraging new ventures and startups. In Brazil, differences in court enforcement of the same bankruptcy law, affected the impact of financial reforms on firm access to finance, investment and size.

Essentially, the role of the IBC and IBBI working together is to ensure a mutually supportive and accommodating framework. This allows for necessary adjustment and works constantly towards plugging enforcement gaps. These features of the IBC hold the promise for making the Indian law a model for other jurisdictions.

IBC’s Legality Established

There is no longer any ambiguity about the jurisdiction or validity of the IBC. The Supreme Court of India in January 2019 upheld the constitutional validity of the law. Justices R. Nariman and N. Sinha, when dismissing several petitions challenging the IBC, settled the matter once and for all by declaring that it is good in law and enforceable. Further, in the other judgments of the Supreme Court, it has been held that the commercial wisdom of the committee of creditors (CoC) cannot be interfered with judicially. The Supreme Court has unequivocally stated that there is no provision for the Tribunals to interfere with the commercial decision of the CoC. The Bankruptcy Law Reform Committee (BLRC), headed by Shri T. K. Vishwanathan, which provided the intellectual nucleus of the IBC, as well as its first draft, in its report envisaged the resolution plan being approved on commercial grounds by the CoC and provided certain safeguards for operational and dissenting creditors. These safeguards are in line with the UNCITRAL Legislative Guide as well as the World Bank DBR parameters to prevent holdouts. So long as such safeguards are met, the Tribunal is not required to intervene, or manifest any violation of law or process.

Also addressed in the landmark judgment by the Supreme Court was the right to experimentation in economic legislation, and the positive role of the IBC, through timely and confidence enhancing resolution and recovery of debts, within an ethical framework. The Apex Court has settled a variety of issues pertaining to the IBC. Confidence in the system and outcome dependability will greatly help the time bound nature of the IBC. In fact, the amendment to the IBC in August, 2019 that mandates closure of CIRP in 330 days, includes the time spent on litigation, and is widely considered the speediest resolution framework in the world.

Enforcement and Innovation in the IBC

The IBC provides a four pillar ecosystem to resolve their stress. Firstly, a class of regulated persons, insolvency professionals (IPs), who play a key role in the efficient working of the insolvency, liquidation, and bankruptcy processes. Next is the new industry of the Information Utilities (IUs) that store financial
information about debtors, eliminating delays and disputes during resolution. Thirdly, the National Company Law Tribunal (NCLT) and Debt Recovery Tribunals (DRT) in insolvencies are the adjudicators of matters pertaining to the IBC. Finally, and importantly comes the regulator, the IBBI which regulates professions as well as processes.

The report of the BLRC, speaks of the criticality of speed for the working of the bankruptcy code, specifying two reasons- inability to make significant decisions without full clarity of ownership and control, and, the longer the delay, the more likely that the entity in question would move towards liquidation rather than resolution, and that too a low value liquidation due to a high economic rate of depreciation. Higher value stems from the firm being acquired as a going concern.\textsuperscript{9} In December, 2019, an amendment to the IBC was introduced. It essentially released the corporate debtor from liability pertaining to offences committed under the prior management before the commencement of the CIRP. Overall, it was a major progressive move in building confidence. Taken together with the August, 2019 amendment making the resolution process time bound to 330 days in total would also have made a difference to investor and investee confidence.

OTHER MEASURES FOR IMPROVING EASE OF DOING BUSINESS IN INDIA

The IBC plays a key role in helping economic growth. It is an integral part of the overall framework that the Government of India is setting out to make India a hub for investment. One of the measures that is playing an important part along with the IBC is the decriminalisation of minor offences.

A clear insolvency framework is undeniably the necessary condition for instilling investor confidence and supporting entrepreneurship. However, the IBC also needs a supporting framework for creating a friendly business ecosystem. For achieving this, the Government of India has taken some key steps towards ensuring that good faith acts are enabled and encouraged. One of the key measures taken is the broad-based effort to bring in decriminalisation of minor offences as a focus area for reform. NITI Aayog is playing an active role in this laudable exercise.

The risk of imprisonment for actions or omissions that are not necessarily fraudulent or \textit{ab-inito malafide} of intent is a big hurdle for the private investors who are liable to make genuine mistakes in making investment decisions and conducting business operations. Criminal penalties including imprisonment for minor offences act as major deterrents to investment activity, and negatively impacts business sentiment for both domestic and foreign investors. While some initiatives have been taken in this direction, there is scope for more reform.

Already, decriminalisation of technical and procedural violations under the Companies Act, 2013 to reduce the burden on the Courts has led to the shift of 16 offences/sections to a penalty structure, through the Companies (Amendment) Bill, 2019 which was notified on July 31, 2019. The Finance Minister, in her Union Budget 2020 speech, had also mentioned that the Government of India will look into making amendments to the Companies Act, 2013 and other laws where certain provisions impose criminal penalties on acts that are essentially civil in nature.

Actions taken on these aspects would go a long way in further improving ease of doing business and will also help in unclogging the court system. It would also be a significant step in the Government of India’s pursuit to achieve ‘Sabka Saath, Sabka Vikas, Sabka Vishwas’.

Decriminalisation of minor offences is a major part of the overall goal to improve both ease of doing business and the ease of living of the common citizen. Another reform that complements other efforts
in this area is the on-going identification and repeal of archaic and obsolete laws. Already, more than 1500 archaic laws have been repealed, and several more have been identified for repeal in the coming days. All these put together along with the IBC represent a significant reform effort in improving the investment and business climate in India for private foreign and domestic investors.

WAY FORWARD IN THE POST PANDEMIC PERIOD

It is certain that the IBC has provided a major stimulus to ease of doing business. It has enhanced investor confidence and helped encourage entrepreneurship while also providing support to MSMEs. The COVID-19 pandemic has understandably necessitated several changes to the dispensation of laws and justice. In response to the challenges necessitated by the pandemic, a moratorium under IBC has been announced for several months to protect businesses adversely impacted. To protect MSMEs, the threshold for eligibility for initiation of corporate insolvency process under the IBC has been raised to Rs. 1 crore from Rs. 1 lakh.

As with any law, let alone a landscape altering and reaffirming legislation such as the IBC, robustness and dynamism is absolutely key. In large part through the efforts of the IBBI in increasing capacity, incorporating leading practices, and remaining on top of policy tweaks, the IBC has remained agile and responsive to emerging realities and challenges. The two-year Graduate Insolvency Programme is an outstanding skill and education tool for building capacity and training insolvency professionals at scale. Going forward, there could perhaps be a look at institutionalising the introduction of pre-packed insolvency resolution process (PPIRP), the need for which is highlighted by the necessary suspension of the IBC proceedings. This will also help in expeditiously resolving matters outside of the formal court system. The PPIRP could help bring consensus for lenders together in a particular issue, incentivise management and promoters to participate productively and proactively in the process and, with suitable checks and balances, can look after the interests of non-participating affected parties as well. It will also permit efficient, bid-free restructuring of debt. The UK has an innovative concept known as a ‘prepack pool’ which is an independent body of experienced professionals that provides expert opinion and recommendations regarding pre-packed deals. This could be usefully considered also for our situation.

A February, 2020 report by the Vidhi Centre for Legal Policy titled ‘Designing a Framework for Pre-Packaged Insolvency Resolution in India’ sets out the beneficial aspects of pre-packs. These advantages are speed, confidentiality, statutory sanction and lower costs. It further proposes three kinds of pre-packs, namely, pre-packaged insolvency resolution process, pre-arranged insolvency resolution process, and lastly a pre-arranged sale. Taking into context the adoption from other jurisdictions adapted to India and the IBC’s mandate, the report recommends these three somewhat distinct options.

Extended lockdowns may have led to several jurisdictions contemplating this mechanism. The MCA, along with IBBI, are working diligently on putting together an MSME and non-MSME framework in place to help expedite this process.

At the same time, given the need for social distancing and suspension or limitation of physical hearings, a concerted effort could be made to bring in technology to facilitate all processes and hearings to enable capacity and efficiency in the new normal. The IBC introduced the IU, giving India a uniquely practical and useful option to help meet the stakeholders' needs for information supply.

Artificial Intelligence tools that are non-invasive, automated technology driven platforms for essential processes, and other such leading practices from other sectors in India should be considered seriously
for their application in the insolvency processes. Bringing in technology would help the ease of access to justice and greatly help ease of doing business from a process and efficiency standpoint as well. Standardising use of IU in furtherance of the May 12, 2020 circular of the NCLT\textsuperscript{10}, would help in gathering useful and reviewable data pertaining to the nature of defaults and patterns within them. Along the lines of innovative practices being introduced through the eCourts project and other adoption roadmaps, NCLT, could use technology for case listings, flow management, and of course, online hearings. This will greatly improve efficiency of the entire process.

With frameworks in place, markets will find solutions from within so as to enable seamless market functioning and at the same time allow disruption to alter the traditional way of operating or ‘business as usual’ mindset, as keys to rapid growth. India is on track to reaching within the top 25 position in the World Bank’s DBR rankings. IBC’s contribution to that achievement will undoubtedly be a significant one. It will be a key contributor to India’s successful transition to becoming a middle-income economy.

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**NOTES**

\* The views expressed are personal.

\textsuperscript{1} World Bank Database, https://data.worldbank.org/indicator/IC.LGL.DURS.


\textsuperscript{6} Ibid.


\textsuperscript{8} Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta & Ors. (Civil Appeal No. 8766-67 of 2019) and K. Sashidhar v. Indian Overseas Bank 2019 SCC Online SC 257.


\textsuperscript{10} NCLT order No. 25/02/2020–NCLT dated May 12, 2020, requires all concerned to file default record from IU along with the new petitions being filed under section 7 of the IBC and further states that no new petition shall be entertained without such record of default.
Ease of Exit
The IBC Way

Bibek Debroy and Aparajita Gupta

The Olympic motto of *Citius, Altius, Fortius* resonates with the life of a living organism that evolves, adapts and self-learns as it grows to survive in the external environment. This is akin to the life of a company that also evolves, adapts and self-learns with the objective to innovate and compete, and ultimately survive. While it is the duty of the State to provide a conducive environment for competition and innovation, it is the individual companies who have to ultimately compete. Competition essentially means freedom of entry and freedom of exit of firms. In India, while we had the freedom of entry, the exit route for firms was rather murky. Back in the 1960s and 1970s, a large number of sick private sector enterprises were nationalised into public sector enterprises due to absence of a mechanism by which these enterprises could easily exit. Sooner than later, these public sector enterprises also became sick. Even for unincorporated enterprises the so-called exit provisions was a piece of legislation that went back to 1926. The existence of an exit door for errant promoters was more or less non-existent. The need for a modern and comprehensive legislation in India to provide for ‘ease of exit’ for companies was essential.

Four years ago, India enacted the path breaking Insolvency and Bankruptcy Code, 2016 (Code/IBC) to address, what the Economic Survey of 2015-16 called the ‘Chakravyuha challenge’. Lack of exit often leads to generation of externalities that hurt others (like firms that end up competing with subsidised ‘sick’ firms, taxpayers paying for subsidising corporates and even the poor who pay costs through indirect taxes and who might pay higher prices for substandard goods and services of inefficient firms that should have ideally exited).\(^1\) The IBC brought about a significant change by moving to a creditor-in-possession regime from the debtor-in-possession regime.\(^2\) It seeks to resolve the corporate debtor (CD) and is not merely a recovery mechanism for creditors given that resolution has a far greater impact by securing employment, ensuring future cash-flows, promoting entrepreneurship and contributing to economic growth.\(^3\) To handle the cases under the new law, the National Company Law Appellate Tribunal (NCLAT), Principal Bench of National Company Law Tribunal (NCLT) at New Delhi and 11 benches of NCLT- one each in Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Kolkata, Mumbai and Hyderabad along with two at New Delhi were constituted on June 1, 2016. Soon on October 1, 2016, the regulator, in the form of the Insolvency and Bankruptcy Board of India (IBBI) was established. While the IBC is still in its early days, it has proved to be revolutionary when compared to the erstwhile insolvency regime.

In this article, the first part looks at how the IBC has been a game changer for companies that need to exit. The next part looks at the role of IBC in helping India improve its Ease of Doing Business ranking as measured by the World Bank. The third part studies the impact of IBC on Micro, Small and Medium Enterprises (MSMEs). The fourth part highlights that while necessary amendments have been made, there are some issues that still need to be addressed in the future.
IBC: THE GAME CHANGING LAW

While IBC is still in its early days, the transformation it has brought about is evident from data released by the Reserve Bank of India (RBI). Table 1 shows that as a percentage of claims, banks have been able to recover 42.5 per cent of the amount involved through IBC for the financial year 2018-19, which is the highest as compared to recovery under other modes and legislations. Further, the amount recovered under IBC was Rs. 70,819 crores.

Table 1: Non-Performing Assets of Scheduled Commercial Banks recovered through various channels

<table>
<thead>
<tr>
<th>Recovery Channel</th>
<th>2017-18</th>
<th>2018-19 (P)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of cases referred</td>
<td>Amount involved</td>
</tr>
<tr>
<td>Lok Adalats</td>
<td>33,17,897</td>
<td>45,728</td>
</tr>
<tr>
<td>DRTs</td>
<td>29,345</td>
<td>1,33,095</td>
</tr>
<tr>
<td>SARFAESI Act</td>
<td>91,330</td>
<td>81,879</td>
</tr>
<tr>
<td>IBC</td>
<td>704@</td>
<td>9,929</td>
</tr>
<tr>
<td>Total</td>
<td>34,39,276</td>
<td>2,70,631</td>
</tr>
</tbody>
</table>

Notes:
1. P: Provisional.
2. *: Refers to the amount recovered during the given year, which could be with reference to the cases referred during the given year as well as during the earlier years.
4. @: Cases admitted by NCLTs.
5. Figures relating to IBC for 2017-18 and 2018-19 are calculated by adding quarterly numbers from IBBI newsletters.


Data available from the IBBI informs that of the corporate insolvency resolution process (CIRP) that have been admitted under the IBC, as of end of March, 2020, in 221 instances, resolution plan has been approved, while 914 CIRPs were closed by liquidation. Analysis of cases that have been resolved indicates that realisation by financial creditors (FCs) under resolution plans in comparison to liquidation value is 183.37 per cent, while the realisation by them in comparison to their claims comes to 45.96 per cent. Of the 221 CDs rescued under the processes under IBC, 70 were in BIFR or defunct.

The sectoral distribution of the CDs under CIRPs as on March 31, 2020, based on IBBI data, shows that a maximum number of CDs under CIRP belong to the manufacturing sector followed by real estate, renting and business activities and construction. Coming to the category of stakeholder initiating CIRP, it is evident that both operational creditors (OCs) and FCs are initiating the processes under the Code with respective share of 49.6 per cent and 43.6 per cent of the total CIRPs as of March 31, 2020 through data provided by IBBI.

Now, we look at the timeline under IBC. Of the data on the 2170 ongoing CIRPs published by IBBI, as on March 31, 2020, 34 per cent have taken 270 days or more, 22.8 per cent have taken between 180 to 270 days, 25.8 per cent have taken between 90 and 180 days and close to 17.4 per cent have taken under 90 days. These timelines need to be seen in light of the fact that under the previous regime, delay
in proceedings was one of the major issues that led to huge erosion in value of assets of the companies. The average time taken for approval of resolution plans of 221 CIRPs was 415 days and for approval of liquidation in 69 cases was 270 days. Time for approval of resolution plans is much lower than 4.3 years taken earlier as reported in the World Bank’s Doing Business Report of 2019. This figure has come down significantly since the enactment of the IBC and the World Bank has also acknowledged the same in its Doing Business Report of 2020 in which the time required for recovery of debt has been reported to be 1.6 years.

With respect to data till end of March, 2020, one finds that while the number of companies going into liquidation (914) is nearly four times that of companies that have seen resolution (221), one needs to understand that assets of companies rescued were valued at close to Rs. 0.96 lakh crore as against the assets of companies sent to liquidation which were valued only at Rs. 0.36 lakh crore when they entered the IBC process.

Thus, overall, one finds that the data is encouraging given these are only the initial few years of the new regime under the IBC.

### IBC AND INDIA’S IMPROVING EASE OF DOING BUSINESS RANKING

In both the Doing Business 2016 and 2017 Reports of the World Bank, India was ranked at 136th on the ‘Resolving Insolvency’ indicator. In the next edition of the report (Doing Business 2018), India drastically improved its rank to 103rd on the same indicator. The Report recognised the importance of enacting IBC by stating that:

> India made resolving insolvency easier by adopting a new insolvency and bankruptcy Code that introduced a reorganization procedure for corporate debtors and facilitated continuation of the debtor’s business during insolvency proceedings.

It is interesting to note that IBC was also seen as a reform under the ‘Getting Credit’ indicator. The Report noted that:

> India strengthened access to credit by amending the rules on priority of secured creditors outside reorganization proceedings and by adopting a new law on insolvency that provides a time limit and clear grounds for relief to the automatic stay for secured creditors during reorganization proceedings.

India secured the 29th rank when it comes to the ‘Getting Credit’ indicator, a jump from its 44th rank in Doing Business 2017 Report. Coming back to the ‘Resolving Insolvency’ indicator, India was ranked 108th with a score of 40.84 in the Doing Business 2019 Report. In World Bank’s Doing Business 2020 Report, India’s ranking on this indicator improved to 52nd rank with its score of resolving insolvency standing at 62 out of 100. This huge improvement in ranking also helped India to improve its overall Ease of Doing Business rank to 63rd out of 190 economies (its highest ever).

Within the ‘Resolving Insolvency’ indicator, the Report found that:

- time required to recover debt stands at 1.6 years which includes the appeals and requests for extensions.
- cost required to recover debt (as a percentage of debtor’s estate) is 9 per cent which covers Court fees, insolvency administrators’ fees, lawyers’ fees, fees of assessors and auctioneers and other related fees.
- outcome (whether business continues to operate as a going concern or business assets are sold as piecemeal) is 1 which denotes that the business continues to operate as a going concern.
- recovery rate for creditors (cents on the dollar recovered by the secured creditors) is 71.6 (official costs of the insolvency proceedings are deducted and depreciation of furniture is accounted for).
- strength of the insolvency framework index on a scale of 0 to 16 is 7.5. This is arrived at by looking at scores of the following:
  - Commencement of proceedings index (on a scale of 0 to 3) where the score was 2
  - Management of debtor’s assets index (on a scale of 0 to 6) where the score was 4.5
  - Reorganization proceedings index (on a scale of 0 to 3) where score was 0
  - Creditor participation index (on a scale of 0 to 4) where the score was 1

Therefore, from a recovery time of 4.3 years and recovery rate (cents on the dollar) of 26.5 as per Doing Business 2019 Report, India now has a recovery time of 1.6 years and recovery rate (cents on the dollar) of 71.6 as per Doing Business 2020 Report. Table 2 shows where India stands on this indicator as compared to others.

Table 2: Comparative analysis of India, South Asia, OECD and the Best Regulatory Performer

<table>
<thead>
<tr>
<th>Indicator</th>
<th>India (Delhi/Mumbai)</th>
<th>South Asia</th>
<th>OECD high income</th>
<th>Best Regulatory Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recovery rate (cents on the dollar)</td>
<td>71.6</td>
<td>38.1</td>
<td>70.2</td>
<td>92.9 (Norway)</td>
</tr>
<tr>
<td>Time (years)</td>
<td>1.6</td>
<td>2.2</td>
<td>1.7</td>
<td>0.4 (Ireland)</td>
</tr>
<tr>
<td>Cost (% of estate)</td>
<td>9.0</td>
<td>9.9</td>
<td>9.3</td>
<td>1.0 (Norway)</td>
</tr>
<tr>
<td>Outcome (0= piecemeal sale, 1=going concern)</td>
<td>1</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Strength of insolvency framework index (0-16)</td>
<td>7.5</td>
<td>6.5</td>
<td>11.9</td>
<td>None in 2018/19</td>
</tr>
</tbody>
</table>


The Doing Business Report rankings play an important role in developing perceptions about the strength of an insolvency and bankruptcy resolution framework of a country. The improved performance of India on the index is a by-product of the IBC. While we have improved our rank when it comes to resolving insolvency, there is scope for more improvement in future given that we are still in the initial stages of implementation of IBC.

**MSMEs AND THE IBC**

In India, we have close to 633.88 lakh unincorporated non-agricultural MSME units. The importance of the MSME sector for the Indian economy is evident from the fact that it provides jobs to close to 11.10 crore people. Of this, 612.10 lakh are employed in the urban areas and 497.78 lakh are employed in the rural areas. Of the total employees, 844.68 lakh are male employees and 264.92 lakh are female employees. When it comes to understanding the contribution of the MSME sector to the Indian economy, one finds that it contributes over 28 per cent of the GDP, 45 per cent to the manufacturing output and more than 40 per cent of exports. Given the sector’s significance, its failure can have a domino effect.
When it comes to the IBC, it is well recognised that MSMEs can either be part of the group of creditors or fall in the group of debtors. In both capacities, they will come within the ambit of IBC. As an OC, it has been found that many large corporates deal with MSMEs in India only on a credit basis and MSMEs hesitate to complain against non-payment for fear of loss of business.\(^\text{17}\) Often delayed payments and negligible pay outs to MSMEs by the corporates, in case the latter end up in bankruptcy tribunal, lead to stress among MSMEs.\(^\text{18}\) This needs to be checked.

Now, let us look at their role as debtors. In India, MSMEs are either proprietorship or partnership firms by an overwhelming majority.\(^\text{19}\) It has been widely recognised that when it comes to exit, the IBC provides a differentiated regime for insolvency/bankruptcy of firms, proprietary firms and individuals.\(^\text{20}\) Some part of this differentiated regime is still under process of implementation. But once it is put in place, lenders will have more clarity and predictability when it comes to recovering defaulted loans which can boost credit availability for MSMEs in India.\(^\text{21}\) The other advantages would be reduction in cost of credit for MSMEs and preservation of jobs of MSMEs employees.\(^\text{22}\)

As mentioned above, the provisions for individual insolvency are being implemented in a phased manner. While the individual insolvency resolution for personal guarantors to corporate debtors has commenced from December 1, 2019, work is in progress for operationalising the provisions for partnership firms, proprietorship firms and other individuals.\(^\text{23}\) The Report of RBI’s Expert Committee on Micro, Small and Medium Enterprises (2019) highlighted the lack of sophistication of MSMEs and therefore recommended that the IBC regime should provide MSMEs with the option of out-of-court assistance like mediation, debt counseling, financial education or the appointment of a trustee.

Till then, an amendment has been made keeping in mind the plight of MSMEs. The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 inserted section 240A that clarified the applicability of section 29A in respect of the CIRP of MSMEs and also provided that the Central Government may, by notification, direct that any of the provisions shall either not apply to the MSMEs or apply to them with modifications. A special resolution framework for MSMEs is currently in the pipeline.

**EVOLUTION AND THE WAY FORWARD**

Even in its initial years, the Parliament has made course corrections through amendments to the Code. The Insolvency and Bankruptcy Code (Amendment) Act, 2018 clarified the applicability of the Code to personal guarantors to CDs; partnership firms and proprietorship firms; and individuals to enable phased implementation of provisions relating to individual insolvency and bankruptcy under the Code. Further, it added section 29A to make certain groups of individuals ineligible to submit a resolution plan. This was also aimed at ensuring that promoters were barred from bidding for their own companies and prevent defaulters from getting back control over their companies at a cheaper value.\(^\text{24}\) The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 inserted section 12A which allowed withdrawal of application after the same has been admitted by the NCLT on an application of the applicant who triggered the CIRP with the approval of 90 per cent of voting share of committee of creditors.

Through the Insolvency and Bankruptcy Code (Amendment) Act, 2019, section 12 has been amended to clarify that the CIRP shall mandatorily be completed within 330 days from insolvency commencement date including extended CIRP period granted and time taken in legal proceedings for such resolution process. While the term ‘mandatorily’ has been struck down by the Supreme Court for being manifestly arbitrary under Article 14, it emphasized that the CIRP should be ‘ordinarily’ completed within 330 days.
unless extended by court due to sufficient cause. Further, section 31 was amended to mention that plan shall also be binding on the Central Government, any State Government or local authority to whom a debt is owed in respect of the payment of the dues. Insolvency and Bankruptcy Code (Amendment) Act, 2020 amended section 14 to clarify that license, permit, registration, quota, concession, clearances or a similar grant or right that has been given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law, shall not be suspended or terminated on the grounds of insolvency during the moratorium period. Further, supply of critical goods and services shall not be terminated, suspended or interrupted during the moratorium period for CDs continuation as a going concern. It also added section 32A to protect the CD from liability for prior offences.

In Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors., the Supreme Court upheld the constitutional validity of the law in its entirety. In addition to Supreme Court decisions, NCLAT and NCLT have contributed to an evolving jurisprudence when it comes to the IBC. Further, the IBBI, as the regulator, has stepped in whenever necessary.

Inspite of all this, some issues remain to be ironed out. When it comes to timelines, the original timeline for resolution was 180 days which could be extended by 90 days. Through the recent amendment, this has now been increased to 330 days. But the average time for resolution is close to 415 days. Some cases are delayed even beyond the time limit which is partly a reflection of repeated litigations.

To tackle this, the Report of the Standing Committee on Finance has reiterated the need to increase the number of NCLT benches and also establish e-courts for speedy disposal of cases. Further, more members need to be appointed to expedite the resolution process. The government is looking at setting up separate benches of NCLT for insolvency cases with a view to bring down the time to 330 days. This is important since the increase in IBC cases has had an adverse effect on company law cases that are also handled by NCLTs and the latter are facing delays. Further, technology should be used to enhance case management by NCLT for strict timekeeping.

The present NCLAT was also facing burden of cases being the only appellate body. Thus, the Government has recently notified the constitution of NCLAT Chennai bench. This new bench will hear appeals against orders of NCLT benches with jurisdiction over Karnataka, Tamil Nadu, Kerala, Andhra Pradesh, Telangana, Lakshadweep and Puducherry and for appeals from other NCLT benches, the Principal Bench of NCLAT will have to be approached.

It is also important to note that some NCLT benches are more burdened as compared to the others. The Report of the Standing Committee on Finance has made an interesting recommendation. It underlines the need to collect empirical evidence on the performance of the insolvency framework. It adds that this would include data on cases admitted by different benches, cases divided according to industry/sector, experience of different stakeholders, type of resolution and the time taken, recovery by resolution type and finally the impact on employment and other output indicators. This would ensure that corrective action can be taken backed by robust data.

Development of the insolvency profession will also play a critical role in taking the CIRPs to their logical end successfully. To keep the principles of ethics and integrity alive within the insolvency profession, the broader issue of corporate governance or corporate mis-governance, as has been experienced with respect to other professions in the country, will have to addressed from the very nascent stages of the profession.
CONCLUSION

While Abhimanyu in Mahabharata could not get out of the Chakravyuha, companies in India are fortunate that they do not have to meet the same fate. The IBC has put in place a strong regime marking a major change from the previous regime. This regime has been evolving thanks to course corrections by the Parliament, IBBI, judiciary and the adjudicating bodies. In light of the global health emergency, the Union Finance Minister recently announced the increase of threshold for default from Rs. 1 lakh to Rs. 1 crore under section 4 in order to prevent triggering of insolvency against MSMEs.\(^4\) Further, to prevent companies from being pushed into insolvency due to their inability to repay debt as a consequence of business disruptions caused by COVID-19 pandemic, the recourse to IBC under sections 7, 9 and 10 has been suspended for any default arising on or after March 25, 2020 for a period of six months or such further period, not exceeding one year from such date.

This is only a temporary halt to the IBC process and going forward, one is confident that the IBC regime will continue to evolve in order to help businesses exit in a timebound manner.

(The views expressed are personal)

NOTES


3 Ibid.


5 Ibid.

6 Address by Justice N.V. Ramana, Judge, Supreme Court of India at the Colloquium of members of NCLT and NCLAT on “Judicial Sensitization on Insolvency Law and Associated Best Practices”, March 6, 2020.

7 Supra Note 4.


9 Interview of Dr. M. S. Sahoo, “80% of stressed assets resolved via IBC, only 20% in liquidation”, Financial Express, 02 March 2020.


11 Ibid, p. 131.

12 This excludes the ones registered under the Factories Act, 1948, Companies Act, 1956 and construction activities falling under Section F of the National Industrial Classification. See Annual Report of Ministry of Micro, Small and Medium Enterprises, 2018-19, p. 28.

13 Ibid, p. 32.

14 Ibid.

15 Ibid, p. 33.

17 Ibid, p. 22-23.
19 Supra Note 16, p. 37.
20 Ibid.
21 Ibid, p. 38.
22 Ibid, p. 38.
23 Keynote address by Dr. M. S. Sahoo, Chairperson, IBBI at the Seminar on “Bankruptcy and distressed investment market in India: Opportunities, perspectives and the road ahead” at London, February 10, 2020.
28 Supra Note 2.
29 Supra Note 28.
With immense enthusiasm, the nation gave unto itself a basic framework of insolvency laws (in December of 2016) aimed at a new economic regime. The new framework, the Insolvency and Bankruptcy Code (Code/IBC), emphasised on resolution rather than recovery, aiming at maximising the ‘value of assets’ as well as keeping the entity as a ‘going concern’. Timelines for each step were crucial to preserve asset value. The intent of the Code is the ‘timely resolution’ of stressed assets and distressed debts, which would support the development of credit markets and encourage entrepreneurship. This would also improve ‘Ease of Doing Business’, and facilitate more investments leading to higher economic growth and development. Its thrust is to ‘resolve’, ‘revive’ and ‘reinforce’ the recovery efforts of the creditors. Recovery, as understood in the pre-IBC era, no longer remains the main focus of the new regime. Although at the end of the tunnel every creditor is concerned about the recovery of his dues.

It was expected that market forces would determine commercial needs within a legal framework. Law could be fine-tuned, where required. The Code was to provide market-driven freedom to non-performers to exit, encourage entrepreneurs (who were willing to steer ahead a viable though insolvent entity) and ensure availability of credit, with greater powers to the financial creditors. In short, it aimed at balancing the interests of all stakeholders. In an exciting journey, since its inception, several stakeholder and market-driven needs have been considered at judicial forums leading to a series of Ordinances, which have eventually culminated in amendments to the laws.

This article traces some of the constitutional challenges to the legislation, judicial pronouncements thereon and the continual journey of Ordinances and Amendments. IBC has been a delight for academics and practitioners alike. A classic example of economic legislation, born with a skeletal framework, growing into a complete Code taking precedence over several other legislations – thanks to the immense and timely concerted, judicial and legislative action, to advance the objectives set out in the new law.

**CONSTITUTIONAL QUESTIONS**

One of the challenges posed to the new law was regarding section 7 of the Code on the ground that it violates principles of natural justice. Section 7 empowers the Adjudicating Authority (AA) to reject a corporate insolvency resolution process (CIRP) application without a hearing. Rejecting this contention, the Court opined: ‘where the statute is silent on the right of hearing, and it does not in express terms, oust the principles of natural justice, the same can and should be read into it.’ Hence, the Courts have held that the AA should hear the corporate debtor (CD) before admitting or rejecting any matter.
The validity of sections 7, 8 and 9 was challenged again, before the Calcutta High Court on the ground that the differentiation between operational creditors (OCs) and financial creditors (FCs) violated the constitutional guarantees of equality. Rejecting this argument, the Calcutta High Court (HC), accepted the rationale given by the Bankruptcy Law Reforms Committee (BLRC) that the FCs were better suited, on various counts, to decide the fate of the CD. The Calcutta HC rejected the challenge to these sections.

Finally, in 2019, Hon’ble Supreme Court of India (SC) in Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors held that the constitutional validity of the Code in its entirety. The Court, laying to rest several issues which arose due to the departure of the Code from previous laws governing insolvency, reiterated the legislature’s right to experimentation in the field of economic legislation and the courts’ obligation to stay away from interfering with the same.

The petitioners had challenged the constitutionality of various provisions of the Code such as sections 7, 9, 12A, 21, 24, 29A, and 53. The principal argument was that the distinction between FCs and OCs was uncalled for and discriminatory. The SC took into account commercial realities especially the fact that most FCs are secured creditors, they lend more significant amounts for working capital or term loans, have a better understanding of the viability of the CD and also have the capacity to take hair-cuts in the interest of preserving the debtor as a going concern. On the other hand, agreements with OCs involve smaller sums which are mostly in the nature of service agreements or work contracts. Hence, financial considerations and procedural distinctions between the two groups, whether on the point of dominance of the committee of creditors (CoC) or in the manner of invoking the CIRP, are based on ‘intelligible differentia’.

Finally, the Hon’ble SC concluded that the distinction is ‘neither discriminatory, nor arbitrary, nor violative of Article 14 of the Constitution of India’ and these amendments stood ground.

**Position of a lessor**

Judicial engineering has also brought in a Lessor- Lessee relation within the ambit of the Insolvency laws. In Mobilox Innovations Private Limited v. Kirusa Software Private Limited the SC, relying on the BLRC brought in a lessor into the Code as an OC. Relying on this matter, the National Company Law Tribunal (NCLT) delineated this concept and held: ‘receiving any consideration by way of rent, lease from time to time or license fee for letting out the premises falls under the purview of providing services, and the consideration that is receivable becomes an ‘Operational Debt’. Accordingly, the Court held, that ‘arrears of rent’ would be like operational debts within the Code.

Judiciary has also brought home buyers within the scope of the law, who otherwise could have proceeded to the consumer fora and also the real estate stakeholders who should have continued to be in the ambit of Real Estate (Regulation and Development) Act, 2016 (RERA). The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018, and subsequently the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 included home buyers in the category of FCs. It also inserted a proviso to section 7 which states that in the case of homebuyers, an application under section 7 ought to be filed jointly by at least 100 allottees under the same real estate project or 10 per cent of the total number of such allottees, whichever is less.

**Section 29A: Preventing a backdoor entry for defaulting promoters**

The Swiss Ribbons decision also saw a challenge to section 29 A, which was introduced through the Insolvency and Bankruptcy Code (Amendment) Bill, 2017. Section 29A stipulated the ineligibility criteria
for submitting a resolution plan, an aspect missed out in the original version of the Code. This omission permitted back door entry to defaulting promoters. It enabled them to regain control of the assets at a fraction of the original price. This in essence meant: ‘I am not making the account operational. The account will continue to be NPA, and yet I am going to apply for this.’ These concerns were reflected in the Statement of Objects and Reasons, to the 2017 amendment. However, a fundamental difference existed between those who were/are in management and responsible for the account to become insolvent or a non-performing asset (NPA) and those who had not contributed to the mismanagement of the CD but held the NPA account only because of acquisition of a stressed asset. The Insolvency Law Committee (ILC) felt that the new section 29A should only disqualify those who had contributed to CD’s downfall either directly or indirectly. The SC elucidated this issue in Chitra Sharma v. Union of India: ‘the provisions of section 29A are intended to ensure that among others, persons responsible for the insolvency of the CD do not participate in the resolution process.’ Section 29A was provided foundational stability by virtue of clause (c).

The Constitutional validity of section 29A was challenged on several counts in Swiss Ribbons. Specific emphasis was placed on the contention that vested rights of erstwhile promoters to participate in the resolution process and regain control of the corporate entity were impaired by retrospective application of section 29A. Further, the period of one year prescribed in section 29A for disqualification to apply was arbitrary and lacked basis. The provision could keep out a person not having any business connection with the erstwhile promoters only because he falls in the definition of a ‘relative.’ Before going into details on each of these grounds, it is essential to cover another challenge attacking the very root of the disqualification of un-equals being treated as equals.

Treatment of un-equals as equals

It was argued that a blanket ban, without distinguishing between sincere and unscrupulous promoters, amounted to ‘treating unequals as equals’ which was violative of Article 14. The ‘unequals being treated as equals’ argument was rejected.

Retrospective Application

On the point of retrospective application, the SC opined that no vested rights (were?) bestowed on anyone to have their resolution plans approved, and therefore, no right was being taken away by retrospective applicability of the section 29A. In fact, the SC had, in earlier matters, concluded on the absence of vested rights in resolution applicants (RAs) and the same dicta held ground.

Arbitrariness of the One-Year Period

Justifying the ‘one-year period,’ the SC referred to the Reserve Bank of India’s (RBI) Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances dated July 1, 2015. It held that a person’s accounts are classified as NPA only when the debt remains overdue for more than 90 days. After that, one year of grace period is granted to the defaulter to pay off this debt, and if the defaulter is still unable to pay off the debt in this period, the person becomes ineligible to become a RA. The SC recognised the ‘legislative policy’ that a person who is unable to service its debt beyond the grace period is unfit to become a RA. The one year, as stated in section 29A, was thus sealed.

Arbitrariness in relatives being excluded

On the next argument concerning ousting of a ‘related person’ from being an eligible RA, the Hon’ble SC clarified that to be kept away under section 29A, the person needs to have ‘a connection with the
In the absence of showing that such a person is ‘connected’ with the business or the activity of the resolution applicant, such person cannot possibly be disqualified under section 29A(j). More specifically, if such a person, disqualified under provision (c), repays the debt with interest before submission of the plan, he can be eligible to be a RA. The Hon’ble SC distinguished between de facto as opposed to de jure position of the persons mentioned therein. It referred to this as a ‘see-through provision’ where each case would have to be examined on merits to determine whether, in the facts of a particular case, the disqualification would be applicable.

Furthermore, the terms ‘acting jointly’ and ‘in concert’ (as appearing in the opening line of section 29A) were also interpreted by the SC- ‘acting jointly’ is not to be confused with joint venture agreements. Instead, what is to be seen is whether certain persons are or were acting together or whether such persons shared an objective or purpose. The term ‘control’ as appearing in the phrase ‘under the management or control’ in clause(c) is interpreted to include positive control, where someone can positively influence in any manner whatsoever, the management or policy decisions. ‘Management’ would refer to de jure management such as the board of directors, manager, officer.

Further Clarifications to Section 29A

The challenge to clause(d) of section 29A on its applicability to a juristic person was settled in Renaissance Steel India Pvt. Ltd. & Ors. v. Electrosteeels Steel India Ltd. & Ors. The Hon’ble National Company Law Appellate Tribunal (NCLAT) giving a purposive interpretation held that a corporate entity could also be disqualified under section 29A(d) if, upon lifting of the corporate veil, it is evident that a natural person has been convicted of an offence while operating on behalf of such company.

Another provision which was the subject of a challenge was section 29 (h). Prior to the 2018 amendment, the issue whether a guarantor of a CD was also ineligible to participate in a resolution process had come up for adjudication before the NCLT. The Hon’ble Tribunal held that the legislature would not have intended to debar all the promoters, only because they have issued an enforceable guarantee unless such guarantee had been invoked and not paid for, or the guarantor suffered from any other antecedents listed in section 29A. Subsequently, the 2018 amendment stated the law that a guarantor would be ineligible if the guarantee has been invoked by the creditor and remains unpaid in full or part.

Thus, section 29A brought in by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, was enacted in the larger public interest and to facilitate effective corporate governance. Due to the absence of any precedents on this aspect of the law, it is expected that many judicial journeys would lie ahead further clarifying the various provisions.
Flexibility and Autonomy: Section 12A

A significant amendment, propagating value addition and asset maximization, ensuring more flexibility and autonomy to the creditors, as well as enhanced opportunities to the CD, is section 12A, introduced by the 2018 amendment.22 This amendment followed the mandate of the SC in the matter of Uttara Foods and Feeds Pvt Ltd v. Mona Pharmacham.23 The Hon’ble SC held that relevant rules under the Code need revision to ‘obviate unnecessary appeals to the SC in matters where an agreement between a CD and the creditors has been reached.’24 Subsequently, the constitutional validity of section 12A was upheld in the matter of Swiss Ribbons.25

Before this amendment, the NCLAT had held that once the CIRP is initiated by admitting the application, it cannot be withdrawn nor can it be set aside ‘except for illegality to be shown or if it is without jurisdiction or for some other valid reason’26. The SC intervened to exercise its powers under Article 142 of the Constitution, taking into consideration the settlement reached between the parties. The amendment has now settled this position.27

This is another case of legislative amendment following a judicial verdict highlighting a lacuna in the Code as originally enacted. Today the matter stands sealed.

TIMELINES: LIFEBLOOD OF THE RESOLUTION PROCESS

The Insolvency and Bankruptcy (Amendment) Act, 2019, introduced section12(3), which capped the time limits at 330 days from the insolvency commencement date (ICD). The 2019 amendment followed the resolution process of Essar Steel Ltd, where the time taken for the entire CIRP process was over 700 days, as against the 180 days prescribed in the Code.

The importance of timelines in the scheme of the Code, with a thrust on ‘value preservation’ and ensuring that the entity remains a ‘going concern’, has always been highlighted through legislative amendments as well as judicial pronouncements. The need for adherence to strict timelines has been re-emphasized in Arcelor Mittal. Section 12 requires the process to be completed in 180 days, extendable by 90 days (only once). Section 34, clause 3, makes this compulsion of timelines clearer. The SC after taking note of sections 12, 13 to 15, 17, 18 (1), 21, 22, 29, 30 and 40 A, re-emphasised that a reasonable and balanced construction of the statute is necessary and ‘the time (is) taken in legal proceedings to decide the matter cannot possibly be excluded, as otherwise, a good resolution plan may have to be shelved, resulting in corporate death and the consequent displacement of employees and workers’.

OVERRIDING POWERS OF THE CODE: SECTION 238

Section 238 of the IBC has attracted significant judicial discourse. Section 238 gives overriding powers to the Code to sweep over any other legislation.28 With this powerful tool, the Code has stood its ground against several challenges.

Way back in 2017, while deciding on the test of repugnancy, the SC had observed that if a state legislation were identical to central legislation in a manner where both could not stand together, then the state legislation would be said to be ‘repugnant’ and the central legislation would prevail. This was the case of Inventive Industries Ltd v. ICICI Bank and Anr.29 where the FCs had filed an application before the NCLT for initiating the CIRP in a situation where Maharashtra Government had passed a relief order under Maharashtra Relief Undertaking (Special Provisions) Act, 1958 (MRUA) and the debtor
sought to argue that the liabilities stood suspended. The SC had observed that the non-obstante clause, contained in section 4 of MRUA would be subservient to section 238 of the Code.

In *Sterling Sez Infrastructure Ltd v. Deputy Director of Enforcement* the NCLT held that attachment of property by the Enforcement Directorate under Prevention of Money Laundering Act, 2002 (PMLA), while the moratorium is in force, would be null and void on several justifications, including section 238, which lends supremacy to the Code over any other statute.

A contrary view was expressed by the Delhi HC in *The Deputy Director Directorate of Enforcement Delhi v. Axis Bank* where the Court observed, besides other points, that section 71 of the PMLA, would have an overriding effect over other existing laws in the matter of dealing with 'money-laundering' and 'proceeds of crime'. At the same time, the Court cautioned that other ‘debt recovery statutes like Recovery of Debts and Bankruptcy Act, 1993, Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and the Code must co-exist in harmony with PMLA’.

There could be several fallouts of such reasoning. Firstly, the IBC is not a mere ‘recovery’ statute but is concerned with resolution and restructuring. Needless to state, under the Code’s waterfall mechanism, the Government stands last in the priority in receiving its dues. Therefore, the overriding effect of the PMLA may just be a less time-consuming route for the Government in claiming its dues.

Again, in the matter of *Roofit Industries Ltd.* after an order of liquidation had been passed, the occupant of one of the assets owned by the CD filed a civil suit seeking direction or decree for the grant of a prohibitory injunction restraining the liquidator etc. from disturbing, what he claimed was, his lawful possession, and emphasised that he had built a wall surrounding the property which gave him the rights over it. The NCLT quashed the civil suit relying on section 33(5) of the Code. It appeared as if the NCLT had taken upon itself the rights of a writ court. Someday the SC may need to settle this too!

Lately, in *Bhanu Ram v. HBN Dairies*, the NCLT held that the Code has precedence over the Securities and Exchange Board of India Act, 1992 (SEBI Act). Therefore, once the moratorium period has been declared, SEBI does not have the power to attach any property of the debtor. The NCLAT has upheld this judgement and an appeal is pending before the SC. The SC has previously held that by virtue of section 238 of the Code, the Code will override anything inconsistent contained in any other enactment. The verdict of the SC on the clash of the titans is awaited.

THE CODE AND ITS UNDERLYING INTENT

At the centre of the IBC regime is the aim of achieving a balanced resolution plan, compliant with applicable laws which can be all-engulfing. It may take in its sweep any formula for restructuring and include promoters of the erstwhile CD so long as the objectives of the Code, i.e. ‘value preservation’ and ‘going concern’ are met. This provision is meant to facilitate proposals to rescue commercially viable insolvent entities.

The Code has been amended to necessitate an affidavit, along with the resolution plan, stating that the applicant meets with the eligibility criteria under section 29A and also reducing the voting percentage in the CoC from 75 per cent to 66 per cent. The plan should aim at ‘resolution’ and ‘restructuring’ rather than ‘recovery’ and include in its ambit payment of costs in preference to payment of debts, repayment of OCs, promotion of entrepreneurship, availability of credit, the balance of interest of all stakeholders, maximisation in the value of the asset and compliance with applicable laws et cetera. In short, rescue a viable but failing entity.
The roles and responsibilities of all the players/stakeholders are clear- the RA, desirous of saving an insolvent but viable entity, makes an application to the resolution professional (RP) who has the limited role of ensuring that the request meets the requirements as stated in the law. He is given no other option but to submit the plan to the CoC. They shoulder the primary responsibility of approving the plan after applying their minds to the feasibility and viability thereof. This is the most crucial step in the process and determines the future of the entity. Once the CoC approves the plan, the RP must submit it to the AA. \(^{35}\) The SC has emphasised this in *K Sashidhar v. Indian Overseas Bank.*\(^ {36}\) On receipt of such a proposal, the AA is required to satisfy itself that the resolution plan, as approved by the CoC, meets the requirements specified in section 30(2) of the Code; no more and no less.

In cases where the CoC does not approve a plan, there is no other option left with the RP but to invite new plans. At this stage, the law does not contemplate challenging the decision of the CoC before the AA as there is no vested right or fundamental right in the RA to have its resolution plan approved. The role of the AA is limited to being satisfied that the plan, as approved by the CoC, meets the requirements of section 30(2). Nothing beyond. AA has no jurisdiction or authority to analyse or evaluate the commercial wisdom of the CoC.

In *Binani Industries Ltd. v. Bank of Baroda & Anr,*\(^ {37}\) the resolution plan, as approved by the CoC, and upheld at the NCLT, envisaged payment of 35 per cent of the verified claims (of about Rs. 90 crores) to the OCs as against payment of 100 per cent to FCs.\(^ {38}\) Related parties were entitled to nothing. In appeal, the NCLAT cautioned that any resolution plan, if shown to be discriminatory against one or other FC or the OC, would be against the provisions of the Code. The Appellate Authority also cautioned that if the OCs are ignored and provided with ‘liquidation value’ [based on a misplaced notion and misreading of section 30(2)(b)] then no creditor will supply goods or render services on credit to any CD.

**CONCLUSION**

The last of the amendments is the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 promulgated as recently as on June 5, 2020. This amendment has been triggered on account of the economic distress caused by the ongoing COVID-19 pandemic. The Government has suspended the operation of sections 7, 9 and 10 of the Code in order to prevent defaulting corporates that are experiencing distress from being pushed into insolvency. It has often been argued in the last couple of months that the likelihood of finding White Knights to rescue an entity would be difficult in these times of economic distress. Cases of default prior to March 25, 2020 (the start of the lockdown) have been expressly excluded in the explanation. Hence, the bar under the newly inserted section 10A is on filing of insolvency applications for defaults committed from the period starting March 25, 2020 and continuing till the end of six months or the extended period as the case may require. Government has also enhanced the limit of Rs. one lakh to Rs. one crore for initiation of CIRP.

The Code has been a successful economic instrument to revive corporate entities which would otherwise have faced liquidation. It has brought about a complete reversal of policy, switching from recovery to revival. Liquidation is only when the last opportunity of revival does not succeed.

The over-ambitious timelines fixed by the legislature had been breached in quite a few cases. If the essence of the Code is value preservation then should not the same strictness in adherence to timelines be applicable to the judiciary and also to the Bar when it comes to seeking adjournments on various grounds? As things stand, the resolution process has taken an average of 340 days to conclude as against the time limit of 330 days envisaged in the Code. When we compare that with the pre-IBC
period of 4.3 years required for the completion of the processes, one realises the magnitude of the revolution brought by the new regime. The economic scenario brought about by the COVID-19 pandemic is putting the new framework to its severest test yet. The executive has in the circumstances, shown great dexterity in adjusting the sails to duck the storm through the issue of the June, 2020 Ordinance. Further developments need to be seen in the months to come.

NOTES

* Author would like to thank Mr. Shriraj Khambete, Senior Associate, The Law Point, for assistance.
1 Report of the Joint Parliamentary Committee on Insolvency and Bankruptcy (2019), 17th Lok Sabha.
2 Section 7 deals with initiation of CIRP by an FC.
7 The Court held: ‘When considering an application for staying the operation of a piece of legislation and that too pertaining to economic reform or change, then the courts must bear in mind that unless the provision is manifestly unjust or glaringly unconstitutional the courts must show judicial restraint in staying the applicability of the same.’
8 (2018) 1 SCC 353.
9 Similarly, ‘the lessor that the entity rents out space from is an OC to whom the entity owes monthly rent on a three-year lease.’ Ibid, para 16.
11 Stated by the Hon’ble Minister of Finance and Corporate Affairs, Late Shri Arun Jaitley, while moving the Insolvency and Bankruptcy Code (Amendment) Bill, 2017 - December 29, 2017 on the floor of the House.
12 ‘Concerns have been raised that persons who, with their misconduct contributed to defaults of companies or are otherwise undesirable, may misuse this situation due to lack of prohibition or restrictions to participate in the resolution or liquidation process, and gain or regain control of the CD’.
16 Section 29A (j) provides that any ‘connected person’ ineligible through clauses (a) to (i) would also
be ineligible.

17 As provided under Explanation I to section 29A(j) which defined the term ‘connected party’.

18 Supra Note 15.

19 Section 29A (d) disqualifies a person who has been convicted for any offence punishable with imprisonment for two years or more under any Act specified under the Twelfth Schedule or for seven years or more under any other law for the time being in force.

20 146 CLA 216.

21 RBL Bank Ltd. v. MBL Infrastructures Ltd; CA(IB) No. 543/KB/2017 arising out of Company Petition (IB) No.170/2017.

22 Insolvency and Bankruptcy Code (Second Amendment) Act 2018, (No: 26 of 2018).


24 Ibid.

25 In Swiss Ribbons, the SC relied upon the report of the ILC of March, 2018 which led to the insertion of section 12A: the 90% threshold has been explained as all FCs ‘have to put their heads together to allow such withdrawal as, ordinarily, an omnibus settlement involving all creditors ought, ideally, to be entered into’. Again, the Court analysed under section 60 of the code that the CoC does not have the last word on the subject. If the CoC arbitrarily rejects a just settlement then the NCLT, and thereafter NCLAT, can always set aside such decision under section 60 of the Code.

26 Binani Industries Ltd v. Bank of Baroda, Company Appeal (AT) (Insolvency) no 82 of 2018.

27 Section 12A permits AA to permit the withdrawal of an application submitted under section 7,9 or 10 by the applicant with the approval of 90% voting share of the CoC.

28 Section 238 states ‘notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.’

29 (2018), 1 SCC 407.


33 Section 52, ‘when a liquidation order has been passed, no suit or other legal proceedings shall be instituted by or against the CD: Provided that a suit or other legal proceedings may be instituted by the liquidator, on behalf of the CD, with the prior approval of the adjudicating authority’.

34 (IB)-547(PB)/2018.

35 Mr. Bohar Singh Dhillon v. Mr. Rohit Sehgal (IRP) & Ors., Company Appeal (AT) (Insolvency) No.665/2018.


Towards this end, we have initiated far-reaching legal reforms. Over a thousand archaic laws have been scrapped. We have enacted a comprehensive Insolvency and Bankruptcy Code, 2016, implemented the National Company Law Tribunals.... Further, in harmony with the Bankruptcy Code, we have amended the SARFAESI and DRT Acts this year to suit the changing credit landscape and augment ease of doing business.

- Shri Narendra Modi, Hon'ble Prime Minister of India in his address at National Initiative towards Strengthening Arbitration and Enforcement in India, October 23, 2016.
Theoretical Framework of Insolvency Law

Medha Shekar and Anuradha Guru

It is important to recognise that the world in which we live and the creation of wealth depends upon a system founded on credit and that such a system required as a correlative, an insolvency procedure to cope with its casualties.

- The Cork Committee

INTRODUCTION

Non-viable businesses need to be allowed to fail so that the larger economic ecosystem can reallocate resources from non-viable projects to viable initiatives. This is, in a sense, a sine qua none of an efficient, effective, efficacious economic system. The important role of exit mechanisms for businesses has also been recognised by Joseph Schumpeter, the 20th century economist, who argued that innovation by entrepreneurs leads to what he described as 'creative destruction'. He suggested that: ‘Capitalist reality is first and last a process of change.’ For this change to be facilitated, entrepreneurs need to be provided easy entry and exit opportunities from the markets. The purpose of insolvency and bankruptcy law is to provide an orderly process for such an exit.

This article explores the theoretical underpinnings of various aspects of the insolvency and bankruptcy laws which work towards meeting its objectives, looking away from bankruptcy being envisaged mainly as a practical and legal matter. The first step is to understand the differing views that Traditionalist and Proceduralist theories have on the role of insolvency law and manner of its conduct. What aspects of these theories are embodied in the Indian insolvency law, the Insolvency and Bankruptcy Code, 2016 (IBC/Code) is discussed further. While doing so, the authors blend the theories into questions of why formal insolvency procedures are required in the first place and how the IBC holds as against these theories. Some theories guiding the procedure of distribution or entitlement in bankruptcy among a group of agents and the manner in which IBC stands against them are also explored.

TRADITIONALIST AND PROCEDURALIST PERSPECTIVES ON CORPORATE INSOLVENCY

There are two dominant theoretical schools in the field of insolvency and bankruptcy law, viz. ‘Traditionalist’ and ‘Proceduralist’. These two camps of theories were first discussed in detail in the celebrated article of Douglas G. Baird (1998). These two theoretical schools have differing perspectives on the role of insolvency law in the reorganisation and rescue of insolvent but viable businesses; the substantive law
that is or ought to be applied in a bankruptcy process; the inter-se rights of different types of creditors and the role of judges in interpreting insolvency disputes during insolvency proceedings.

While the Traditionalists, such as Korobkin (1993) propose a more inclusive approach to resolving corporate insolvency that takes into consideration the interests of all stakeholders, Proceduralists contend that insolvency law should address issues that arise only within bankruptcy and non-insolvency creditors should not be protected by law unless doing so maximises value for creditors, such as Alan Schwartz (1998).

Traditionalists believe that the objective of insolvency law should be to reorganise a financially distressed company and avoid liquidation so as to maintain the going concern value of the business and preservation of the company itself. On the contrary, Proceduralists advocate that the question of life or death of a company should be a market-determined process. The insolvency law should not attempt to prolong the life of a sick company and should only strive to prevent premature liquidation of the company due to uncoordinated creditor actions. Proceduralists also contend that secured creditors should have the same absolute priority in an insolvency setting as in a non-insolvency setting. They believe that calls for fairness or equality of distribution, such as to employees and other stakeholders, twist these rights of secured creditors and that such principles should have no place in insolvency laws unless they are given effect outside bankruptcy. Au contraire, Traditionalists propagate principles of fairness and equity for all stakeholders as it increases the probability of reorganisation of the distressed company and minimises chances of liquidation.

The role of the judiciary in the insolvency law is also viewed through opposite lens by Proceduralists and Traditionalists. The role of the judge is envisaged to be to minimise stakeholders’ conflicts, ensure transparency and integrity of the entire process by the Proceduralists. Their role is not to question the commercial wisdom of the creditors. Traditionalists however rely on the judges for upholding the equity goals of an insolvency law on a case by case basis and suggest that judges should exhibit broader discretionary powers.

Ted Janger (2001) summarised Baird's identification of the important aspects of the Traditionalist-Proceduralist divide, as follows:

According to Douglas Baird, three litmus test questions, or axioms, determine a scholar’s affiliation. These questions are (1) whether the Bankruptcy Code should seek to rehabilitate firms; (2) whether bankruptcy judges should alter non-bankruptcy entitlements in order to rehabilitate firms; and (3) whether bankruptcy judges are capable of distinguishing likely candidates for reorganization from firms that are destined to fail. The paradigmatic proceduralist answers “no” to each question, while the paradigmatic traditionalist answers “yes” to all three.

Having recognised these two schools of thought on the role of insolvency law and its contours, the next section explores what aspects of these theories have found favour in the design of the IBC in the Indian context.

FORMAL INSOLVENCY PROCEDURES

When a firm becomes insolvent, there are two options before its stakeholders to resolve the insolvent firm. They can either choose informal out-of-court workouts such as pre-packaged restructuring, alternative dispute resolution mechanisms or choose formal insolvency proceedings that are overlooked
by a Court or Tribunal. The pros and cons of each procedure have been well documented by scholars. However, due to the inherent conflict of interest between the various stakeholders of the corporate debtor (CD), especially the promoters/managers and the creditors, peculiar problems emerge which can be effectively resolved through formal insolvency procedures. In fact, some of the negative fallouts of informal insolvency procedures can be mitigated when such procedures are fused with formal insolvency procedures backed by legislation. In this section, how information gaps, conflict of interest and perverse incentive structures between the managers and the creditors of the CD can be resolved through formal insolvency and bankruptcy procedures such as the IBC is discussed. Further, this section also delves into the debate of high bankruptcy costs in formal procedures and how the IBC is striving to minimise them.

**Information Asymmetry**

The renowned ‘market for lemons’ hypothesis by George Akerlof explains how information asymmetry can affect choices made by the parties to a transaction. In the context of insolvency and bankruptcy, information asymmetry seeps in when the insiders, that is, the promoters and equity holders of the CD have more information about the affairs of the CD than the outsiders who are the creditors and the debtholders. In a precarious situation such as this, the outsiders may not be able to differentiate between a ‘good firm’ and a ‘bad firm’ in terms of value, viability, and future prospects of the firm, while the promoters/management (who may hold a major equity shareholding, a scenario which is typical of Indian corporates) are privy to such valuable information. This creates an asymmetry of information between the equity and debtholders of the CD.

Firms can signal their type, whether ‘good firm’ or ‘bad firm’, by offering the creditors a carefully calibrated debt-equity package. One theory suggests that the presence of information asymmetry between public debt holders and firm insiders ensures that firms with adverse private information will offer highly contingent claims such as equity to bondholders, while firms with favourable private information will offer the least contingent claim possible, such as senior or secured debt. Information asymmetry frustrates the chances of negotiating a private workout between the promoters/managers and creditors of the CD. In the presence of asymmetric information distressed firms may in fact forgo private or informal workouts and enter the formal resolution process to resolve financial distress. The Bankruptcy Law Reforms Committee (BLRC) in its report recognised that asymmetry of information was a critical barrier to fair negotiations or ensuring swiftness of the process. A formal insolvency proceeding is an ‘information revelation process.’ In a formal insolvency proceeding, the court can force mandatory information disclosure on all relevant aspects of the firm to the extent desirable to the creditor and the court. The substantial amount of judicial discretion in the formal proceedings may help mitigate the asymmetric information problem between bondholders and stockholders about the firm value.

The IBC facilitates the ‘information finding’ and ‘information revelation’ process when a CD formally enters the corporate insolvency resolution process (CIRP). The BLRC noted one of the principles of design of the Code as an enabler of symmetry of information between creditors and debtors including third parties who can participate in the resolution process, through the regulated professional.

As the control of the CD shifts away from the CD’s promoters/management to the Insolvency Professional (IP), the process of attenuating asymmetric information problems begins immediately. The BLRC envisaged the role of the IP to be the manager of all information about the CD so that debtors and creditors are equally informed about the business and viability of the entity during the negotiations.
To this effect, the IP furnishes an Information Memorandum to the committee of creditors (CoC) which details all material information about the assets, finances, operations and more importantly the value of the CD. This enables the CoC to gauge the economic and financial viability of the CD. The IP conducts a thorough inspection into the financial transactions of the CD to unearth any preferential, undervalued, fraudulent and extortionate transactions. Further, the IP regularly files progress reports to the Adjudicating Authority (AA), making extensive disclosures about the CIRP of the CD. The IP shares vital information about the CD with the resolution applicants (RAs) to facilitate drawing up of viable resolution plans based on credible information. All the resolution plans received for resolution of the CD are laid before the CoC for its consideration, enabling it to weigh the options of resolution or liquidation objectively. The IBC thus tips the balance scale for both outsiders and the insiders in the information disclosure process. It grants credibility to the information revelation process.

Another facet of information asymmetry addressed by the BLRC is the inability of the creditors to assess revenue flows and assets over which the debtor has a beneficial control or exercises a power over its disposition. The Committee thus suggested creating provisions in the law that would capture all possible violations that the debtor may engineer to maintain opacity over his assets and deny the creditors access to those assets that legally fall within the ownership of the insolvent. To this effect, the Code provides for the IP to report to the AA any preferential, undervalued, extortionate, or fraudulent transactions noticed by him.

**Hold-out Problem**

Hold-out problems arise when there are multiple groups of creditors, creating incentives to holdout, or to free ride, especially when a reorganisation plan allows creditors to decide whether to participate or not. In a hold-out situation, a group of creditors decline to participate in the restructuring work of a firm and use this as a leverage to pocket value for themselves by demanding full payment of their dues either from the firm or from the other creditors and become ‘free riders’. Free riders are those creditors that do not contribute to the restructuring of the firm, at the expense of cuts by other creditors, but garner gains of a financially stable firm once restructuring is complete. Simply put, hold-out creditors that are unsuccessful in preventing restructuring become free riders when restructuring is successful. Studies have shown that private workouts and the conflicting interests of creditors give rise to coordination failure and result in a free-rider or hold-out problem among creditors. A legal bankruptcy procedure resolves these problems because the bankruptcy court plays the coordination role.12

The IBC is designed to effectively resolve the free rider problem. While the Code was being designed by the BLRC, it provided that the Code will ensure a collective process that allows all stakeholders to collectively assess viability of a firm. It envisaged that all creditors who have the capability and the willingness to restructure their liabilities must be part of the negotiation process while also providing that the liabilities of creditors who are not part of the negotiation process must also be met in any negotiated solution. By clearly laying out the priority of distributions in bankruptcy to all stakeholders, the BLRC envisioned to incentivise all stakeholders to participate in the cycle of building enterprises with confidence.

In line with the vision of the BLRC, the Code incentivises creditor participation. The CoC under the IBC comprises of financial creditors (FCs) who have the right to vote on decisions and operational creditors (OCs) who can participate in the CoC but cannot vote. The CoC facilitates coordination between various creditors and strives to balance the interest of all stakeholders. Major decisions of the CoC, such as appointment of the Interim Resolution Professional (IRP) as Resolution Professional (RP), approval of resolution plan or decision to liquidate the CD, are taken with a majority vote of 66 per cent or more.
This majority vote is binding on all members of the CoC. The binding nature of decisions of the CoC dilute the possibility of hold-outs by a creditor or creditors. In fact, this voting threshold was brought down from 75 per cent to 66 per cent with the very objective of mitigating hold-out problems. The IBC allows creditors to decide the fate of the firm as well as the fate of their dues. The creditors get to retain synergies generated if the firm is resolved or receive their dues in accordance with the waterfall mechanism prescribed in section 53 of the IBC in case the firm is liquidated. The BLRC noted that a sound legal framework provides procedural certainty about the process of negotiation, in such a way that it reduces problems of common property.

Conflict of Interest in Value Estimation

The resolution of a firm effectuates a change in the value of the assets of the distressed firm. In case of a private workout, different stakeholders perceive a different value of the firm, based not only on differing information but also conflicting interests between them. Each class of claimants has an incentive to present a biased estimate of firm value depending on the priority of its claims and the management also has its own biased estimate. For example, those situated at the lower end of hierarchy of claims will favour an upward biased estimate of firm value as this would increase the share of firm value they receive. Similarly, senior claimants would favour a downward-biased estimate as this would increase their share in firm value if eventually the firm ends up performing well. The managers have an incentive to value the firm above its liquidation value to save their jobs, but below the true value (if it is higher than the liquidation value) so that they can deliver ‘abnormally’ good equity performance post the distress resolution.

The aforesaid biases can lead to conflicts of interest between various stakeholders, making the probability of resolution bleak outside a formal resolution framework. The IBC seeks to ameliorate such conflicts by enabling coordination and cooperation amongst the members of the CoC. It has laid down an objective mechanism for estimation of value of the CD. When CIRP is initiated, the IBC mandates estimation of fair value and liquidation value of the assets of the CD. The estimation of these values lies in the capable hands of registered valuers (RVs) who are qualified and carefully screened by the Insolvency and Bankruptcy Board of India, the regulator, under IBC before they can be employed in CIRPs. The RV’s estimates are realistic and scientific. These values serve as reference for evaluation of choices, including liquidation, and selection of the choice that decides the fate of the CD and consequently of all the stakeholders. Formal insolvency procedures aid in dissipating the smoke screen of incredulous firm value that the managers may portray to the outsiders.

Investment Incentives and Debt Overhang

The investment incentive problem arises when inefficient investment decisions are taken by the managers of a CD due to the inherent conflict of interest between the shareholders and the bondholders. The managers feel that benefits of a good investment will end up flowing to creditors instead of them. In the absence of a formal insolvency framework, the managers (acting on behalf of shareholders) of the CD may hold the upside potential of an investment project fixed, and prefer projects with lower payoffs in states of bankruptcy, because that would induce individual bondholders to accept poorer terms in a debt exchange offer, thus generating a greater residual for shareholders in states of solvency. As explained by Myers (1977), due to the absolute priority rule that is accorded to debtholders, the managers have an incentive to pass up projects with positive net present values when such returns are certain. This is the classic under-investment problem.
The conflict that arises in the approach of the creditors and debtor to preserving the time value of their own investment was also flagged by the BLRC in its report. The report rightly identified that creditors have the incentive to close out their investments quickly to avail of alternative investment opportunities. On the flip side, the debtor has the incentive to hold on to the assets, either to benefit from potentially higher returns by deploying the assets in more risky ventures or to benefit by stripping asset value.

Another form of under-investment problem is that of debt-overhang. Sometimes firms can accumulate such large proportions of debt that almost all earnings of the company are spent on servicing the debt, leaving small amount for investment. The under-investment problem will arise in such a situation when the managers exercise their discretion on whether a new investment should be taken or not. The managers will have a bias as they know that any increase in the firm’s value, on account of the investment, will be split with the firm’s creditors. At the same time, they will have an incentive to invest in riskier projects, as the upside of such investments will accrue to them, while the downside risk will be borne by the creditors.

The debt-overhang problem is maximised when the firm is insolvent because it may be unable to finance projects at all if later lenders are subordinate to earlier ones (or even take pro rata). In the US, the Bankruptcy Code authorises the bankruptcy court to give later lenders a super priority in any (or all) of the firm’s assets, which mitigates the debt-overhang effect for insolvent firms. Literature indicates that the debt-overhang and the consequent underinvestment problem can be reduced by various measures such as: (a) creditors can forgive a part of their debt, renegotiate it or give up their seniority to reduce the debt burden (although these offer only a partial solution); (b) shortening debt maturity; (c) matching the maturities of the firm’s assets and liabilities; and (d) covenant restrictions in the debt contract that preserve the value of senior debt such as restricting the financing policy, maintaining the seniority, limiting leverage ratios, etc.

A formal insolvency and bankruptcy process, such as the IBC, can effectively mitigate the problems identified in the aforesaid discussion. By taking away control from managers and prescribing their ineligibility in submission of resolution plans vide section 29A, any vested interests which may translate into underinvestment problems are effectively stalled by the IBC. This allows creditors to take charge of the firm through the RP. The creditors can choose which resolution plan received from RAs has the potential to restore the health of the firm thereby improving its investment prospects in the future. The creditors can choose to take a few haircuts on their own or restructure their loan contracts by tweaking maturities or inserting contract covenants to resolve the debt overhang problem of the CD. The creditor-in-control feature of the Code allows the creditors to objectively assess the viability of the CD and incentivises them to consider resolution of the CD for their own good.

**Bankruptcy Costs**

There are *ex post* or deadweight costs associated with insolvency and bankruptcy procedures. The direct costs of bankruptcy are in the form of payment of legal and professional fees. As the time taken in resolving or liquidating the CD increases, the cost of engaging professionals also rises. There are indirect costs of bankruptcy as well. Altman (1984) has identified these indirect costs to be disguised in the form of inefficient investments induced by the reorganisation process, disruptions in the relationship of the firm with stakeholders such as capital providers, customers, suppliers etc., causing increase in input costs, reduction in product demand as customers fear that the firm may go bankrupt again and flight of key personnel to other competitor firms. There is also the probability of certain social costs that may arise if a viable firm, whose going concern value is higher than liquidation value, is liquidated.
While there is a large amount of literature that points to the fact that the direct costs of bankruptcy are not that significant, the studies pertaining to indirect costs have shown mixed results. Some studies indicate indirect costs to be quite significant like that of Altman (1984) while others suggest the costs are insignificant, like Andrade and Kaplan (1998).

Castanias (1983) finds that firms with high probabilities of bankruptcy employ smaller amounts of debt. He concludes that this is consistent with significant ex-ante costs associated with bankruptcy. These ex-ante costs are perceived to be the perverse incentives for incumbents when they expect that financial distress is imminent. These costs, also known as ‘financial agency costs,’ are more pronounced where the interests of shareholders and managers are closely aligned as in the case of a closely-held debtor.

Even though there are mixed empirical results on the indirect costs of bankruptcy, whether significant or not, the BLRC was of the view that under a common law in the form of IBC, the resolution can be synchronous, less costly and help more efficient recovery.

The IBC provides for a creditor to trigger insolvency against a CD using evidence of a default through an Information Utility (IU) which is a central repository of financial information of CDs, thereby reducing the cost of determination of default. The IBC has helped in reducing the time taken to resolve or liquidate an insolvent firm, within a range of 300 to 375 days on an average, thereby reducing the cost of engaging various professionals. This is a far cry from the earlier regime that entailed a cost of almost 9 per cent of estate value and took 4.3 years, according to the World Bank’s Doing Business Reports. The indirect cost of disrupted relations with suppliers and customers is mitigated by the IBC as it strives to keep the CD as a going concern throughout a CIRP. This also allows retaining key personnel and workmen of the CD. Further, the current operations of the CD are kept in motion as the IBC provides for raising of interim finance. Another indirect cost such as risk of inefficient investments induced by resolution is minimised as the CoC approves a resolution plan only when it is convinced that the plan is financially and commercially sound. The CoC which comprises of competent institutional FCs weighs whether the RA has the capacity and the ‘know how’ to effectively turnaround the CD. The aforesaid features of the IBC aid in minimising the direct and indirect costs of formal insolvency procedures.

From the discussions above, it appears that the Traditionalists’ concepts of equity and fairness for all stakeholders in an insolvency process and preserving the value of the firm in distress are enshrined in the basic architecture of the IBC. At the same time, the Proceduralist principles of allowing the commercial wisdom of creditors to prevail is also imbibed in the Code.

**THE DISTRIBUTION PROBLEM**

The bankruptcy problem is, in effect, an entitlement distribution system involving the distribution of a given asset, which is inadequate to meet and satisfy all the creditors’ demands. The insolvency of a corporate impinges upon a diversity of interests, including that of creditors, employees, customers and the community at large. Whose interests are more important to safeguard or should they all be treated at par? It is also a fact that claims recovery may not be achieved by all creditors when a company becomes bankrupt because the assets are insufficient to satisfy all the demands. The theories underpinning bankruptcy is discussed in the next section. It also looks into how close is the IBC to these theories when it comes to distribution to the proceeds of liquidation.
Creditors’ Bargain Theory

The Creditors’ Bargain theory of bankruptcy, developed by Jackson (1982)\(^{23}\) postulates that the main objective of insolvency law is to maximise the collective return to creditors through a compulsory collective system. This theory generally embraced the principles attributed to Proceduralists by Baird (1998), including respect for non-bankruptcy entitlements in bankruptcy except as necessary to solve the collective action problems facing creditors. According to the theory, the bankruptcy process aims to regulate the inherent conflicts among different groups having separate claims against a debtor’s assets and incomes. Secured and unsecured creditors act differently preferring liquidation or reorganisation to suit their interests and maximum recovery. Given this position, the theory suggests that bankruptcy law should provide incentives for creditors such that each of them finds it optimal either to wait or to collect immediately their share with the central objective of maximising the total welfare of the group as a whole. In effect, the creditors’ bargain conception focuses on maximising group welfare through collectivisation. The theory is based on the idea that bankruptcy law generally reflects the hypothetical creditors’ bargain that creditors would reach if they were to bargain before their extensions of credit.

Risk-sharing Theory

The Creditors’ Bargain theory was modified by Jackson and Scott (1989)\(^{24}\) considering the gap that presumed that creditors would agree to alter pre-existing contractual priorities, which seemed unrealistic. Risk-sharing theory argues that all types of investors in a business entity, viz. bondholders, equity investors, and creditors, need to be compelled to share the risk of loss from the debtor’s insolvency, with the aim to maximise general value of available assets and resources of the debtors. These risks are of two types as identified by Miles (2011)\(^{25}\), viz. (a) common, economic-wide, industry specific or government policy risks which are exogenously determined and are outside the control of the management and (b) company-specific risks relating to endogenous sources. The creditors can bargain and choose to bear one or other type of risks. The bankruptcy law can provide a manner in which this sharing of risk of bankruptcy is handled so that all participants are able to obtain optimum value.

Value-based Theory

This theory, presented by Korobkin (1991)\(^{26}\) suggests that a mere economic account of bankruptcy may be flawed and needs to be understood in terms of all its facets. The bankruptcy legal framework provides a forum in which competing interests and values associated with financial distress are expressed and recognised. The theory proposes that insolvency law should consider the distributional impact of winding up of a corporate entity on those who are not technically creditors and who may not have formal legal rights to the assets of the business. In other words, aim of the bankruptcy law is to take into consideration and resolve the multidimensional, social and political issues arising from the financial stress of a corporate. Since each claimant would necessarily possess conflict of interest, the law should provide for each of them to derive optimum value.

IBC and Value Maximisation

The theories discussed above emphasise on the value maximisation aspect of a bankruptcy law and more importantly how it should strive to distribute the value so maximised in the most efficient manner amongst the stakeholders. At the same time, the theories highlight that a bankruptcy law that incentivises either voluntary or compulsory collectivisation and risk-sharing amongst the stakeholders, especially creditors, welfare gains are maximised for all, allowing positive spillovers to be funneled to those stakeholders who may have weaker rights to the assets of the CD vis-à-vis formal creditors. The IBC’s design and implementation channel these principles to the core.
The BLRC used, *inter alia*, two design principles for a CIRP under the IBC, namely, (a) the liabilities of all creditors, who are not part of the process, must also be met; and (b) the rights of all creditors shall be respected equally. Thus, it appears that the framework of the Code is closer to the value-based theory. In keeping with these principles, the IBC provides opportunity to all key stakeholders to participate in the insolvency proceedings and collectively assess the viability of the defaulting firm. This is different from the individual recovery rights accorded to secured financial creditors by laws such as the SARFAESI, to the detriment of other creditors.\(^{27}\) It casts a duty on the CoC to maximise the value of the assets of the firm while also balancing the interests of all stakeholders, irrespective of composition of the CoC.

The National Company Law Appellate Tribunal (NCLAT), in the matter of *Binani Industries Limited Vs. Bank of Baroda & Anr.*\(^{28}\), held that given that resolution plans are complex financial structures that require analysis by commercial minds in order to maximise the value of the assets, they cannot be treated at par with a sale or auction where the only measure for value is the monetary value. It further held that: ‘I&B Code’ is for reorganisation and insolvency resolution of corporate persons, ....for maximisation of value of assets of such persons to…. balance interests of all stakeholders. It is possible to balance interests of all stakeholders if the resolution maximises the value of assets of the ‘Corporate Debtor’. One cannot balance interest of all stakeholders, if resolution maximises the value for a or a set of stakeholders such as ‘Financial Creditors’. One or a set of stakeholders cannot benefit unduly stakeholder at the cost of another.’

The Code enables maximisation of value of the assets of the CD by requiring the creditors to make a collective endeavor to revive the failing CD and improve utilisation of the resources at its disposal. If revival is not possible, the Code releases resources for other efficient uses. In either case, the value of the assets of the CD improves. It prevents depletion of value by enabling early initiation of process for revival and expeditious conclusion of process. In fact, the CD would be tempted to initiate process early with a view to minimise potential loss to creditors. It makes provision for information symmetry which would enable discovery of best value.

The Code mandates the RP and the Liquidator to determine if the CD has been subject to irregular transactions, such as preferential transactions, fraudulent transactions, undervalued transactions, and extortionate transactions in the past, and if so, he is obliged to file an application with the AA for appropriate directions. This exercise will not only recover lost value for the stakeholders, but also deter the management from indulging in such transactions. This will cleanse the corporate governance and improve confidence of stakeholders.

The Code envisages the CoC to consider only those resolution plans which (i) have been received from credible and capable RAs, (ii) comply with the applicable laws, (iii) are feasible and viable, (iv) have potential to address the default, and (v) have provision for effective implementation of the plan. These considerations ensure that the resolution plan achieves reorganisation of the firm as a going concern, on a sustained basis. Of the plans which meet these requirements, the CoC must approve that resolution plan which maximises the value of the assets of the firm, irrespective of realisation for creditors under the plan.

By imbibing principles of preserving going concern value and striving to maximise value for all stakeholders, the Code leans towards the Traditionalist theory of insolvency law. This is opposed to the Proceduralist theory that envisions maximising value for creditors only, to the detriment of other stakeholders like employees and suppliers.
CONCLUSION

Economic theories try to unearth the invisible workings of an economy by working them into their models to verify their presence. While theorists supply advice, forecasts and proposals, policymakers, try to imbibe them into their policies. Thus, policy making and economic theories tie into a neat bow, enabling the market forces to operate in a free yet calibrated policy tweaked environment. The insolvency and bankruptcy regime has evolved over time, across jurisdictions, moulding its contours as per emerging theories that have helped identify market failures and fallouts of a particular policy. Theories have strived to settle the evergreen debate on formal versus informal bankruptcy processes by identifying the pros and cons of each. Overtime, policymakers have facilitated the creation of an environment that provides both the options to the market, formal as well as informal procedures, allowing stakeholders to pick and choose on a case-by-case basis. This is the equilibrium where theoretical underpinnings of a particular policy and the policy itself meet. As the insolvency regime in the country matures, the IBC will continue to evolve, backed by a vast body of supporting literature, to meet the emerging challenges and deliver its mandate effectively.

NOTES

1 The Committee which was tasked to redraft the UK Insolvency Law in 1982.
14 Ibid.
Medha Shekar and Anuradha Guru


20 Supra note 9.


28 Company Appeal (AT) (Insolvency) No. 82 of 2018.
We started the year with the implementation.... The Insolvency and Bankruptcy Law not only got passed, but by the end of the year, got effectively implemented.

- Shri Arun Jaitley, Hon’ble Minister of Finance and Corporate Affairs in his address at the inauguration of the NISM Campus, December 24, 2016.
Transforming India’s Credit Culture

Madhavi Goradia Divan

In India, farm loan waivers by State Governments have generated a great deal of heated debate in the media. However, in contrast, for a long time, the diversion of government funds to bail out government-owned banks after huge defaults by corporate borrowers, went relatively unnoticed. The scale of non-performing assets (NPAs) from the corporate sector reached far more staggering proportions than farm loan waivers. In 2017-2018, ten State Governments across the country announced farm loan waivers to the tune of Rs. 1,84,800 crore. As against this, in March 2015, the total debt from the country’s top ten corporate borrowers was about four times that amount, at Rs. 7,31,000 crore and the top 12 NPA accounts were at Rs. 3,45,000 crore. The total gross NPAs in Indian banking was about Rs. 10.3 lakh crores in March 2018.1

HOW DID THINGS COME TO SUCH A PASS?

We need to go back a bit in banking history. The nationalisation of banks in 1969, arguably the single most important financial measure since Independence, was aimed at breaking the nexus between banks and big businesses. Large industrial houses were disproportionately cornering bank finance at the expense of neglected sectors, particularly, agriculture. Banks were largely owned by industrialists who lent to themselves at the cost of other productive sectors, leading to lop sided lending, largely concentrated in urban conglomerates. Over time, bank nationalisation yielded a more even spread of banks and their branches across the country, leading to agricultural growth and better social inclusion.2

Public sector banks dominated banking till the liberalisation of the economy in the early 1990s. After over two decades of nationalisation, private sector banks were allowed to enter the fray. The objective was to introduce competition in the banking system, and to increase productivity and efficiency. After years of monopoly, complacency, inefficiency and corruption had set into public sector banking. There was little accountability or incentive to set standards. Public sector banks were lacking professional capability when it came to the evaluation of the commercial viability of projects. They failed to gauge the management capacity and the financial capacity of promoters. Little independent analysis was done and diligence was outsourced to other agencies, increasing the possibilities for undue influence. There was a disproportionate and misplaced emphasis on secured credit. Lenders were comfortable with granting loans against collateral securities. What was missing was lending based on an assessment of the cash flows of a company and the potential of its enterprise. Lending was easy to firms who had fixed assets. However, enterprises with real potential but without much tangible capital faced financing constraints.3

Even after the initial loans were granted, banker performance was not up to the mark. The inflation of the cost of capital equipment through over-invoicing went undetected or was glossed over. For several decades, the banking industry in India was deeply damaged by shoddy governance and poor lending standards.
This incompetence was compounded by the political control of the banking sector. A deeply entrenched culture of crony capitalism pressured public sector banks to lend to favoured parties of dubious antecedents. Good money was put after bad even though projects were under water and the intentions of the promoters questionable. Mass defaults were window-dressed for years on end through ‘evergreening’ until it simply could not be covered up any more. Apart from incompetence and corruption, the sheer information opacity made it possible for borrowers and bankers to get away. There was little or no accountability. No fraudster or defaulter, banker or politician who made those frauds possible was brought to book. Investigative agencies blamed banks for acknowledging frauds too long after the frauds had taken place. Bankers also dragged their feet fearing harassment by investigative agencies or covered up because one of their own was involved.4

For several decades, policy makers and analysts were acutely aware of the enormous strain that India’s very feudal culture of corporate governance put on job creation, growth and capital formation. While liberalisation took off in the 1990s and India Inc. attracted billions of dollars of foreign capital, the corporate culture had not been liberated from its feudal shackles. Pedigreed families continued to control 60 per cent of the assets of publicly traded companies. Family-promoted businesses were averse to raising outside equity, fearing that it would dilute their stake or loosen their grip. The easier option was to borrow from obliging bankers who were more willing to lend to established businesses than to new entrants. Till the Insolvency and Bankruptcy Code, 2016 (IBC/Code) was enacted, defaults on bank loans had no impact on the promoter’s control and they could drag on the resolution process for a long time. An over-dependence on debt financing is unhealthy and can bring economies crashing down.5 Banks have been overburdened and often needed government bailouts using taxpayers’ money to survive.6

Vijay Mallya-owned Kingfisher Airlines defaulted on loans worth about Rs. 9000 crore to a consortium of banks led by the State Bank of India (SBI). He fled to the United Kingdom (UK) in March, 2016 just as a Debt Recovery Tribunal (DRT) in Bengaluru ordered action against him. For four years, the Government of India fought extradition proceedings in the British courts.7 According to the Central Bureau of Investigation (CBI), the corporate guarantees executed by Mallya-controlled United Breweries Holdings Ltd., were far in excess of the tangible net worth and market capitalisation of the company. It claimed that the corporate guarantees were merely an ‘ornamental security’, grossly inadequate to repay loans extended to Kingfisher Airlines. It questioned how the banks accepted these guarantees, parting with public money without ascertaining their real value.8

Another scam that came to light in early 2018, was the fraud in the Punjab National Bank (PNB), India’s second largest public sector bank by a high profile diamantaire. Companies owned by diamond merchants, Nirav Modi and his uncle Mehul Choksi, are alleged to have swindled PNB of over Rs. 14,000 crore. It started with a single letter of undertaking (LOU) of Rs. 800 crore under which the bank undertook to repay the loan if the principal borrower, Nirav Modi failed to pay. The first LOU was issued by two bank employees via SWIFT sanctioning loans to be disbursed overseas. When the credit due was not paid in time, further LOUs were issued on behalf of the bank to offset the payment. The bank management failed to detect what had happened in time, allegedly because the bank did not have a fully integrated core banking system. Both Modi and Choksi fled the country, and once again the Government of India had to adopt extradition proceedings.9

Other scams that came to light around this time showed that some private banks were tainted too and the top brass of some had recklessly doled out funds for favours to themselves. Chanda Kochhar, Chief Executive Officer (CEO) of ICICI Bank was made to resign after her family’s unholy nexus with
the Videocon group came to light. The CBI booked Kochhar, her husband and Venugopal Dhoot of the Videocon group on charges of cheating and corruption in sanctioning loans to the Videocon group. It is alleged that the bank had sanctioned six high value loans to various Videocon companies between June, 2009 and October, 2011, that commenced soon after Kochhar took over as CEO. It is alleged that just as these loans were disbursed, Dhoot transferred Rs 64 crore from one of his companies to a company owned by Kochhar's husband. It is interesting that when the matter first came out in the mainstream media following a whistleblower's complaint, the Board of ICICI Bank immediately gave her a clean chit. It was only later when the Board’s haste to protect her became indefensible, did it institute an independent inquiry led by a former judge of the Supreme Court (SC). The inquiry report found her guilty and her services were eventually terminated. It is interesting that the transactions in question took place many years before but did not come to light till much later. Had the media coverage not been so relentless, the Board might have successfully pushed the matter under the rug.

In 2019, Punjab and Maharashtra Cooperative Bank collapsed because it brazenly violated basic lending norms by lending about Rs. 6500 crore, amounting to at least 70 per cent of its entire loans to a single client, Housing Development and Infrastructure Ltd (HDIL). The bank was effectively captured by the promoters of HDIL, the Wadhawan family. The bank’s former chairman, Waryam Singh held shares in the bank. Over 21,000 bogus accounts were created to cover up the mounting defaults of HDIL.

In a 17-page note to Parliamentary Committee dated September 06, 2018, Reserve Bank of India (RBI) Governor, Raghuram Rajan raised a cautious flag on the nexus between bad loans and corruption by bankers:

> [U]nless we can determine the unaccounted wealth of bankers, I hesitate to say a significant element was corruption. Rather than attempting to hold bankers responsible for specific loans, I think bank boards and investigative agencies must look for a pattern of bad loans that bank CEOs were responsible for- some bank went from healthy to critically undercapitalized under the term of a single CEO. Then they must look for unaccounted assets with that CEO. Only then should there be a presumption that there was corruption.

### ASSET QUALITY REVIEW BY RBI

By 2014, the Indian banking sector was deeply dented by a high percentage of NPAs. Based on the performance of the loan, it may be categorised as a standard asset, that is where the borrower makes regular payments, or a non-performing asset, where the borrower has stopped paying interest or principal payments for over 90 days. Sensing that banks were evergreening loans by repeatedly restructuring and deferring loan payment installments, the RBI introduced an Asset Quality Review (AQR) in 2015-2016.

An accurate assessment of asset quality is an important responsibility of the RBI. Usually, the RBI conducted an Annual Financial Inspection (AFI) to inspect the balance sheets of banks. However, owing to the mounting NPAs, and the feeling that some banks were underreporting their NPAs and postponing bad loan classification, the RBI came out with additional inspections on the balance sheets of banks to assess the genuineness of bank assets. The AQR was conducted in October, 2015. This was a special inspection where the sample size was much larger and most large borrower accounts were inspected. It revealed much higher level of asset quality deterioration. Banks were concealing bad assets under the practice of forbearance, and followed their own methods. In some banks, a loan that was non-performing was shown as performing. They were neither making adequate procedures for non-performing loans nor
attempting to have projects put back on track. Credit growth had also slackened.\textsuperscript{15}

There were other reasons for the NPAs, such as over-optimism based on economic growth in the past, delays in obtaining governmental permissions and the loss of promoter and banker interest on that count. However, the major reasons were fundamental flaws in the banking system.\textsuperscript{16}

The AQR resulted in the unearthing of hitherto unclassified NPAs, having a significant impact on the capital adequacy ratio of banks. The RBI in its Financial Stability Report in June, 2018, estimated that Gross NPAs of banks were likely to rise from 11.6 per cent in March, 2018 to 12.2 per cent in March, 2019.\textsuperscript{17} According to an Associated Chambers of Commerce & Industry of India-Crisil joint study reported on January 22, 2018, the gross NPAs were estimated to be worth a staggering 9.5 lakh crore rupees as on March 31, 2018 i.e. about 10.5 per cent of total advances, while stressed assets were estimated at 11.5 lakh crore rupees.\textsuperscript{18} About 85 per cent of the NPAs were from loans and advances extended by public sector banks. For instance, as of March, 2018, the NPAs in the SBI were worth 2.23 lakh crore rupees. The gross NPAs of banks (as a proportion of total loans in the market) increased from 2.3 per cent in 2008 to 9.3 per cent in 2017. This was a matter of grave concern for the banking sector as well as the economy as a whole. Given that an increased proportion of banks’ assets ceased to generate income, automatically, the profitability of banks and their ability to extend further credit was dented.

A vast proportion of the loans that came to be classified as NPAs date back to transactions that originated in the mid-2000s. This was a time when the economy was exuberant and the business climate appeared very upbeat. Banks were generous with loans to large corporations based on their recent performance. Corporations grew highly leveraged as loans had become much more easily available than before. This meant that they depended mostly on external borrowings and much less on internal promoter equity. After the global economic crisis in 2008, the ability to repay was impacted. This led to the Twin Balance Sheet problem where both the banks and the corporate sector came under financial stress. What exacerbated the problem was that banks adopted the practice of ‘evergreening’ by giving fresh loans to promoters to enable them to pay back interest. This only fended off the evil day, because it extended recognition of the NPA to a later date when it became even more unmanageable.

**IBC: CHANGING THE BUSINESS PARADIGM**

The IBC is a measure of bold economic reform intended to achieve a tectonic shift in the mindset of both borrowers and lenders. The IBC heralds a paradigm shift in the business culture of the country. It seeks, along with other reforms, to put an end to the culture of casual defaults on loans and advances without consequences. There is now an understanding that companies cannot bank on automatic bail-outs from taxpayer’s funds. The IBC framework tries to reduce the arbitrage that borrowers have enjoyed while raising funds through borrowing from banks vis-à-vis raising funds from the capital markets. If borrowers default on principal payments on a corporate bond, the market would penalise the borrower heavily. However, bank borrowings have not attracted similar consequences. Therefore, debt contracts embedded in bank loans in India lost sanctity. One of the aims of the Code is to restore the sanctity of the debt contract.\textsuperscript{19}

The Code was intended to engender effective deterrence against defaulting debtors, to uproot the cavalier or at best, complacent culture of borrowing that had sunk its roots deep in corporate India. It was a wakeup call for bankers and borrowers to change their ways in the larger interest of the economic
well-being of the nation, a jolt to awaken them to a realisation that there is going to be zero tolerance for defaults.

The Code encourages timely and preventive action on the part of creditors, so that there can be redress at the earliest signs of distress, rather than prolong matters in a way where redress becomes impossible. The IBC enjoins the banks as creditors to enforce their contracts or renegotiate their contracts with their borrowers so that they are not in default in the first place. Bank books should reflect such renegotiation through asset classification and provisioning, and banks are required to report even a one day default and draw up resolution plans so that the borrower is not in default on the 180th day from the date of such default.

Displacing defaulting promoters

Feudalism has long characterised corporate culture in India. Even the largest Indian companies publicly traded on the stock exchange have been treated by promoters as heritable commodities that get passed on from generation to generation with a divine right for sons (sometimes, but seldom daughters) to run. In the past, the promoter family had the right to manage, and even to mismanage without consequences. So even if the promoters ran the company aground and took with it the creditors, shareholders and other stakeholders, the promoters remained firmly in the saddle. So even if the company was declared ‘sick’ under the Sick Industrial Companies Act, 1985 (SICA), the promoters remained in charge. Existing schemes such as the Strategic Debt Restructuring (SDR) that were previously invoked did not result in change of management (i.e., the debtor remained in possession), implying that the scheme was only used for asset classification. Not infrequently, the promoters’ continuation in management served as a license to the promoters to siphon away assets and milk the company dry, leaving nothing for the other stakeholders. Under the erstwhile regime, under laws such as SICA and Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), the promoters of the defaulting company continued to remain in charge and would typically drag the process on for years on end. The passage of time also inexorably resulted in the value of the net worth and assets of the company suffering an irreversible depletion, leaving virtually nothing for the creditors to recover. Permitting defaulting promoters to retain their stranglehold over the management was tantamount to rewarding them for running the company aground. It amounted to putting a premium on inefficiency, incompetence and mismanagement.

The IBC jolts promoters out of their complacency. Under this regime, once the corporate insolvency resolution processes (CIRP) commences, creditors acquire control and the promoters are automatically ousted. As the Bankruptcy Law Reforms Committee (BLRC) Report, the recommendations of which form the basis of the IBC, recognises:

Control of a company is not divine right—When a firm defaults on its debt, control of the company should shift to the creditors. In the absence of swift and decisive mechanisms for achieving this, management teams and shareholders retain control after default.

While moving the IBC in Parliament, Mr. Arun Jaitley, the then Minister of Finance and Corporate Affairs, stated on the floor of the House:

One of the differences between your Chapter 11 and this is that in Chapter 11, the debtor continues to be in possession. Here the creditors will be in possession. Now, SICA is being phased out, and I will tell you one of the reasons why SICA didn't function. Under SICA, the predominant experience has been this, and that is why a decision was taken way back in 2002
to repeal SICA when the original Company Law amendments were passed. Now since they were challenged before the Supreme Court, it didn’t come into operation. Now, the object behind SICA was revival of sick companies. But not too many revivals took place. But what happened in the process was that a protective wall was created under SICA that once you enter the BIFR, nobody can recover money from you. So, that non-performing investment became more non-performing because the companies were not being revived and the banks were also unable to pursue any demand as far as those sick companies were concerned, and therefore, SICA runs contrary to this whole concept of exit that if a particular management is not in a position to run a company, then instead of the company closing down under this management, a more liquid and a professional management must come and then save this company. That is the whole object. And if nobody can save it, rather than allowing it to be squandered, the assets must be distributed — as the Joint Committee has decided — in accordance with the waterfall mechanism which they have created.

It was unthinkable under the erstwhile regime for promoters to lose control. The IBC displaces the presumption of feudal entitlement and punctures the smug complacency of the company being treated as a family jagir. The ousting of the management immediately upon the commencement of the CIRP and the takeover by an Interim Resolution Professional is nothing short of revolutionary. The sheer fear of losing management jolts promoters into an awareness that they will have to keep the company well managed and default-free if they wish to remain in the saddle. The apprehension of losing control over their companies has prompted promoters to settle or resolve their dues. The specter of displacement incentivises more responsible credit behaviour on the part of borrowers. In one of the early judgments delivered by the SC on the IBC, *Innoventive Industries Ltd. v. ICICI Bank Ltd.*, the court noted:

...we thought it necessary to deliver a detailed judgment so that all Courts and Tribunals may take notice of a paradigm shift in the law. Entrenched managements are no longer allowed to continue in management if they cannot pay their debts.

In *Swiss Ribbons v. Union of India*, which arose out of a challenge to the constitutional validity of the IBC, one of the grounds of challenge was the perceived arbitrariness of promoters losing control for even ‘petty’ defaults of a lakh of rupees. Upholding the constitutionality of the IBC, and the provisions permitting ouster of the promoters from management upon the commencement of the CIRP, the SC emphasised the need to treat the company as separate from its promoters.

28. It can thus be seen that the primary focus of the legislation is to ensure revival and continuation of the corporate debtor by protecting the corporate debtor from its own management and from a corporate death by liquidation. The Code is thus a beneficial legislation which puts the corporate debtor back on its feet, not being a mere recovery legislation for creditors. The interests of the corporate debtor have, therefore, been bifurcated and separated from that of its promoters/those who are in management. Thus, the resolution process is not adversarial to the corporate debtor but, in fact, protective of its interests. The moratorium imposed by Section 14 is in the interest of the corporate debtor itself, thereby preserving the assets of the corporate debtor during the resolution process. The timelines within which the resolution process is to take place again protects the corporate debtor’s assets from further dilution, and also protects all its creditors and workers by seeing that the resolution process goes through as fast as possible so that another management can, through its entrepreneurial skills, resuscitate the corporate debtor to achieve all these ends.

Indeed, it is important to recognise that a company’s identity, interests and destiny are not synonymous with that of its promoters. That the company must not be equated with its promoters or shareholders and must be treated independently is a fundamental tenet of company law. The steady rule of corporate
jurisprudence laid down in the old English case, Saloman v. A. Saloman & Co.\textsuperscript{30} is that a company is an independent legal personality, and there exists a corporate veil which separates the company from its owners and shareholders. There may be situations where it may become necessary to salvage a company from its own promoters.

The IBC provides several opportunities for the promoters to repay their debts and rectify the default before the process of admission. Promoters who want to stave off the take-over of their businesses have several chances of paying up and retrieving the company from the CIRP. In Swiss Ribbons case,\textsuperscript{31} the SC recounted the multiple opportunities available to settle at various stages: before admission of the application under section 7,\textsuperscript{32} after admission but before the constitution of the committee of creditors (CoC),\textsuperscript{33} after constitution of the CoC but before the invitation of expression of interest and after issuance of invitation of expression of interest.\textsuperscript{34}

The chance to settle the matter by paying up before the chopper comes down on the management is a vital facet of the effective working of the IBC. Statistics compiled in the last four years of the working of the IBC show that a very large number of corporate debtors (CD) have settled their dues before the CIRP commences. It is reported that by December, 2019, cases involving 3.75 lakh crore rupees were disposed of at pre-admission stage of IBC.\textsuperscript{35}

All in all, the seemingly drastic consequences of promoters losing control at the commencement of the CIRP makes the IBC an important catalyst for improving debtor behaviour and encouraging efficiency in management.\textsuperscript{36}

In the event that the matter is not settled, and the CIRP commences, the situation offers opportunities to new investors and entrepreneurs. Control may change hands, but the company must go on with its business. Once creditors are in control, they want quick resolution and optimisation of value. In their own interest, they are likely to want the company to continue to run as a going concern. The threat of liquidation could potentially result in larger losses for the creditors as a whole, and therefore, this works as an incentive for them to ensure effective coordination to arrive at a timely resolution. In the vast majority of cases, the show is likely to go on. One of the most successful outcomes of the cases before the IBC was the takeover of Essar Steel India Ltd. by the UK based Arcelor Mittal for Rs. 42,000 crore. ArcelorMittal had been on the lookout for investment opportunities in India for a while. While many of its planned ventures in India hit roadblocks due to various other factors such as land acquisition issues and other delays, it found the opportunity it was looking for through the bankruptcy proceedings against Essar Steel India Ltd.\textsuperscript{37} This case shows how IBC proceedings can present opportunities for entrepreneurs.

By December 2019, Rs. 1.58 lakh crores became realisable in cases resolved under the CIRP. The proceedings under IBC took on an average about 340 days, including time spent on litigation, in contrast with the previous regime where process took about 4.3 years.\textsuperscript{38}

For the Code to work effectively and to ensure that companies are protected from their own defaulting promoters, it is necessary to ward off creeping comebacks by them. Section 29A was inserted in the IBC in order to ensure that those who are responsible for the defaults are not brought back into management. The provision was introduced by the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 promulgated on November 23, 2017, and ultimately enacted as the Insolvency and Bankruptcy Code (Amendment) Act, 2018. Section 29A was inserted in the IBC to render ineligible as a resolution applicant, a person who is an undischarged insolvent,\textsuperscript{39} has been declared a willful defaulter,\textsuperscript{40} whose account is classified as a non-performing asset by RBI for a year or more,\textsuperscript{41} has indulged in
preferential transactions, undervalued transactions or fraudulent transactions under the Code, has been prohibited by Securities and Exchange Board of India (SEBI) from trading in securities or accessing securities market, has been disqualified to be a director in a company under the Companies Act, has been convicted for any offence punishable with imprisonment for two years or more, or has been subject to corresponding disability under any law in any jurisdiction outside India, or is a ‘connected person’ not eligible under clauses (a) to (i).

The proviso under section 35(1)(f) of IBC bars the liquidator from selling the immovable or movable properties or actionable claims of the CD in liquidation to any person who is not eligible to be a resolution applicant. This proviso was inserted with the same object, to prevent persons who through their misconduct contributed to defaults of companies or are otherwise undesirable from gaining or regaining control of the CD.

During the Parliamentary discussion on the Insolvency and Bankruptcy Code (Amendment) Bill, 2017, the then Minister of Finance and Corporate Affairs, Mr. Arun Jaitley said on the floor of the house:

In the case of resolution also, all types of creditors may take some haircut and the man who created the insolvency pays a fraction of the amount and comes back into management. Should we allow that to continue? The overwhelming view, as expressed by the Members, is that it should not be allowed. This was a gap which was there in the original Bill and by bringing in 29A we have tried to fill in the gap. That is the objective. In order that this provision must apply to all existing cases of resolution which are pending, that is the case for urgency. If we had not done this, then all such defaulters would have rejoiced because they would have merrily walked back into these companies by paying only a fraction of these amounts. That is something which besides being commercially imprudent would also be morally unacceptable. That is the real rationale behind this particular Bill.

In the landmark judgment, Arcelormittal India (P) Ltd. v. Satish Kumar Gupta, which paved the way for the takeover of the beleaguered Essar Steel Ltd. by the UK based steel giant, Arcelor Mittal, the SC interpreted the broad contours of section 29A(c):

57. ... This provision therefore ensures that if a person wishes to submit a resolution plan, and if such person or any person acting jointly or any person in concert with such person, happens to either manage, control, or be promoter of a corporate debtor declared as a non-performing asset one year before the corporate insolvency resolution process begins, is ineligible to submit a resolution plan... Any person who wishes to submit a resolution plan acting jointly or in concert with other persons, any of whom may either manage, control or be a promoter of a corporate debtor classified as a non-performing asset in the period abovementioned, must first pay off the debt of the said corporate debtor classified as a non-performing asset in order to become eligible under Section 29A’c’.

59. Since Section 29A’c’ is a see-through provision, great care must be taken to ensure that persons who are in charge of the corporate debtor for whom such resolution plan is made, do not come back in some other form to regain control of the company without first paying off its debts...

...If a person has been a promoter, or in the management, or control, of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place, and in respect of which an order has been made by the adjudicating authority under the Code, such person is ineligible to present a resolution plan under Section 29A(g). This ineligibility cannot be cured by paying off the debts of the corporate debtor. Therefore, it is only such persons who do not fall foul of clause (g), who are eligible to
submit resolution plans under clause (c) of Section 29A, if they happen to be persons who were in the erstwhile management or control of the corporate debtor.

60. It is important for the competent authority to see that persons, who are otherwise ineligible and hit by clause (c), do not wriggle out of the proviso to clause (c) by other means, so as to avoid the consequences of the proviso...

... If it is shown, on facts, that, at a reasonably proximate point of time before the submission of the resolution plan, the affairs of the persons referred to in Section 29A are so arranged, as to avoid paying off the debts of the non-performing asset concerned, such persons must be held to be ineligible to submit a resolution plan, or otherwise both the purpose of the first proviso to clause (c) of Section 29A, as well as the larger objective sought to be achieved by the said clause in public interest, will be defeated.51

Thus, if promoters are in a position to rectify their ineligibility, there is no bar on them under section 29A(c).

Altering the Debtor-Creditor Equation & Opening up the Credit Market

Promoters of CD have assumed a false sense of propriety for long, and much of their objection to the Code was founded on the indignation that the creditors who were outsiders, were being permitted to swoop down and take control of companies that the promoters had floated and nurtured. What must, however, be emphasised is that the default is in respect of public money, that is money which belongs to the public. The IBC seeks to alter the equation between the debtor and the creditor. What is being lost owing to the default is not what belongs to the promoter but what belongs to the creditor, who represents public money and public investment. Mr. N. S. Vishwanathan, the then Deputy Governor, RBI in his article- ‘Some Thoughts on Credit Risk and Bank Capital Regulation”52 writes:

In this context, it needs to be recognised that when banks take recourse to legal remedies available to them when a borrower defaults on his debt servicing, including that of security enforcement, they are essentially trying to recover the depositors' money from a defaulting borrower, whatever be the reasons for default. However, the defaulting borrowers portray such an action by banks as a case of a 'ruthless big bank' taking over the assets of a 'hapless borrower'. This is the kind of portrayal used even by the large corporates. Here, one needs to distinguish between a private moneylender lending his own money for making a profit and a bank, which to a large extent uses depositors' money (and tax payers' money, in case of public sector banks). A correct portrayal of the situation would be: public interest (i.e., depositors + taxpayers) vs borrowers' interest.

Corporates have depended disproportionately on borrowing from banks and the latter depended largely on the availability of tangible assets in deciding to lend. The small investor through the bond market lacked the confidence to invest because he had no effective means of recovery and enforcement if the CD defaulted on payment. Contract enforcement in India has been particularly weak owing to the delays in the justice delivery system and continues to drag down India's rankings in the Ease of Doing Business.53 The IBC by enabling the small investor to set into motion the CIRP, seeks to empower the small investor, so that he gained in confidence and became a source of funding for corporate projects. The idea was to encourage the generation of credit in the market so that banks are not the only source of funding.54

Mr. N. S. Vishwanathan goes on to comment on the change in the debtor-creditor equation brought about by the IBC. This, according to him, encourages the generation of credit in the market:
Debtor vs Creditor: The Change in Roles

This changing debtor-creditor equation disturbs the status quo and it is only natural that it is facing resistance. The earlier debtor-friendly environment made it possible for the defaulting debtors to secure moratoriums and force write-downs on debt repayment, while retaining management control over the borrowing units or thwart banks efforts to realise their dues by indulging in serial litigations. The out-of-court restructuring mechanisms too suffered high failure rates resulting in the borrowing entities continuing to indulge in repeated defaults, being confident that the balance of power remained with them and the ability of banks to discipline errant borrowers was weak.55

The debtor friendly environment had its effect on banks' business preference, while also partly contributing to the ever-increasing stressed assets in the banking system. Banks' ability and/or willingness to lend to persons or entities that needed credit were hampered. The Bankruptcy Law Reforms Committee (2015) has observed and I quote:

‘When creditors know that they have weak rights resulting in a low recovery rate, they are averse to lend. Hence, lending in India is concentrated in a few large companies that have a low probability of failure. Further, secured credit dominates, as creditors rights are partially present only in this case. Lenders have an emphasis on secured credit. In this case, credit analysis is relatively easy: It only requires taking a view on the market value of the collateral. As a consequence, credit analysis as a sophisticated analysis of the business prospects of a firm has shrivelled.’56

The report of the BLRC also recognised the poor environment for credit in India and that a bankruptcy law would provide better access to it:

**Poor environment for credit** While SARFAESI has given rights to creditors on secured credit, the overall recovery rates remain low particularly when measured on an NPV basis. This creates a bias in favour of lending to a small set of very safe borrowers, and an emphasis on using more equity financing which is expensive. This makes many projects unviable. Better access to credit for new entrepreneurs will create greater economic dynamism by increasing competition.57

Breaking the Banker-Borrower Nexus

The scheme of the Code keeps a check not only on promoters but also on banks. The general approach of bankers had been to avoid de-jure recognition of non-performance of accounts with stressed assets. Existing restructuring schemes by RBI such as the SDR were used for avoiding downgrade rather than resolving the asset. Prolonging the true asset quality recognition suited both the bankers and borrowers in what the RBI Governor referred to non-pejoratively, as the ‘borrower-banker nexus’, implying that the banks indulged in the proverbial act of ‘extending and pretending’.58 The IBC acts as an external nudge to banks to refer specific cases of default against large borrowers for resolution. The information symmetry that the IBC ushers in makes it difficult for banks to neglect defaulters. The IBC creates Information Utilities (IU), defined under section 3(21) read with section 210 of IBC which act as a ready electronic storehouse of the status of a loan. Financial creditors are required to submit financial information and information relating to assets in relation to which any security interest has been created in the manner and form prescribed.59 Such information is maintained by the IU and is made universally accessible under section 214 of IBC. Such information can be updated, modified, or rectified by any person in the required manner under section 216 of IBC.

The IBC is one of the vital prongs in a multi-pronged strategy to secure prudential banking and effect a culture of credit discipline. The Fugitive Economic Offenders Act, 2018,60 enacted to deter economic
offenders from evading the process of Indian law by remaining outside the jurisdiction of Indian courts, provides for attachment of property of a fugitive economic offender, confiscation of such offender’s property and disentitlement of the offender from defending any civil claim. To make other recovery mechanisms more effective, the SARFAESI Act was amended to create a centralised database storing information of creation or modification of security interests by any creditor and for lender getting possession of mortgaged property within 30 days. This could also supplement the IUs in the future. Six new DRTs have been established and the minimum pecuniary limit for filing of cases in DRTs has been revised in 2018 from Rs. 10 lakhs to Rs. 20 lakhs to enable focus on higher value cases in these fast-track tribunals.

The Banking Regulation Act, 1949 was amended in August, 2017 to provide for authorisation to the Central Government and RBI to issue directions to banks to initiate the insolvency resolution process under IBC, and in respect of stress assets under which RBI issued a Circular dated February 12, 2018. This amendment was upheld but the Circular dated February 12, 2018 was, however, struck down by the SC in Dharani Sugars and Chemicals Ltd. v. Union of India. Following that judgment, a Prudential Framework for Resolution of Stressed Assets was introduced by the RBI. The framework envisages early identification and reporting of stress, and any action by lenders to conceal the actual status of accounts or evergreen the stressed accounts, will be subjected to stringent action. RBI has issued instructions to banks to introduce changes to fall in line with its new guidelines to strengthen their monitoring mechanism. It has also taken measures to ensure strict compliance of banks with IBC to maintain information symmetry as prescribed by the IBC, in particular through IU set up under the IBC to serve as ready electronic records of the status of loans.

CONCLUSION

In a short span of four years, the IBC has made remarkable progress. It was met with enormous resistance from vested interests and was put through several agniparikshas, which included several rounds of challenge in court. The IBC was aimed at creating an economic ecosystem where there is ease of doing business. The object was to create conditions so that credit could be generated from the domestic market and investments drawn from the international market. In order to achieve those objectives, it was necessary to create a culture of deterrence against default. In order to attract more credit in the market, unsecured creditors who cannot fall back on secured assets as banks and financial institutions, need to feel adequately empowered against default. The power to trigger the IBC set into motion the CIRP as a powerful tool in the hands of an otherwise unsecured creditor. It is only when the small creditor feels adequately empowered would she be emboldened to lend and invest in the market.

Those who opposed the IBC laid misplaced emphasis on the relatively large number of companies that went into liquidation in the early stages of the IBC. These were the companies that had languished in BIFR for years on end and had no hope of revival long before the IBC came into force. Therefore, to paint a picture of pessimism based on the fate of what could be referred to as the ‘backlog’ companies is misleading. The net result has been an overwhelmingly positive one. The proof of the pudding is in the quantum leap that India took in the World Bank’s Ease of Doing Business rankings, jumping 14 places to 63 in 2019, largely courtesy IBC. In resolving insolvency, India jumped 56 places to 52 in 2019 from 108 in 2018. As the Latin expression goes, res ipsa loquitur, that is, the thing speaks for itself.
NOTES

1 Rohit Prasad and Gaurav Gupta (2019), “Top 12 Corporate NPAs Cost Exchequer Twice as Much as Farm Loan Waivers”, Business Standard, 18 February.
8 Raghav Ohri (2018), “Vijay Mallya’s guarantees for debt were overvalued: says CBI”, The Economic Times, 19 September.
13 Evergreening is the practice by which a bank restructures loan repayments or masks loan defaults by giving new loans to help defaulting borrowers repay or pay interest on old loans. See Seema Jhingan and Neha Yadav (2018), “India: Ever-Greening Of Loans And Bad Debts - RBI’s Stand And Its Implications”, Mondaq, 05 November and Rashmi Rajput and Sugata Ghosh (2019), “Auditor’s dilemma: When is evergreening a fraud?”, The Economic Times, 10 June.
16 Supra Note 12. Also see Ahita Paul (2018), “Examining the rise of Non-Performing Assets in India”, Pre-Legislative Research, 13 September.
19 N.S. Vishwanathan (2018), “Some Thoughts on

20 Ibid.


22 David Yong (2016), “This Zombie on India Sick-List of About 6,000 Firms Lost $2 Billion Value”, Bloomberg, 24 November.

23 Section 17 read with Sections 22, 23 and 28, IBC.


26 Ibid, para 11, p. 421.


28 Section 4, IBC and Notification dated March 24, 2020 of the Ministry of Corporate Affairs, Government of India. In March, 2020, as a fall out of the economic difficulties following the outbreak of the COVID-19 pandemic, the Government of India raised the default threshold to Rs. 1 crore from Rs. 1 lakh.

29 Ibid., para 28, p. 55.

30 1897 AC 22 (HL).


32 Rule 8, Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016.

33 Section 12A, IBC.


39 Section 29A(a), IBC.

40 Section 29A(b), IBC.

41 Section 29A(c), IBC; Swiss Ribbons (P) Ltd. v. Union of India, (2019) 4 SCC 17, paras 99-106; and Arcelormittal India (P) Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1, paras 38-60.

42 Section 29A(g), IBC.

43 Section 29A(f), IBC and Arcelormittal India (P) Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1, para 61.

44 Section 29A(e), IBC.

45 Section 29A(d), IBC.

46 Section 29A(i), IBC.

47 Section 29A(j), IBC; Swiss Ribbons (P) Ltd. v. Union of India, (2019) 4 SCC 17, paras 107-110; and Arcelormittal India (P) Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1 (para 63).
35. Powers and duties of liquidator. –

(1) Subject to the directions of the Adjudicating Authority, the liquidator shall have the following powers and duties, namely: -

(f) subject to section 52, to sell the immovable and movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels in such manner as may be specified:

Provided that the liquidator shall not sell the immovable and movable property or actionable claims of the corporate debtor in liquidation to any person who is not eligible to be a resolution applicant.


Ibid. at pp. 65-67, para 57, 59, 60.

Supra Note 19.


In March, 2020, as a fall out of the economic difficulties following the outbreak of the COVID pandemic, the Government of India was compelled to raise the default threshold to Rs 1 crore from Rs 1 lac. However, it would appear that this measure is a stop gap one, aimed at tiding over an unprecedented global crisis. See Notification dated March 24, 2020 bearing F. No. 30/9/2020-Insolvency issued by the Ministry of Corporate Affairs, Government of India.

Supra Note 19.

Ibid. p. 3.


Section 215(2), IBC read with Form-C under regulation 20, IBBI (Information Utilities) Regulations, 2017.

Act No. 17 of 2018.

Act No. 54 of 2002.


Sections 35AA and 35AB, Banking Regulation Act, 1949.

Dharani Sugars and Chemicals Ltd. v. Union of India, (2019), 5 SCC 480, para 1 and 2. The subject-matter of the circular were debts with an aggregate exposure of 2000 crores rupees where, if default persisted for 180 days from March 1, or if the date of first default was after March 1, 2018, then after 180 days calculated with effect from that date, lenders shall file applications under the Insolvency Code within 15 days. In short, unless a restructuring process in respect of debts with an aggregate exposure of over 2000 crores rupees is fully implemented on or before 195 days from the reference date or date of first default, the lenders will have to file applications as financial creditors under the Insolvency Code.

Ibid at pp. 506-512, paras 25-32.

(2019) 5 SCC 480, paras 64-66 at pp. 529-530 and para 72-73 at p. 533. It was held that the Circular dated February 12, 2018 was issued by RBI under powers derived from section 35AA of the Banking Regulation Act, 1949 that refers only to specific cases of default and not to all cases generally, directions for which were issued by the said Circular.


73 Ibid.
The Insolvency and Bankruptcy Code, the National Company Law Tribunal, a new arbitration framework and a new IPR regime are all in place. New commercial courts have also been set up. These are just a few examples of the direction in which we are going. My Government is strongly committed to continue the reform of the Indian economy.

- Shri Narendra Modi, Hon’ble Prime Minister of India in his address at the inauguration of the Vibrant Gujarat Global Summit, January 10, 2017.
Deeming Provisions in the Indian Insolvency Law

Surbhi Kapur

A fiction is intended to escape the consequences of an existing, specific rule of law.

-Lon Fuller

INTRODUCTION

Sir William Blackstone considered legal fictions to be of ‘...beneficial character, made to advance the interests of justice.’ While what is posited by Fuller is partially right, the scheme of interpretation of law and adjudication is much more constructive and not confined to merely ‘fictionalising’ the statutes. For this reason, clearly, legal scholars have been ambivalent about the utility of legal fictions. And the judiciary while resorting to several, nested fictions proceeds with prudence in extending their applicability to the factual matrix before it. Overall, interpretation of a statute depends on text and context. The text is the texture; context is what ascribes colour to the legislation. It is well established that a statute is best interpreted when one can retrieve with ease why it was enacted. For this reason, it must be interpreted in a way that gives effect to its purpose or object. Legal interpretation, in its hermeneutic character, endeavours to crystallise the historical will of the legislator, or the normative or objectively clear meaning of the law or a blend of both in terms of ascertaining the latter on the basis of the former. In fact, judicial deference to legislative judgment is oftentimes evident in the beneficial construction afforded by the Courts to the various provisions of both the principal and the subordinate legislation.

While legal narratives abound in fabrications, relatively few of them are considered as showing the inventive or creative attributes, that deserve the label of a ‘legal fiction’. These so-called fabrications exhibit the kind of creativity, that one conjoins with literary writings. Alf Ross, in his classical exposition on the types of ‘legal fictions’ and their utility, noted that a ‘creative legal fiction’ is ‘no more than a peculiar technique for the analogical extension of legal rules’. One of the widely known legal doctrines grounded in a legal fiction includes the common criminal law maxim, ‘ignorantia juris non excusat’ translating to ‘ignorance of the law is no excuse’. It is based on the legal fiction that ‘believes’ or ‘deems’ that all persons know the law. Some of these ‘deeming provisions’ are codified in our laws and are generally thought of as creating a legal fiction, i.e. positing that a legislation is to be applied as if something were different from what it ‘actually’ is. However, their construction has unveiled varied meanings, including, but not limited to being a ‘statutory fiction’.

Deeming provisions are a common attribute of legislative enactments worldwide. The term ‘deem’ is derived from the old English word ‘domas’ which meant ‘judgment or law’. The Concise Oxford
Dictionary, (8th ed.), defines the verb ‘to deem’ as ‘believe, consider, judge, or count, to be.’ Webster’s Ninth New Collegiate Dictionary provides the following meanings: ‘to come to think or judge: consider; to have an opinion: believe.’ Black’s Law Dictionary (9th ed.), gives as the main definition of the verb ‘deem’ ‘to treat (something) as if (1) it were really something else, or (2) it had qualities that it does not have.’ Bennion Statutory Interpretation (3rd ed. 1997, p. 735), states: ‘Deeming provisions Acts often deem things to be what they are not. In construing a deeming provision, it is necessary to bear in mind the legislative purpose.’

The Parliament of India has used ‘deem’ in varied legal instruments, including the Insolvency and Bankruptcy Code, 2016 (Code/ IBC). The verb ‘deem’, and its variants feature numerous times in the Code, and the rules and regulations made thereunder. But what does it actually mean when it incorporates deeming provisions in a statute? Reflect on the following examples:

The Chairperson, Members, officers and other employees of the Board shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Code, to be public servants within the meaning of section 21 of the Indian Penal Code10; (emphasis added)

…an application shall be deemed to be false in material particulars in case the facts mentioned or omitted in the application, if true, or not omitted from the application as the case may be, would have been sufficient to determine the existence of a default under this Code.11; (emphasis added)

The interim resolution professional or the resolution professional, as the case may be, may call for such other evidence or clarification as he deems fit from a creditor for substantiating the whole or part of its claim.12; (emphasis added)

Any modification in the request for resolution plan or the evaluation matrix issued under sub-regulation (1), shall be deemed to be a fresh issue and shall be subject to timeline under sub-regulation (3).13(emphasis added)

If the authority is satisfied, after such scrutiny, inspection or inquiry as it deems necessary, that the applicant is eligible under these rules, it may grant a certificate of registration to the applicant to carry on the activities of a registered valuer for…;14 (emphasis added)

the appropriate regulator may, where deemed necessary, constitute an Advisory Committee, within 45 days of the insolvency commencement date15...; (emphasis added)

Taking into consideration the aforesaid examples of the statutory deeming provisions in the Indian insolvency law regime, it is clear that the word ‘deem’ can have diverse meanings. In the first, second, and fourth statutory specimens, the word ‘deem’ denotes ‘considered or regarded as or reckoned’ for explicitly treating something or someone to be or think of it or her/ him as something else. In the third, fifth, and sixth samples, it is used in the nature of a ‘determination or ‘judgement’, as in the exercise of discretion while making a decision.

It bears emphasis that the meaning to be attached to the word ‘deemed’ must depend upon the context in which it is used. The usage of the term does not invariably and necessarily implies an introduction of a legal fiction, but it must be read and understood in the context of the whole statute.16 In fact, deeming provisions take a variety of forms and perform different functions. For example, they may,
inter alia: (a) appear in the interpretation sections of a statute to modify a definition; (b) relate to the legal, jurisdictional or geographical status of particular persons; (c) be used to regulate contractual terms; (d) be used to affect the basis for the calculation of payments such as tax or compensation; or (e) stipulate when something has been done, or regulate whether it has been done in time.

In this milieu, Sullivan classifies deeming rules into four broad categories according to their purpose:

- to create a legal fiction by declaring that something exists or has occurred regardless of the truth of the matter;
- to declare the law;
- to create a legal presumption by declaring that certain facts are to be taken as established; and
- to confer discretion.

From a compendious reading of the aforesaid, one can deduce that a deeming provision might be made to include what is obvious or what is uncertain or to impose for the purpose of a statute an artificial construction of a word or phrase that would not otherwise prevail. However, in each case it would be a question as to with what object the legislature has made such a deeming provision. In the discussion that ensues, the author explains each class in further detail by alluding to relevant examples from the Code.

**CREATION OF STATUTORY FICTIONS**

‘A deeming provision is a statutory fiction...A deeming provision artificially imports into a word or expression an additional meaning which they would not otherwise convey besides the normal meaning which they retain where they are used; it plays a function of enlargement analogous to the word “includes” in certain definitions...’

Statutory fictions are well-known in law. It is widely believed that deeming provisions create legal fictions. Deeming provisions are often used in statutes to give the subject-matter a meaning not ordinarily associated with it. In Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited v. Axis Bank Ltd., (Anuj Jain) the Supreme Court of India (SC) discussed the ambit of ‘deemed preferences’ in the scheme of the Code. By referring to section 43 of the Code, it observed that legal fictions were created whereby preference is deemed to have been given; and is deemed to have been given at a relevant time, if the stated requirements are satisfied. It placed reliance on its own judgment in Pioneer Urban (discussed infra) and Hindustan Cooperative Housing Building Society Limited v. Registrar, Cooperative Societies and Anr.

Both the sub-sections (4) and (2) of section 43 were held to be ‘deeming provisions’, and upon the existence of the ingredients stated therein, the legal fiction would come into play. Any such transaction entered into by a corporate debtor (CD) would be regarded as a preferential transaction with the attendant consequences as per section 44 of the Code, irrespective of whether it was in fact intended or even anticipated to be so. It held that any transaction that answers to the descriptions contained in sub-sections (4) and (2) of section 43 will be presumed to be a preferential transaction at a relevant time, even though it may not be so in reality. This conclusion was based on their finding on the principal purpose of ‘deeming provisions’ viz. ‘to deem what may or may not be in reality, thereby requiring the subject-matter to be treated as if real.'
For the construction of a ‘deeming fiction’, the SC referred to Pioneer Urban to cull out some settled principles from the judgment of Lord Asquith in East End Dwelling Co. Ltd. v. Finsbury Borough Council:

If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequence and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it -. The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs.

Some pre-independence case laws are also relevant to understand the judicial stewardship in this area. In Commissioner of Income Tax, Bombay v. Bombay Corporation, Lord Dunedin observed:

Now when a person is ‘deemed to be’ something the only meaning possible is that whereas he is not in reality that something the Act of Parliament requires him to be treated as if he were.

Lord Justice James in Ex parte, Walton: In re, Levy observed:

When a statute enacts that something shall be deemed to have been done, which in fact and truth was not done, the court is entitled and bound to ascertain for what purposes and between what persons the statutory fiction is to be resorted to and full effect must be given to the statutory fiction and it should be carried to its logical conclusion.

In effect, a normatively desirable outcome was reached in Anuj Jain by reading a legal fiction into a deeming provision. To take another example, the fiction of corporate personality creates a legal entity with its own powers, rights, duties, and liabilities. It allows the corporations to function and exist independently of its shareholders and directors as a separate juristic person. This facet is relevant vis-à-vis section 32A of the Code. In Tata Steel BSL Limited & Anr. v. Union of India & Anr., the High Court of Delhi held that the CD would not be liable for any offence committed prior to commencement of the corporate insolvency resolution process (CIRP). It also clarified that due to the application of section 32A of the Code, the order will not affect the prosecution of the erstwhile promoters or any of the officers of the CD who may be directly responsible for committing the offences.

DEEMED APPROVALS

In project development and management, “deemed approvals” means that if a project does not get approval from a Government agency within the period stipulated, then it is deemed to be approved. The Uttar Pradesh Real Estate Regulatory Authority (UPRERA) issued an order, according to which the authority shall order possession to the allottees in case the occupancy certificate is pending for approval beyond stipulated time. The authority shall consider the situation as deemed approval. To apprise, section 11 (4) (b) of the Real Estate (Regulation and Development) Act, 2016 (RERA) makes it mandatory for the promoter to obtain Occupancy or Completion Certificate from the competent authority, as the case may be. Upon submission of the intimation by the developer regarding the completion of project, the authority has to take a decision within seven days and intimate the deficiencies to the developer.

Deemed approvals are in the nature of proactive steps taken by the regulators generally to reduce bureaucratic red-tapism and affix responsibility on the concerned public official. For example, section 31 of the Competition Act, 2002, empowers the Competition Commission of India (CCI) to afford
approval to certain proposed combinations on the pedestal of a determination whether they entail any ‘appreciable adverse effect on competition’. Pertinently, sub-section (11) of section 31 comprises the provision regarding ‘deemed approval’ of the CCI to a combination. An example of a deemed renewal is encompassed in regulation 12A of the Insolvency and Bankruptcy Board of India (Model Bye- Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016. It stipulates that if the authorisation for assignment is not issued, renewed or rejected by the Insolvency Professional Agency within fifteen days of the date of receipt of application, the authorisation shall be deemed to have been issued or renewed, as the case may be, by it.

In a similar vein, in the Indian insolvency law framework, the Circular (dated January 28, 2020) by the Insolvency and Bankruptcy Board of India (IBBI), as an Authority designated under the Companies (Registered Valuers and Valuation) Rules, 2017 is relevant. The Circular encapsulates ‘deemed no objection for transfer’ of the membership of a professional member from one Registered Valuer Organisation (RVO) to another. The issuance of a ‘deemed no objection’ sought for by the professional members (valuers) for the transfer ensures the processing of such applications in a time-bound manner by the concerned RVO. For this purpose, the Circular classifies the timeline for transfer in two categories, namely, transfer of membership before registration as a valuer with the IBBI and transfer of membership of a registered valuer.

Similarly, rule 5 (d) of the IBBI (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 provide for affording a ‘deemed no objection’ to persons who would be in control or management of the financial service provider (FSP) after approval of their resolution plan by the committee of creditors under section 30 (4) of the Code and by the Adjudicating Authority (AA) under section 31 of the Code. Upon a ‘no objection’ being sought by the Administrator, the appropriate regulator shall issue ‘no objection’ on the basis of the ‘fit and proper’ criteria applicable to the business of the Financial Service Provider. Where the appropriate regulator does not refuse the “no objection” within 45 days of the receipt of such application from the Administrator, it shall be deemed that the “no objection” has been granted.

**DEEMING RULES CONFERRING DISCRETION**

The provisions that empower a certain entity or a Government agency to, *inter alia,* ‘deem fit’ or ‘deem necessary’, are in the nature of conferring discretion on the said entity or agency. Statutory powers of all forms are often exercisable when an authorised holder of the power ‘deems’ something. In this context, ‘deem’ is employed to confer a discretionary power and is synonymous with the words ‘consider’ or ‘decide.’

The Code and the rules and regulations, made under its auspices, contain a few examples of the word “deem” being used in this manner. One instance is sub-section (2) of section 207 empowering the IBBI to ‘specify the categories of professionals or persons possessing such qualifications and experience in the field of finance, law, management, insolvency or such other field, as it deems fit.’ Regulations 10 and 23 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 and IBBI (Liquidation Process) Regulations, 2016, respectively, provide that in the matter of substantiation of claims, the interim professional (regulation 10) or the liquidator (regulation 23), may call for such other evidence or clarification as he deems fit from a creditor for substantiating the whole or part of its claim.
DEEMING RULES THAT DECLARE CERTAIN FACTS AS BEING CONCLUSIVE

Deeming rules that declare certain facts as established create a presumption that accepts something as a fact without the benefit of evidence. The presumption created by such a deeming provision may be either conclusive or rebuttable. The latter type may be useful to deal with an evidentiary gap. The purpose of the former is rather to create a legal rule: since legal consequences attach to a set of facts, if the facts are conclusively presumed, the legal consequences follow automatically in all the circumstances.

Our normative texts encompass a plethora of deeming rules. One of the main reasons for incorporating them is to ascribe equal treatment to two scenarios or transactions that are different in legal substance but analogous in economic or commercial effect. For instance, in Pioneer Urban Land and Infrastructure Limited & Anr. v. Union of India and Others, the SC deliberated upon the constitutional validity of the amendment, in respect of the categorisation of the home buyers as financial creditors (FC), by the insertion of an Explanation to section 5(8)(f) of the Code. It observed that the deeming provision contained in the Explanation is only clarificatory of the initial legal position as was enunciated at the time of the inception of the Code. The effect of the deemed categorisation of a home buyer as an FC in section 5(8)(f) is that any amount raised from an allottee under a real estate project would have the commercial effect of a borrowing and treated the same way as a ‘financial debt’ disbursed against the consideration for the time value of money, to the extent that such amount should be raised under any other transaction, including any forward sale or purchase agreement. The logic behind the legal fiction of section 5 (8) (f) appears patent: although any amount raised from a real estate allottee is not technically the same as a financial debt, economically it has the same effect and therefore, equivalent to a ‘financial debt’.

The SC placed reliance on Stroud’s Judicial Dictionary of Words and Phrases (Seventh Edition, 2008), that defines 'deemed' as

to extend the denotation of the defined term to things it would not in ordinary parlance denote, is often a convenient device for reducing the verbiage or an enactment, but that does not mean that wherever it is used it has that effect; to deem means simply to judge or reach a conclusion about something, and the words ‘deem’ and ‘deemed’ when used in a statute thus simply state the effect or meaning which some matter or things has- the way in which it is to be adjudged; this need not import artificiality or fiction; it may simply be the statement of an indisputable conclusion.

The said reference was grounded in traversing a path of divergence from the usual stride of interpretation. While recognising that ‘a deeming provision is to deem what is not there in reality, thereby requiring the subject matter to be treated as if it were real...’, the departure was made palpable by the SC in that a ‘deeming fiction can also be used to put beyond doubt a particular construction that might otherwise be uncertain’. The SC, thus, observed that the deeming fiction that is used by the Explanation is to put beyond doubt the fact that real estate allottees are to be regarded as FCs in terms of the operative part of section 5(8)(f) of the Code.

The Code ‘declares the law’ by the utilisation of ‘deemed’ provisions. For example, the provision enunciating a ‘deemed withdrawal’ as contained in the third proviso to sub-section (1) of section 7 of the Code deserves mention. The first and second provisos provide for the initiation of the CIRP against a CD by creditors in a class, referred to in clauses (a) and (b) of sub-section (6A) of section 21 and allottees in a real estate project. The third proviso builds upon the first two in stipulating that the non-
admission of an application under either of the two provisos for the CIRP by the AA before December 28, 2019 (the commencement of the Insolvency and Bankruptcy Code (Amendment) Act, 2020) would necessitate modification by the applicants to ensure compliance with the requirements of the first or second provisos, within thirty days thereof. And, upon failure to undertake the said modification, the application shall be deemed to be withdrawn before its admission.

Consider further the declaration encompassed in section 33 (7) of the Code regarding an order for liquidation to be deemed to be a notice of discharge to the officers, employees, and workmen of the CD. This deeming provision cannot be seen to create a legal fiction. It may be quite realistic to state that an order of liquidation effectively discharges all the stakeholders and particularly the officers, employees, and the workmen of the CD.

**VALIDATING STATUTES**

Sometimes the legislature uses ‘deeming provisions’ to validate certain laws. For instance, while repealing the Presidency Towns Insolvency Act, 1909 (3 of 1909) and the Provincial Insolvency Act, 1920 (5 of 1920), the Code in clause (iii) of sub-section (2) of section 243 states—

> anything done or any action taken or purported to have been done or taken, including any rule, notification, inspection, order or notice made or issued or any appointment or declaration made or any operation undertaken or any direction given or any proceeding taken or any penalty, punishment, forfeiture or fine imposed under the repealed enactments shall be deemed valid;
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(emphasis added)

**CONCLUSION**

Deeming provisions while frequently resorted to by the Courts must be utilised prudently. Since such provisions are not operative components of a legislative enactment their interpretive import is limited. Therefore, while enacting such provisions the legislature needs to assess the consequences of such an automatic conferment of status. Some determination would be required to be conducted before the conferment of such a status on the concerned persons. It may, unknowingly, lead to excessive delegated legislation, thereby twisting the real legislative intent. Despite these concerns, deeming provisions, at least the ones that that facilitate understanding about the law and its functions and impart justice are sometimes indispensable to legal thinking. With deemed approvals unequivocal responsibility could be affixed with the decision makers and relevant agencies, to allocate their resources appropriately and fulfil their roles within the expected time frames. The expectation is that, following this, social and economic benefits flow, with greater clarity and certainty for the applicants as well as speedier on-the-ground provision.

Just as musical renditions are composed on staves with bars signalling timing, the legal provisions should have a coherent framework for their component parts such as, sections, sub-sections, and other segments. Structural conventions, for music and for statutory provisions, provide a framework for both the readers, judges, lawyers, and the users of the law. The framework aids in communicating the intent of the adjudicator and the legislators. Jerome Frank holds that judges while interpreting the myriad statutory provisions may be likened to musical performers when playing the musical symphonies. Inevitably, judges like musical performers are to some extent creative artists who communicate the intent, the meaning, and spectacle of the law to varied audiences.44
Having said that, it is also important to be taken note of that the vitality of drafting to the practice, propagation and understanding of law is underrated. Legislative drafting is not a form filling exercise. Any legal analysis involves a dexterous interpretation of the different components of a piece of law enacted by the legislative body of a country. While judicial deference to the legislative intent is the interpretive norm, any legislative action is subject to the power of judicial review. This entails testing it on the touchstone of legislative competence and generally, in constitutional democracies, on the parameter of not being ultra vires the constitutional provisions. This gives an indication that makes the task of legislative drafting a difficult one.

NOTES


3 Id. at p. 718.


5 As observed by the Supreme Court in Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd., [1987 SCR (2) 1].


7 Objective theory of legal science- ibid.

8 Simon Stern (2015), Legal Fictions and Exclusionary Rules, Chapter 8, pp. 157-174, in Del Mar and Twining.


10 Section 232, IBC.

11 Section 77, IBC.

12 Regulation 10 (Substantiation of claims) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.


14 Sub-rule (6) of Rule 6 of the Companies (Registered Valuers and Valuation) Rules, 2017.

15 Clause (c) of Regulation 5 of the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019.


17 See the definition of “managing director” in section 2 (54) of the Companies Act, 2013; Also See clause (2) of Article 110 of the Constitution of India; Also See definition of “promoter” in section 2 (zk) of the Real Estate (Regulation and Development) Act, 2016.

18 Section 30 of the Mines and Minerals (Development
and Regulation) Act, 1957—“...the Special Court shall be deemed to be a Court of Session and shall have all powers of a Court of Session and the person conducting a prosecution before the Special Court shall be deemed to be a public prosecutor.”

19 For example—section 12 of the Hindu Adoption and Maintenance Act, 1956 states that an adopted child from the date of his adoption will be deemed to be the child of his adoptive parents and all his ties with his natural family will be severed.

20 Sections 22(1) and 25, Companies Act, 2013.

21 Section 115J, Income-tax Act, 1961 creating a deeming fiction.

22 Explanation I to section 42, Companies Act, 2013.

23 See Article 109 of the Constitution of India pertaining to the procedure in respect of Money Bills—Clause (5) provides that (5) if a Money Bill passed by the House of the People and transmitted to the Council of States for its recommendations is not returned to the House of the People within the said period of fourteen days, it shall be deemed to have been passed by both Houses at the expiration of the said period in the form in which it was passed by the House of the People; Also See section 5 (2) of the RERA regarding the “grant of registration”—“If the Authority fails to grant the registration or reject the application, as the case may be, as provided under sub-section (1), the project shall be deemed to have been registered,...”; Also section 9 (4) of the RERA—Registration of real estate agents; section 31 (5) and (9) of the Competition Act, 2002—deemed appreciable adverse effect on competition.


28 2020 SCC Online SC 237.

29 2019 SCC Online SC 1005.


32 (1951) 2 All ER 587.

33 AIR 1930 PC 54.

34 Also see M/s Ispat Industries Ltd. v. Commissioner of Customs, Mumbai (2006) 202 ELT 561 (SC).

35 (1881) 17 Ch D 746.

36 Supra note 2.


38 Id. at p. 5.

39 Order dated September 16, 2019- https://www.up- rera.in/pdf/CCorOC.PDF.

40 If the CCI does not, on the expiry of a period of two hundred and ten days from the date of notice given to the Commission under sub-section (2) of section 6, pass an order or issue direction in accordance with the provisions of sub-section (1) or sub-section (2) or sub-section (7), the combination shall be deemed to have been approved by the Commission.


42 2019 SCC Online SC 1005.

43 Para 83/ p. 178- ibid.

The focus on resolution of stressed legacy accounts of Banks continues. The legal framework has been strengthened to facilitate resolution, through the enactment of the Insolvency and Bankruptcy Code and the amendments to the SARFAESI and Debt Recovery Tribunal Acts.

- Shri Arun Jaitley, Hon'ble Minister of Finance and Corporate Affairs in the Budget Speech 2016-17, February 1, 2017.
Social Ramifications of Bankruptcy Law

Pihu Mishra and Sushanta Kumar Das

But at present the laws of bankruptcy are considered as laws...founded on the principles of humanity as well as justice; and to that end they confer some privileges, not only on the creditors, but also on the bankrupt or debtor himself.

Bankruptcy law has generally emerged as a purely economic legislation. For personal bankruptcy law, however, it is also, if not primarily, a social legislation. Bankruptcy law is not just economic legislation, but social legislation that establishes ‘how far individuals should be expected to go on carrying responsibilities that have grown onerous.’ When individuals file for bankruptcy, they obtain relief from debts incurred or have their debts entirely forgiven. Essentially, this process creates a system of legalised post-contractual opportunism, which is justified in large part by the moral judgment that an honest but unfortunate debtor should be entitled to a discharge of debts.

Although some scholars have examined the social foundations of individual bankruptcy law, these discussions focus almost exclusively on the moral foundations of the fresh start and ignore the larger moral and social issues raised by bankruptcy law.

The article studies the role of social faiths and beliefs in evolution of personal bankruptcy law, the social stigma attached with ancient bankruptcy norms and the evolution of the law from a law aiming for recovery from body of the debtor to recovery from the property of the debtor. It also provides an insight into the individual insolvency provisions of the Insolvency and Bankruptcy Code, 2016 (Code/IBC) highlighting the unique features of the new personal bankruptcy regime.

EMERGENCE OF BANKRUPTCY LAW: EARLY PRACTICES AND SOCIAL STIGMA

Individual bankruptcy has been condemned throughout most of human history. Debtors’ prisons remained the dominant response to bankruptcy through history. The austerity of the moral and legal condemnation, traditionally associated with bankruptcy, reflects the social thinking about the gravity of the act. In part, societal and moral extremities reflect the datum that for most of human history, and during the formative period of both psychological makeup of the society and most major religious codes, individuals lived in static economies. Borrowing was a short-term transfer from the lender to the borrower and the borrower was expected to repay it. A debtor therefore had no good explanation for why he might later be unable to repay the loan. The failure to do so was therefore traditionally considered a form of fraud or theft, punishable by similarly severe sanctions. A legal discharge of debts through bankruptcy did not exist.
Person of the Debtor

The practice of recovery of debt from the person of the debtor was the most common practice since the inception of bankruptcy law. Though the law in every region had its own mode of evolution, this practice of recovery can be found in most of the depicts of law. It was the debtor himself and his family members (not debtor’s property) that formed the debt insurance guarantee. This rule can be found in the strict laws of Manu and in the law of Moses. It was also established practice in Egyptian and Greek Laws.

Under Hindu law the creditor could seize the person of his debtor and compel him to labour for him. Actual violence might also be resorted to by the creditor; he could kill or maim the debtor, confine his wife, sons or cattle, or besiege him in his home. This is typical of primitive law in general. A number of Biblical references, to prove that slavery for debt, did exist. The Egyptians regarded the claim of the state to the debtor’s person as superior to that of the creditor, for the state might at any time require the debtor’s service, in peace as an official or laborer, in war as a soldier. In the Code of Hammurabi, the insolvent debtor was regularly sold into slavery. It also frequently happened that the debtor’s kinsmen would be sold into bondage in order to pay off his obligations.

The shift from recovery of debt from debtor’s person to debtor’s property can be said to be the real point of evolution of bankruptcy law as before that it was more of a private venture free from intervention of any State authority. But the arbitrary nature of the recovery procedure still continued even after involvement of State authorities as the legal position remained biased towards the debtor.

Interest on the debt

It is only when the concept of economic progress and the understanding of investment and capital growth became established, that the idea of charging interest became morally acceptable. Given the modern appreciation of investment as the source of economic growth, it is understandable why bankruptcy is taken for granted in the context of business investment. Although bankruptcy may now be acceptable in the business context, bankruptcy remains suspect in many countries and legal systems as a remedy for individuals.

In bankruptcy law literature, many scholars have opined on the phenomenon, mainly arguing whether the stigma associated with bankruptcy still exists or has declined over time. To date, the legal literature has generally treated bankruptcy stigma as an ‘all or nothing’ issue; that is, arguing over whether a stigma exists (or not), or exploring whether the stigma has declined (or not) over the past several decades. In this regard, legal scholars addressing bankruptcy stigma have fallen into two general camps. On one side of the divide are Professors Teresa Sullivan, Elizabeth Warren and Jay Westbrook, who argue that not only is bankruptcy stigma alive and well, but that this social phenomenon may have increased in the past several decades (Sullivan, Warren and Westbrook, 2006). Conversely, Professors Todd Zywicki and Rafael Efrat contend that the stigma associated with filing for bankruptcy relief has declined over time (Zywicki, 2005; Efrat, 2006a). Each camp has in the past criticised the other regarding the merits of their respective claims over the continued vitality of bankruptcy stigma.

BANKRUPTCY: A SOCIAL LEGISLATION OR ECONOMIC LEGISLATION?

The term ‘society’ means relationships social beings, express by creating and re-creating an organisation which guides and controls their behavior in myriad ways. Society liberates and limits the activities of men and it is a necessary condition of every human being and need to fulfillment of life. Society is a system of usages and procedures of authority and mutual aid many divisions of controls of human
behavior and of liberties. Society exists only where social beings ‘behave’ toward one another in ways determined by their recognition of one another.

Within any given society, there is a generally acceptable range of permissible individual behaviors that is culturally determined and relevant. ‘Standards or rules about what is acceptable behavior are referred to by social scientists as norms. The importance of a norm usually can be judged by how members of a society respond when the norm is violated’. More specifically, prevailing cultural norms are ‘shared rules or guidelines that define how people [in a society] ‘ought’ to behave under certain circumstances’.

The vilification of bankruptcy is easy to understand with respect to societal bondages. Incurring a debt creates a contractual and moral obligation to repay that debt. The failure to do so usually exposes the debtor to severe legal sanctions as well as moral obligations, whether self-imposed or enforced by society. The debtor, for example, has a moral, as well as legal, obligation to allocate his property to the payment of his debts and generally cannot convey his property without reasonable consideration in return. Thus, when Mr. X borrows some amount from Mr. Y and fails to repay it, X is not simply out of money, but also suffers moral outrage independent of the amount borrowed. The breach of the promise and the failure to recognise and reciprocate the good deed by adhering to the terms of contract triggers a sense of moral resentment related to the breach of trust itself, regardless of the amount borrowed. The emergence of this moral resentment is ‘aroused by the perception of injustice; as such, it is part of the emotional underpinning of human morality’.

In the world of easy bankruptcy laws, individual debt is no longer a disciplining device but an opportunity for profligate spenders to live beyond their means and to impose the costs of doing so on those who live responsibly. As Lynn LoPucki, a professor at UCLA Law School, observes:

Consumer bankruptcy contradicts the morality of Aesop’s fable [of the grasshopper and the ant]. Today’s ants eat beans at home, don’t buy the kids new sneakers, and don’t try to buy the new house until they have stable jobs and down payments. They hang onto the jobs, even when the going gets tough, particularly if the jobs come with health insurance. The grasshoppers eat at the pizza parlor on Friday night and buy the new sneakers and the houses. They quit their jobs when the going gets tough. The fallout lands on their credit cards. When winter comes, they discharge the credit card debt in bankruptcy. The ant played by the rules, the grasshopper did not. In the end, consumer bankruptcy made them equals.

TRANSITION OF BANKRUPTCY LAW: FROM PERSON TO PROPERTY

All bankruptcy laws aim to secure an equitable division of the insolvent debtor’s property among all his creditors, and, in the second place, to prevent on the part of the insolvent debtor conduct detrimental to the interests of his creditors. In other words, bankruptcy law seeks to protect the creditors, first, from one another and, secondly, from their debtor. A third object, the protection of the honest debtor from his creditors, by means of the discharge, is sought to be attained in some of the systems of bankruptcy, but this is by no means a fundamental feature of the law.

In course of time, execution for debt came to be directed against the property of the debtor rather than his person. It is hardly likely that this transition indicates that the religious sanction had lost its pristine potency or that execution against the person had come to be regarded as barbaric. The change from the one form of execution to the other, slow and gradual as it was, is an instance of the general evolution of legal process from the stage were retaliation is the end in view to the stage where compensation is the chief desideratum.
In most systems of jurisprudence, the development of proprietary execution was a natural one. The ancient Jewish and Germanic notion, for instance, of the execution against the person was that the body of the debtor was a pledge or security for the payment of the debt. It is perfectly natural that in course of time the Jewish and Germanic people should come to look upon each portion of the debtor’s property as a pledge or security for the debt. Here the transition was from execution against the person to execution against a particular portion of the debtor’s property seized by an individual creditor for the benefit of himself alone.

Many would be loath to accept the simple assessment that ‘bankruptcy is merely a legal consequence of economic facts,’ and would respond that the consequences (and anticipation) of social stigma, of a stain on one's reputation and one's ‘good name’, are factors that cannot be overlooked in attempting to come to an understanding of the decision to declare bankruptcy. But in this increasingly depersonalized society, how important is a good name? Apparently, it is still especially important. People still fight to protect their good names. Indeed, people's willingness to take such fights to court has created what some have called a 'libel crisis'. And, in an age where the presumption is that litigation is in large part prompted by avarice, research suggests that the libel suit represents a clear exception; people do not sue ‘to obtain monetary relief for financial harm. Instead, the major motivating factors are restoring reputation, correcting what plaintiffs view as falsity, and vengeance.’ Stigma must be viewed as more than simply a residual category (or error term) in a cost-benefit analysis of the decision to declare bankruptcy. Today, default entitles a lender to seize the debtor’s nonexempt property in satisfaction of the debt. In a world in which social assessment of personal worth is grounded (or so many believe) in the belief that ‘bad things happen to bad people,’ the emotional and social consequences of bankruptcy cannot be ignored.

THE INDIAN CONTEXT

The law of insolvency in India, like most other laws, owes its origin to English Law. Before the British came to India there was no indigenous law of insolvency in the country. Earlier statute, dating back to the 16th century and subsequent years, contained only rudimentary provisions as to bankruptcy.

The important statutes on the subject are the Bankruptcy Act passed by British Parliament in 1849, 1869, 1883 and 1914. The need for insolvency law was first felt in the three Presidency Towns of Bombay, Calcutta and Madras where Britishers were carrying on their trade and commercial activities. The Government of India Act, 1800 has section 23 and section 24 conferring insolvency jurisdiction on Supreme Court at Fort Williams and Madras and the Recorder’s Court at Bombay. Power was given to these courts to make rules and orders for granting relief to the insolvent debtors on the lines intended by the Lord’s Act passed by British parliament in 1759.

In 1828, the beginning of insolvency law in India was made with the passing of Statute 9. By this, first insolvency Courts to grant relief to the insolvent debtors were established in Presidency Towns. The Courts were called ‘Courts for the Relief of Insolvent Debtors’. Separate and distinct status was given to the Insolvency Courts which can sit and dispose the insolvency matter as and when necessary. They were court of records. Any person aggrieved by an order of the Court had a right to make a petition to Supreme Court.

Though the Act of 1828 was supposed to be in force for a period of four years only, the same was extended till 1848 by making various amendments as was considered necessary. It was in 1848 that Indian Insolvency Act was passed which differentiated between traders and non-traders in certain
aspects (similar to the Bankruptcy Law in England). By this Act the Courts for the Relief of Insolvent Debtors established by the Act of 1828 were continued, but the Court was to be held before a judge of the Supreme Court.\textsuperscript{33}

The insolvency jurisdiction of the Supreme Court in Presidency Towns was transferred to the High Courts by the passing of Indian High Courts Act, 1861. The Insolvency Courts still continued to be separate tribunals and were not affected by the Act of 1861 except that a judge of the High Court was to preside over such court.\textsuperscript{34}

The main features of the Indian Insolvency Act, 1848, were that the Act was more for the benefit of the debtors than for the benefit of the creditors. The provisions for the discovery of the insolvent's property were very basic and the burden of proving misconduct on an application by the insolvent for his discharge rested entirely on the creditors. The power of the official assignee was very limited. He merely collected assets and he had no power to intervene in any proceedings. Under section 7 of the Act of 1848, on the making of a vesting order the property of the insolvent wherever situate vested in the Official Assignee. The vesting order operated as a statutory transfer of immovable property situated not only within India but also within the British Empire outside India.

To overcome the existing lacunas in the Insolvency Act, 1848, Sir James Fitzjames Stephen, proposed an Insolvency Bill modelled for whole of the India (based on English Bankruptcy Law) in the 70s, but the proposal was dropped as the conditions of that time were not suitable for a new legislation. Thus, the Act of 1848 was in force in the Presidency Towns until the enactment of present Presidency-towns Insolvency Act, 1909. Subsequently, in 1920 after various attempts, Provincial Insolvency Act, 1920 was passed for the provinces (mofussil). Since then, personal bankruptcy was adjudicated by these two archaic laws – The Presidency-towns Insolvency Act, 1909 and The Provincial Insolvency Act, 1920. The former relating to individuals residing in the erstwhile presidency towns of Calcutta, Bombay and Madras. The latter covers all individuals residing in other parts of the country. The Provincial Insolvency Act, 1920, abolished the debtor’s right to be released from prison, if he was in prison at the date of the order of adjudication. The Acts failed to evolve with the changing needs of the society and also the strict provisions of imprisonment continued to stigmatise the honest failures.

During the enactment of the present Presidency-towns Insolvency Act, 1909 it was observed by the Hon’ble Sir H. Erle Richards, \textsuperscript{35}

\begin{quote}
The difference in the conditions between Presidency Towns and mofussil makes it inexpedient to have one uniform act for whole of India at the present time but there will be little difficulty in bringing the two act into complete agreement if it be thought to do wise in the future.
\end{quote}

Asiya Siddiqi documents the conduct of laws in India to deal with bankruptcies in her book ‘Bombay’s People, 1860-98: Insolvents in the City’. Her research informs that in the Indian society, imprisonment for debt has not generally been used as a means of enforcing payments. However, various customary methods were used to induce debt payment which included influence of elders and personal moral pressure. By 19th century, the practice of confinement of debtors in state prisons for non-payment of debts, became a practice in Bombay. However, this was seen as a burden by the colonial government. Hence, the Act of 1828, which laid down initial procedure and infrastructure for the adjudication of bankruptcy petitions, aimed as not booking debtors but providing them with relief. It is known that 85 per cent of the 20,980 petitioners who filed for bankruptcy in Mumbai over the period 1860 to 1898, got protection from arrest or detention.
**Need for Single Bankruptcy Law**

India is predominantly a rural country with a two-third population and 70 per cent workforce residing in rural areas. The rural economy constitutes 46 per cent of national income. Despite the rise of urbanisation more than half of India's population is projected to be rural by 2050.36

Rural development focuses on increasing economic activities in rural areas. To realise higher productivity, capital needs to be infused in the rural economy from time to time. Credit plays an important role in rural development as it is needed by farmers to meet the initial investment on seeds, fertilisers, implements, etc. till the crop is ready. Credit is also required for other family expenses of marriage, death, religious ceremonies, etc. so that the farmers are saved from the exploitation of moneylenders and traders (it is a common practice of charging high-interest rates and manipulating the accounts) whose ultimate goal is to keep them in a debt-trap. In the case of deficit monsoon, crop yield is low and farmers need to be shielded against this loss by providing credit and insurance.

Previously, funds were predominantly borrowed from village-level moneylenders and other informal agents who charged hefty interest rates. This led to a multitude of travails for the farm sector since high-interest rates left little income for farmers and during periods of crop failure, farmers often found themselves unable to repay their dues. To ameliorate the problem of farmer distress, the Government of India has made strides in expanding the formal banking network into rural areas following bank nationalisation. Additionally, to further attract farmers seeking short-term funds for cropping to the formal sector, the government introduced an Interest Subvention Schemes which are announced from time to time.

The dependence of the Indian economy on agriculture is an unquestioned fact, but when referring to the credit market as a whole, other sources responsible for maintaining the credit flow in the rural society also gain importance. These sources are mostly small businesses set up in households, self-help groups, local handicraft workers etc.

**Natural Calamities:** There are 12 types of natural calamities covered by the National Disaster Management Framework of the Government of India viz., cyclone, drought, earthquake, fire, flood, tsunami, hailstorm, landslide, avalanche, cloud burst, pest attack, and cold wave/frost. The damage caused by these unpredictable and unavoidable circumstances leads to a financial crisis in society. Though, the Reserve Bank of India (RBI) has mandated banks to provide relief measures, where the crop loss assessed was 33 per cent or more, in the areas affected by natural calamities, the root cause of the problem continues with every such misfortune. The relief measures by banks, *inter-alia*, include restructuring/ rescheduling existing loans and sanctioning fresh loans as per the emerging requirement of the borrowers.

**Existing Societal norms:** Though there is a shift in the society with regards to availing credit facilities offered by the financial institutions yet, a large portion of the society is still trapped in the bubble of moral obligations and is threatened by the thought of default and state of bankruptcy. There are various examples where, initially an individual is forced to take credit in the name of religious ceremonies like marriage and eventually when he is unable to repay, he is tagged bankrupt by the society.

In an attempt to curb such practices, various tribal activists have highlighted one such practice in the area of Madhya Pradesh, wherein the name of marriage expenses and dowry, innocent individuals are forced into bankruptcy. Tribal right activist Shankar Tadavla, observes:

Earlier, the amount was small, and no one used to mind, but over the years due to the influence of non-tribal and tendency to show-off, the amount has now increased. The reverse dowry has increased to
Rs. 3.5 lakh, liquor served in marriages costs around Rs. 1 lakh. This is apart from the other marriage expenses which cost anywhere between Rs. 50,000 to Rs. 1 lakh. Most tribal families do not have this kind of money and are forced to sell their land, migrate to other places to earn or borrow from money lenders at exorbitant interest rates and thus fall into a debt trap. We are planning to change all of this.38

In many other similar societies, declaring oneself bankrupt is looked down upon and condemned by society. The tag of bankruptcy brings with itself the tag of fraud and cheat.39

Managing agrarian crisis and bankruptcy is a huge challenge in the way forward. The RBI has taken several steps to encourage banks to lend to non-banking financial companies and retail borrowers. In a bid to combat sluggish demand, the government and the central bank have taken several measures to help keep credit flowing to the real economy. Averting a significant slowdown would help borrowers and, therefore, the stability of the financial system, but the measures could push up banking-sector risk if they lead banks to accept higher credit risk than they previously had an appetite for. Incentivising the economy and minting credit flow is an established practice but what is not established is the approach of acceptance towards bankruptcy.

**IBC: A MODERN LAW FOR INDIVIDUAL BANKRUPTCY**

The insolvency law needs to be particularly sensitive to the cultural context of shame and stigma in the context of admission of financial failure, as these notions can prevent the effective participation of debtors. Providing relief to ‘honest but unfortunate’ debtors has long been a primary purpose of insolvency regimes for individuals. Unmanageable debt burdens cause a host of problems for debtors. Constant anxiety arising from inability to pay or from harassment by creditors can cause serious emotional and other problems for debtors, including depression and social withdrawal. Ironically, overwhelming debt burdens might cause debtors to be unable to concentrate on work and other responsibilities, thus preventing them from responsibly managing their own financial distress and plunging debtors into a descending spiral of failure.

Considering the sheer size, diversity, unique social fabric, and the vulnerable sections of the society in dealing with situations where an individual is in the state of insolvency, India has adopted an approach to treat its honest but unfortunate citizens with sensitivity in the insolvency process of the Individuals. The IBC is an innovation in individual insolvency regime in India and influences a large section of the society.

The Code encourages an ‘earned start’ for the debtor, incentivising him to restructure his debts or business or both on the basis of a repayment plan, and obtains a discharge as per the Code, to resume life afresh. A process for coordinating and humanising the individual insolvency resolution process can put debtors on a healthier path to supporting themselves, addressing their obligations in a more measured and regular way, and participating in society rather than viewing themselves as victims of it.

The IBC consolidates the existing framework by creating a single law for insolvency and bankruptcy. In this spirit, Part III of the Code provides for three processes for individuals: the fresh start process, insolvency resolution process and bankruptcy process. This framework of personal insolvency under Code pursues the objectives enshrined in the legislation. It prevents creditors from aiming to be the first to recover their dues, and thereby facilitates collective proceedings to resolve insolvency. It envisages a new beginning for over-indebted individuals by allowing them to avail a discharge from their debts. In doing so, it relieves the debtor of the burden of debt and isolates minimum assets for his subsistence,
while improving the prospects of realisation for creditors, thereby ensuring fairness and equity. In the Indian context, personal insolvency plays a significant role – not just for the debtors and creditors involved- but also for the economy.

The Code establishes a milestone in the evolution of insolvency law equivalent to the transition from debtor’s person to debtor’s property in the history of insolvency law. The provisions for the arrest of the debtor in the instance of default are omitted; instead, the property of the debtor is vested in the Bankruptcy Trustee, who manages the property of the debtor. The approach adopted for the procedures under Part III of the Code is based on the rationale that addressing the concerns of individual insolvency is a sensitive affair as it attracts social, political, and cultural attributes of the society and is mostly based on the rationale of humanitarian empathy. Suicide by farmers sunk deep into the debt is a live illustration that highlights the need of the insolvency law which aims at providing a dignified exit for such over-burdened and vulnerable strata of society.

The Code aims at protecting the rights of both debtor and creditors and provides equal opportunity of representation. The relationship between the debtor and creditor is preserved and the basic necessities are provided to the debtor to live a dignified life allowing a fresh start post-bankruptcy.

It is undisputed that the Code is recognised as an economic legislation, but the social perspective attached to the individual insolvency cannot be ignored. The Code aims to overcome the mental bondages of stigma associated with the bankruptcy norms and emerge as a legislation for the people. Thus, before notifying the personal insolvency provisions of the Code there is a need for aggressive and persistent systemic campaign of public information to educate citizens about the objective of the insolvency and bankruptcy law to overcome the potential problem of stigma. The citizens need to be sensitised and educated about the rescue mechanism provided for them in the Code. Another dimension closely related to treatment of insolvency is ‘prevention’ of insolvency. The provisions of the Code incorporate elements that aim to address insolvency by avoiding it altogether through financial literacy programmes. Financial literacy is crucial not only for treating existing insolvency; its primary purpose is to prevent its recurrence as well.

CONCLUSION

With the change in social norms and beliefs, the bankruptcy and insolvency laws for individuals have evolved through centuries across the world. India too has seen such evolution with the enactment of the modern law in the form of the IBC. The law has brought an impartial, efficient and expeditious framework in the Indian insolvency regime with an objective of economic reform. The modern law in form of the Code encourages both debtors and creditors to come forward and take responsibility of failure and move on with it without any stigma attached. The social stigma associated with bankruptcy law is the result of the archaic penal procedures that the debtor had to undergo in addition to the failure of his business. The Code in its current form not only removes the stigma associated with the status of bankrupt but also provides a dignified exit to the debtor with possibilities of dignified survival. The provisions of the Code have been drafted considering all the related aspects of trauma and social stigma associated with the state of being bankrupt. They provide modern solution to such issues by focusing on fresh start for cases where chances of recovery are very low and resolution where there is scope for revival of the honest debtor. The Code being a modern law, also considers the issue of agrarian crisis and financial illiteracy particularly, in rural India and provides mandatory provisions for managing smooth implementation of the new procedures. Though unnotified, the Code in its current form has given a ray of hope to all such individuals who have been victim of honest failure and past draconian laws.
NOTES

1 The authors are grateful to Dr. Anuradha Guru, Executive Director, IBBI, for her guidance.


3 Discharge may be viewed as a form of limited liability for individuals—a legal construct that stems from the same desires and serves the same purposes as does limited liability for corporations.


5 Lawrence H. White (1977), “Bankruptcy as an Economic Intervention”, J. Libertarian Stud., pp. 281, 283-84 (discussing loans as contracts giving the creditor a right to payment from the debtor or a lien on his property—a contract that bankruptcy provisions interfere with and debtors take advantage of by “resorting to bankruptcy rather than tightening their belts to meet obligations”).


9 In England, for example, debtors could be imprisoned for failure to pay a debt; the debtor was regarded as a thief. This state of affairs continued until the 19th century. See Supra Note 4, pp. 281-82.

10 Sacred Texts of Manu VIII, 48 ff. By whatever means a creditor may be able to obtain possession of his property, even by those means may he force the debtor and make him pay. By moral suasion, a suit at law, by artful management, or by the customary proceeding’ (U. e., by killing the debtor’s wife, children, or cattle, or by the creditor’s fasting, sitting at the debtor’s door), ‘a creditor may receive property loaned; and, fifthly, by force.’


12 See S. ii5, x6. The wording of the latter section indicates that probably in Hammurabi’s day the right of enslavement among the Babylonians was limited to merchant debtors only.

13 Supra note 8, at 306 (Once capital became creative and its utility in economic progress became clear, moral interpretation was obliged to shift ground.). The changing attitude toward ‘commercial’ debtors was evidenced by such practices as separate bankruptcy statutes for commercial and non-commercial debtors. In England, a non-commercial debtor was viewed as a thief as late as the 19th century.

14 For instance, Israel experienced a ‘massive increase’ in the number of debtors being imprisoned as recently as the early 1990s. Rafael Efrat (1999), “The Evolution Of The Fresh-Start Policy In Israeli Bankruptcy Law”, American Bankruptcy Institute Law Review, pp. 555-600. A bankruptcy reform law passed in 1996 was “the first ideological shift in Israeli history from a relatively conservative view to a more liberal view of the fresh start policy.


David Gray Carlson (1995), “Debt Collection as Rent Seeking”, Minnesota Law Review, p. 842 (“It is sometimes thought that debtors are weak and creditors powerful. This may be so at the time a loan agreement is negotiated, but quite the opposite is true when the debtor is broke and has nothing to gain from prudent management of assets.”).


Ibid.

Lynn M. LoPucki (1997), “Common Sense Consumer Bankruptcy”, The American Bankruptcy Law Journal, p.p. 464. Actually, current law makes the grasshopper better off than the ant, as the grasshopper has already consumed many of the goods and services purchased and will be able to retain most of the other goods purchased. Amazingly, among the recommendations of the National Bankruptcy Review Commission was to allow bankrupts to keep even more of the property purchased prior to bankruptcy, such as by allowing the avoidance of all security interests (including purchase money) for household goods under $500.

The fact that it costs money to file bankruptcy may seem “functional” (to the very cold-hearted, at least) in as much as this puts bankruptcy out of the reach of the most poor who may also have the least reputational stake in avoiding bankruptcy. Still, evidence suggests that having the ‘least reputational stake’ in avoiding bankruptcy does not mean having no stake. Although H. Jacob (1969), “Debtors In Court”, pp. 122 - 24, reported that education was positively related to the degree of stigmatisation felt by bankrupts. D. Caplovtrz, Consumers in Trouble: A Study of Debtors in Default (1974) noted that, when ‘the OEO-sponsored legal services program in Washington, D.C., made a concerted effort to assist overextended debtors declare bankruptcy’ in the 1960’s, ‘[o]f those eligible, less than one fourth of those approached opted for this remedy.’


A debtor seeking relief has two options under the Bankruptcy Reform Act. He may liquidate under chapter 7 of the Code, and his non-exempt assets will be sold in a liquidation sale. After the sale, he will be relieved of the vast majority of his debts, even those that remain unpaid. See 11 U.S.C. s.s. 701-766 (1994 & Supp. V 1999). Alternatively, an individual can file for reorganization, usually under chapter 13. Reorganization allows him to keep his assets, but he must pay his creditors at least as much as they would have received under a chapter 7 proceeding. s.s. 1301-1330.

M. Lerner (1976), The Belief In A Just World. This belief, in many respects, is similar to the “blaming the victim” syndrome discussed by Sullivan, Warren and Westbrook.
Act 28 of the 1865 provided for the speedy liquidation of the estates of insolvent traders in Bombay. Power was given under that Act to the creditors to resolve in certain events that the estate of an insolvent trader ought to be wound up under the management of trustees. Upon such resolution being passed an application was made to the court for winding up the estate in the terms of the resolution, and an order was made by the Court vesting the estate of the insolvent in trustees appointed by the creditors. This Act was repealed by Act 8 of 1868.


Credit Delivery and Financial Inclusion, Reserve Bank of India, https://rbidocs.rbi.org.in/rdocs/AnnualReport/PDFs/4CREDITDELIVERYCD7058D23F5A410EACCEDDD0ACF5C457.PDF.


During the seventeenth century in France, the term ‘bankrupts’ referred only to fraudulent debtors. See George J. Bell (1868), *Commentaries on the Law of Scotland and on the Principles of Mercantile Jurisprudence*, p. 471. Similarly, certain segments of the commercial society in medieval Italy formally referred to bankrupts as deceivers and frauds. See Bolkmar Gessner et al. (1978), *Three Functions of Bankruptcy Law: The West German Case*, 12 L. & Soc’y Rev. 499, p. 531.

A neutral third person appointed u/s 125 of Insolvency and Bankruptcy Code, 2016.

Part II

Processes
The Government accords the highest priority to this reform (The Insolvency and Bankruptcy Code, 2016).

- Shri Arjun Ram Meghwal, Hon'ble Minister of State for Finance and Corporate Affairs, during the inauguration of the premises of the IBBI, March 29, 2017.
The Story Behind Section 29A of IBC

Injeti Srinivas

 Barely a week into my new office, on October 25, 2017, at around 4 pm, I got a call from the Prime Minister’s Office (PMO). Mr. Nripendra Mishra, Principal Secretary to Prime Minister asked me if I could meet him the next morning. He sounded a bit concerned about debtors trying to game the Insolvency and Bankruptcy Code (IBC/Code) and wanted my advice on how to prevent it. I did not know how to react, as I was still learning the basics of the Code and wondered how I could advise him on something with which I was yet to get my grip on. Putting my predicament aside, I confirmed that I would be in his office the next day at the appointed time.

After the phone call, I spoke to the Joint Secretary concerned, Mr. Amardeep Singh Bhatia. I asked him whether he was aware of debtors attempting to derail the Code to derive undue personal benefit. Amardeep possessed in-depth expertise on IBC but always reacted thoughtfully. However, on this occasion, I was a little impatient as I had to prepare for my next day’s meeting with the Principal Secretary. I was anxious that, in my very first meeting, after recently having taken over as Secretary of the Ministry of Corporate Affairs, I had to discuss with him about a crisis, which was rather challenging.

Amardeep was calm and composed and told me that the Code was in a nascent phase, and, therefore, he was unable to make any conclusive comment on the issue raised. I was surprised at his relaxed and non-committal response. But before I could react, he told me something which I thought was the crux of the matter. He mentioned that we were navigating unchartered waters, as the Code had reversed the old equation between the debtor and the creditor. The promoters for the first time were dispossessed of possession and control of the company, literally overnight, and the creditors were put firmly in control of the company undergoing corporate insolvency resolution process (CIRP).

Before the Code came into force, the promoters, under the erstwhile Sick Industrial Companies Act (SICA) regime, had managed to retain possession of the company forever, stripping its assets to the last, by the time it went into liquidation. The revival was a far cry and companies became sick and even perished, but promoters were seldom affected. There were rich promoters of poor companies!

The promoters might not have been solely or necessarily responsible for making the company insolvent but being in control of the company could not absolve them of their responsibility either. In the M/s Innovative Industries Limited v. ICCI Bank & Anr. 1, the Supreme Court had held that ‘entrenched managements are no longer allowed to continue in management if they do not pay their debts’. Incidentally, Innovative Industries Limited was the very first company admitted into CIRP under the Code. The old order dominated by debtors considered the Code as draconian because it pushed their interests to the side-lines. Creditors, on the other hand, found their newfound pre-eminence difficult to manage. We were witnessing a backlash from the promoters - an attempt to restore the old order!

The first resolution under the Code, Synergies Dooray Automotive Limited (August, 2017) was an eyeopener. A related party of the defaulter company walked away with the company with a 94 per cent
haircut to the creditors. It was heavily criticised as rewarding unscrupulous persons under the garb of resolution. The Synergies Dooray case nailed the matter of concern in the present context.

After discussing with Amardeep, I concluded that a few unscrupulous promoters were the suspects. I knew, we could not blame all promoters, as not all of them were guilty of misfeasance. But one thing was sure, most of them were trying to regain control of their companies at a fraction of the outstanding dues. Although in the changed circumstances, they were not in physical possession of the company’s assets, they were still deeply entrenched to influence the end outcome easily.

In some cases, the promoters deliberately created information asymmetry to thwart competition and emerge as the only viable bidder. They were trying to exploit a newly introduced system, which was still to take root. A few prominent cases of the ‘Big Twelve’ came to my mind as a case in point. The ‘Big Twelve’ was the first lot of large stressed loan accounts that banks referred to National Company Law Tribunal (NCLT) based on an Reserve Bank of India (RBI) directive in June, 2017. They alone accounted for about 25 per cent of the gross non-performing assets (NPA) of the banking system.

Strengthened with a better understanding of the Code and its undercurrents, I entered the chamber of the Principal Secretary the next morning at the given time. He was engrossed in a discussion with two people who were with him from before. Among them was Dr. M. S. Sahoo, Chairperson of Insolvency and Bankruptcy Board of India (IBBI). Dr. Sahoo is a seasoned regulator. Before joining IBBI, he had served in the Institute of Company Secretaries of India, Securities and Exchange Board of India and Competition Commission of India. He has been a staunch believer in market forces. The other person was a young officer with a pleasant disposition. He introduced himself to me as Brajendra Navnit, Joint Secretary in PMO. Brajendra was looking after many economic ministries, including the Ministry of Corporate Affairs.

Mr. Mishra asked me to take a seat, but before I could do so, he smiled and asked me whether I had come up with any concrete suggestions. I was amazed at his speed and sense of urgency. I sensed that the ongoing discussion, which had hit a brief pause when I entered the room, had been inconclusive. Dr. Sahoo was of the initial view that market forces should be allowed to address the problem. As a regulator, he had already made disclosure of antecedents of the resolution applicants mandatory. He felt that the committee of creditors could refuse to entertain offers from resolution applicants with bad antecedents and also reject bids that were considered low compared with the fair market value. But he admitted that it might not solve the problem entirely because the company may get pushed into liquidation, which was a worse outcome. We all realised that the executive might have a minimal role in what was essentially a quasi-judicial process. Mr. Mishra was in favour of an amendment to the Code to prevent such manipulation. Brajendra echoed his views that it was an emergency, and we had to do something immediately.

I gave my analysis in brief and concluded that if history were not to repeat itself (the SICA way), we had to disable the promoters from gaming the Code. I explained that the promoters being the worst hit were desperate to protect their interests. We all agreed that the promoters and for that matter, no one, could be allowed to derail the process, but the question that remained was how to achieve it. After half an hour of intense discussion, I came up with a solution. I suggested that we debar the promoters from bidding. I realized a blanket ban on promoters might not withstand legal scrutiny and it had to be tweaked to sustain itself.

Mr. Nripendra Mishra looked at me intently and told me that as Secretary, Corporate Affairs, I had to come up with a viable solution, and gave me three days for it. I realised that the matter had assumed
the utmost urgency, which was further accentuated due to the political sensitivity attached to it. If we did nothing and left it to market forces, the outcome would be unacceptable as already explained. The only option left was to intervene and prevent imminent market failure. Otherwise these would be a question mark on the efficacy and credibility of the Code. It became inevitable that we salvage the Code to make it robust.

After the meeting, I left for my office, and Dr. Sahoo accompanied me. On reaching office, I called for Amardeep and briefed him on what transpired in PMO. After another engaging discussion on what to do next, we agreed that an amendment to the Code was the only way out. Mr. Mishra too had expressed the same view in the meeting. The first amendment to the Code, within a year of its commencement, seemed a foregone conclusion now. I requested both Dr. Sahoo and Amardeep to come up with a draft formulation in two days.

By the evening of October 28, 2017, the first cut of the draft was ready. The draft specified several disqualifications making persons ineligible to become resolution applicants. It included an undischarged insolvent, a disqualified director, a person who had been convicted for not less than two years, a person prohibited by SEBI from trading or accessing the capital market, a person held guilty of preferential, undervalued, extortionate or fraudulent transactions under the Code, a personal guarantor to a corporate debtor undergoing CIRP, and a wilful defaulter. We felt that the last three disqualifications would cover most unscrupulous people. But something was still missing. We all knew that unscrupulous people generally game the system indirectly and this also meant that we had to prevent even those collaborating with such people.

Based on these deliberations, the draft was revised. It was suggested that, apart from persons directly getting disqualified, all those acting jointly or in concert with such persons should be excluded. I was satisfied with the revised draft. The only issue remained for resolution was how to deal with chronic defaulters, who were not yet declared wilful.

The next day I spoke with Mr. N. S. Viswanathan, the then Deputy Governor of RBI who was the architect behind the February 12 (2018) RBI circular, which directed lenders to refer any loan account over Rs. 2000 crore under IBC if it is not resolved within 180 days of default. I briefed him about the government’s intention to amend the Code. He told me that he would get back soon after having a word with Mr. Urjit Patel, the then RBI Governor. I assured him that we would wait for RBI’s inputs before finalising the proposal.

During my discussion with Mr. Viswanathan, I had specifically asked him about the criteria RBI had adopted for identifying the large stressed loan accounts. He informed me that they took Rs. 2,000 crore outstanding as the cut off threshold with 60 per cent or more of the outstanding loan classified as non-performing assets (NPA) as on March 31, 2016. This input was particularly helpful in deciding our next steps. We had to align our formulation with the NPA criteria adopted by RBI in terms of duration of NPA status. The RBI-determined threshold in the instant case was not relevant for us, as we had to go by the default threshold under the Code, which was Rs. 1 lakh then.

Before proceeding further, I consulted Mr. Rajiv Kumar, Secretary of the Department of Financial Services. Besides being an excellent friend of mine for close to two decades, Rajiv and I were invariably on the same page on most matters concerning the two ministries (Finance and Corporate Affairs). Rajiv was as alert and sharp as ever. He grasped the essence of my proposal in no time and gave me his nod subject to RBI’s feedback. By then, I had already shared the draft formulation with RBI and was agreeable to Rajiv’s conditional clearance. With just a day left to reach the three days deadline, I had
two things to do – first, we had to factor RBI’s comments, and then finalize our formulation. Due to lack of time, we decided to go ahead with the finalisation of the formulation with a clear understanding to include RBI's inputs as and when they were received.

In the next drafting session, later that evening, the most crucial clause was inserted. All NPA holders of a year or more got included in the ineligible category. This disqualification applied across the board to all NPA holders and not to promoters’ class alone. There was no intention to discriminate against one or favour another. The law must treat everyone - whether promoter or not - on the same level playing field. Then came up the issue whether the disqualification criteria should be made applicable with retrospective effect. We visualised the CIRP as a continuum and various stages of CIRP as consecutive points on the continuum. Therefore, I opined that there was no need to go for retrospective application, as all resolution plans that were not approved by the Tribunal as on the date of commencement of the amendment would have to necessarily go through the eligibility test before they could be considered. I was happy that we could resolve the retrospective application issue, which otherwise could have become a sticky issue and difficult to defend.

We were now ready with our penultimate version of the draft amendment. Just then an e-mail came from Mr. Viswanathan containing the recommendations of RBI. The only substantive addition was the inclusion of ‘connected persons’, which was duly incorporated. The inclusion of ‘connected persons’ clause meant that there would be multiple layers of exclusion - ineligible persons, persons acting jointly or in concert with ineligible persons, persons connected with ineligible persons or those acting jointly or in concert with ineligible persons, and all related parties. Both ‘connected parties’ and ‘related parties’ were elaborately defined to obviate the necessity of judicial determination. I favoured a fool-proof approach in the given circumstances, as nothing could be left to chances.

There was still one outstanding issue: the perception issue. No mature jurisdiction to our knowledge had such prohibition in their insolvency law. We realised that India might become the only country to have such restrictions. I remembered the initial observation made by Dr. Sahoo in the meeting we had with Mr. Nripendra Mishra where he had suggested to let the market forces resolve the issue. But subsequently, we all had agreed that it was not a viable option due to imminent market failure. Since we were navigating unchartered waters, experimentation was necessary. Our view was indeed vindicated by the Supreme Court a year later in the Swiss Ribbons Private Limited & Anr. v. Union of India & Ors case (January 25, 2019). The Apex Court held that,

The experiment contained in the Code, judged by the generality of the provisions and not so by so-called crudities and inequalities that have been pointed out by the petitioners, passes constitutional muster. To stay experimentation in things economic is a grave responsibility, and denial of the right to experiment is fraught with serious consequences to the nation.

I recalled the famous takeover bid of Lord Swaraj Paul in the early eighties. He had made an unsuccessful attempt to takeover DCM and Escorts. He failed then, but loudly demonstrated the relevance of competition for entrepreneurship. I was convinced that we should go ahead with the proposed amendments even if India were the only country to do so.

Equipped with a comprehensive proposal, I sought time with Mr. Mishra for the 30th of October. The meeting went off well. He appeared satisfied with both the efforts made and the outcome. At his behest, a final meeting was organised at the level of Mr. Arun Jaitley, who was then Minister of Finance and Corporate Affairs. The meeting took place later in the evening in the office chamber of the Minister in the North Block. Everyone concerned was present. Mr. Jaitley glanced at the draft formulation for
Injeti Srinivas

In a minute and nodded his head in approval. He referred to his conversation with the RBI Governor and wanted to be doubly sure that RBI's suggestions were incorporated. I confirmed that it had been done. Mr. Jaitley was statesman like in his disposition and always looked at the big picture. He was a liberal and had a knack of toning down things to make them acceptable to all stakeholders.

But this time it was a little different. The efficacy and credibility of the Code were at stake. He knew that disqualifying the promoters, connected parties, and related parties from the bidding process would be opposed vehemently by those affected. At the same time, he visualised support coming from competitors interested in bidding for such assets. Mr. Jaitley observed that the proposed amendment was significant and we should be prepared to meet any judicial challenge. He emphasised the need to avoid any infirmity from the constitutional angle and made two incisive comments.

Mr Jaitley observed that if we change the rules of the game, all persons affected by it need to be given an opportunity to meet the new requirement. Second, once a person is not allowed to participate as a resolution applicant, he should not be allowed to compete at the liquidation stage as well. Otherwise, it would create a perverse incentive to go for liquidation. Being a lawyer of great eminence, the Minister not only pinpointed deficiencies but also suggested a cure. It was agreed to give NPA holders an opportunity to remove the disqualification by payment of overdues (including interest and charges). I admired his sharp intellect and capacity to resolve issues without losing sight of the big picture. No wonder Mr. Jaitley commanded the highest respect from one and all. The decision was made to go for an Ordinance, as the matter was of utmost urgency and Parliament was not in session.

Next day, 31st October, in the evening, I met Mr. Jaitley and obtained his approval on file to go ahead with a cabinet proposal for the proposed Ordinance. It took a week or so to be ready with the preliminary draft note for Cabinet and the draft Ordinance, which apart from the newly proposed section 29A specifying disqualifications concerning resolution applicants, contained a few other small amendments. We referred the draft Ordinance to the Department of Legal Affairs for approval from the constitutionality angle. We held a series of meetings with the Legal Affairs team and I spoke with Mr. Suresh Chandra, the then Law Secretary. The Department of Legal Affairs approved it on the 13th November. After that, the Legislative Department took about a week to vet the draft Ordinance. The two teams had several sittings on the draft Ordinance, especially regarding technical terminologies which had been used. Finally, after I spoke with Dr. Narayana Raju, Secretary of the Legislative Department and explained to him in detail our intent and all the drafting nuances, we were able to retain most of our original draft.

On November 21, 2017, the insolvency team in the Ministry worked beyond midnight to compile the final Cabinet Note and Ordinance in the required number of copies along with Hindi translation. The papers were delivered to the Cabinet Secretariat at the wee hours for table circulation at the Cabinet meeting scheduled for the same day at 10.30 am. The Cabinet approved the proposal. The Ordinance was sent for Presidential assent in the evening, which was accorded. On November 23, 2017, the Insolvency and Bankruptcy (Amendment) Ordinance was promulgated. The Ordinance, among other things, prohibited certain persons becoming a resolution applicant, who on account of their disqualifications may affect the credibility of the IBC process.

The entire exercise was conceived and completed in less than a month. With enhanced potency, the law became even more useful. It deeply impacted the credit culture in the country and brought a significant improvement in bank recoveries, which led to the reduction of NPA.

A replacement Bill was introduced in the Parliament during the winter session in December, 2017. The Statement of Objects and Reasons appended to the Bill stated that section 29A aimed to prevent
rewarding unscrupulous persons at the cost of creditors. Mr. Jaitley, while replying to the parliamentary debate on the Bill said,

In the case of resolution also, all type of creditors may take some haircut, and the man who created the insolvency pays a fraction of the amount and comes back into management. Should we allow that to continue? The overwhelming view, as expressed by the Members, is that it should not be allowed. This was a gap which was there in the original Bill, and by bringing in 29A, we have tried to fill-in that gap. That is the objective. In order that this provision must apply to all existing cases of resolution which are pending, that is the case for urgency. If we had not done this, then all such defaulters would have rejoiced because they would have merrily walked back into the companies by paying only a fraction of these amounts. That is something which besides being commercially imprudent would also be morally unacceptable. That is the real rationale behind this particular Bill.

The replacement Bill carried a few editorial changes to the Ordinance, and a specific proviso was added to section 30 of the Code explicitly giving time upto thirty days to an NPA holder to remove the disqualification by paying the overdues (including interest and charges). A substantive change was made to exclude scheduled banks, asset reconstruction companies and alternate investment funds from the scope of connected parties to enable them to play a strategic role in the resolution process. The Parliament passed the replacement Bill, and the Amendment Act got notified in January, 2018.

As was rightly observed by Mr. Jaitley then, section 29A was challenged in the Supreme Court in Arcelor Mittal India Private Limited v. Satish Kumar Gupta and Ors. and Swiss Ribbons Private Limited v. Union of India. In both cases, the Supreme Court upheld the constitutional validity of the Code, including section 29A. The Supreme Court in the Swiss Ribbons case, whilst upholding the constitutional validity of the Code held that ‘The defaulters’ paradise is lost. In its place, the economy’s rightful position has been regained.’ But for Mr. Jaitley’s last-minute master touch, things could have gone the other way. He steered the Code through choppy waters.

Subsequently, section 29A has undergone many calibrated changes based on the recommendations of the Insolvency Law Committee. The Micro, Small and Medium Enterprises (MSMEs) were exempted from the application of clauses(c) and (h) of section 29A dealing with NPA and personal guarantee, respectively. Successful resolution applicants were allowed a three-year cooling-off period concerning the corporate debtor acquired by them through CIRP. Foreign banks, foreign institutional investors, foreign portfolio investors and foreign venture capital investors were excluded from the scope of connected parties. Also, financial entities becoming a related party solely on account of the conversion of debt into equity were exempted from the scope of related parties.

The other changes included modification of the conviction clause by linking it to specific economic offences, and the resultant disqualification was applied for a limited period instead of permanent exclusion. Successful resolution applicants were given immunity against avoidance transactions committed before the acquisition. And disqualification applicable to personal guarantor was limited only to those who failed to pay up after the invocation of the guarantee. These changes were aimed at fine-tuning section 29A to enhance competition for a quick resolution with value maximisation but without compromising with the public interest.

Section 29A has been diagnosed and analysed a lot since then. The protagonists believe that section 29A was the most significant amendment to the Code, which saved it from meeting the fate of SICA. Some argue that it was excessive, as it excluded too many persons from being a resolution applicant.
even though they may not be guilty of misfeasance or fraud. Others opined that debarring promoters delayed resolution, as they could have aided timebound resolution being the closest to the corporate debtor. But the fact is that when section 29A was introduced, it was the need of the hour. Subsequently, it has been relaxed in a calibrated manner.

With the introduction of section 12A, which allows withdrawal of application after initiation of CIRP (provided 90 per cent of the financial creditors endorse it), bona fide promoters with a proper proposal can participate in the resolution process outside the Code. The possibility of pre-pack, which is a hybrid between the out-of-court resolution process and court-supervised resolution process, is also on the anvil. But it cannot be denied that section 29A was a turning point in the implementation of the Code. It instilled a credible threat that the company will change hands, which changed debtor-creditor relationship once and for all. Its relevance continues to date even though we recognise other complementing options, including emerging ones like pre-pack.

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**NOTES**

4 Supra Note 2.
The Insolvency and Bankruptcy Code, 2016 provides for a market led, time-bound mechanism for orderly resolution of insolvency, wherever possible, and ease of exit, wherever required.

- Dr. M. S. Sahoo, Chairperson, IBBI.
Driving Successful Resolutions through IBC

B. Sriram

Bankruptcy law prevents a destructive race to the firm’s assets by offering a collective proceeding that freezes the rights of all investors in a firm, values them and then distributes these assets according to the priority scheme that the parties agreed would be used in the event that such a day of reckoning should come about.

- Douglas G. Braid

India experienced a major structural change with the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC) which was enacted to consolidate and amend the law on insolvency, revival and liquidation of companies, limited liability partnerships, partnerships, and individuals. Its introduction repealed the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920 while amending eleven other statutes including Sick Industrial Companies Act, 1985, Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), Recovery of Debt and Bankruptcy Act, 1993 and the Companies Act, 2013. IBC provides a mechanism of reorganisation and insolvency resolution of debtors, in a time bound manner. In the pre-IBC era, the growth of the insolvency ecosystem in India was marred by the presence of multifarious statutes which simultaneously governed this sphere.

One of the fundamental changes brought about by this legislation is moving away from the ‘debtor-in-possession’ regime to a ‘creditors-in-control’ (CIC) regime where creditors decide matters with the assistance of Insolvency Professionals (IPs). This regime promotes efficiency in credit markets besides improving availability of credit as lenders by virtue of having control over the process of resolution would be willing to lend and a healthy competition amongst lenders would ultimately bring down credit cost. CIC regime also promotes entrepreneurship while maximising value of assets. IBC has helped create discipline in how borrowers raise financing from banks and how banks take measures to recover the debts before the value of the underlying asset has deteriorated. Promoters are now afraid of losing control of their businesses on default and the moment a resolution professional (RP) is appointed. India has seen repayment rates materially improving owing to a fear among controlling shareholders of borrowers that they may lose control of their businesses if placed in insolvency. Investors and bidders have seen this as a great opportunity to buy stressed companies at attractive prices and foreign investors are seeing this as an opportunity to enter the Indian market.

Despite being hit by several roadblocks and challenges since its inception, continuous monitoring of developments by the regulator, proactive legislative interventions by the legislature as well as the prompt and active judiciary has helped shape IBC into an efficacious legislation. IBC has been successful in
serving its two-fold purpose of allowing credit to flow more freely in India, and instilling faith in investors for quicker resolution of cases filed. Publicly available data supports the positive impact this legislation has had on Indian economy - as per the report on Doing Business 2020 released by the World Bank on October 24, 2019, India has jumped to 63rd position amongst 190 countries in 2020 in overall rating as against 131 in 2015 and 77 in 2019, making it one of the world's top ten improvers in ease of doing business. Further, the report suggests that the overall recovery rate for creditors in India has leaped from 27 cents to 72 cents on the dollar and the time taken for resolving insolvency has remarkably come down from 4.3 years to 1.6 years. Reserve Bank of India’s Report on Trend and Progress of Banking in India 2018-19, indicates that recovery of banks under IBC stood at 42.5 per cent as against 14.5 per cent, 3.5 per cent and 5.3 per cent under SARFAESI Act, Debt Recovery Tribunals and Lok-Adalat modes, respectively. India was also awarded the Global Restructuring Review Award for the Most Improved Jurisdiction in restructuring and insolvency regime.

**IBC: AN EFFECTIVE LEGISLATION**

One of the highlights of the process under IBC has been that ever since the law has been enacted, there has been a continuous feedback mechanism put in place for collating valuable information from the various stakeholders. This has enabled the Government and the Insolvency and Bankruptcy Board of India (IBBI/Board), the regulator of processes and professionals under the IBC, to review the efficiency of systems, processes and dispensations under the law and ensure that there is a constant upgrade to achieve its objectives. As we have seen earlier, one of the key objectives of IBC is to ensure protection of value and capital through enabling successful resolutions. The intent is not only to complete a resolution but to satisfy oneself that a proposed resolution will stand the test of delivery to stakeholders over time through a mechanism of evaluating the strength of the bid over key parameters. Towards achieving such objectives, the IBC has also been subject to several legislative and judicial actions, including amendments in the provisions of the Act and the Rules and Regulations framed under it, enabling faster, better, and efficient resolutions.

**Legislative actions**

The journey of the evolution of IBC has seen many challenges including a challenge to its constitutionality. However, these have been effectively addressed by identifying the required changes and bring in suitable amendments, to keep pace with the changing demands. IBC has, in this short span, already undergone four sets of amendments. A snapshot of the key amendments and other notable developments are as follows:

- Introduction of section 29A dealing with ineligible resolution applicants (RAs), which achieved the objective of preventing backdoor entry of errant promoters in getting back their assets during the corporate insolvency resolution process (CIRP) at significant discounts.
- Introduction of section 12A, permitting creditors to withdraw insolvency petition even after admission. Non-availability of the said provision was resulting in creditors being forced to take huge haircuts in CIRP despite better settlement offers being available from the promoters.
- Uninterested, frivolous and vested interest bids are kept out by enabling the RP, together with the committee of creditors (CoC), to specify the eligibility criteria while inviting resolution plans, considering the size and structure of the corporate debtor (CD).
- Clarification on homebuyers being treated as financial creditors (FCs), which resolved the ambiguity surrounding the rights available to them under IBC.
• Clarification that moratorium does not apply to guarantors, thereby putting an end to various litigations surrounding this issue.

• Reduction in voting threshold, for approval of resolution plans, from 75 per cent to 66 per cent, which enabled speedy resolution and increased the rate of achieving a resolution.4

• Providing that under a resolution process, the operational creditors (OCs) and dissenting FCs shall not be paid less than the amount payable to them in the event of liquidation of the CD, thereby balancing interests of all stakeholders and cutting down the number of litigations filed during CIRP.

• Empowering the CoC to commercially consider the manner of distribution in a resolution plan, which may take into account priority and value of security, feasibility and viability of the plan, thus advancing the vision of IBC to uphold the primacy of creditors and their commercial wisdom.5

• Increasing minimum threshold for initiating CIRP proceedings by a class of creditors, thereby preventing frivolous filings.

• Ring-fencing the assets of the CD and providing immunity to the RAs from liabilities in relation to an offence committed prior to the commencement of CIRP, which has assisted in eliciting an increased interest amongst the RAs and attracting better bids.6

• Exemption of the applicability of section 29A (c) and (h) for the RAs in respect of CIRP of Micro, Small and Medium Enterprises (MSMEs) was allowed (a critical segment of the Indian economy and saves precious capital and employment). It was provided that the Central Government may also in public interest direct that MSMEs be exempted from application of any of the provisions of IBC.

• Securities and Exchange Board of India (SEBI) amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, SEBI (Delisting of Equity Shares) Regulations, 2009 and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 in light of the IBC, to facilitate the process of resolution.

• In order to boost interim financing, repayment was given super priority under IBC. To further encourage interim finance, in 2018, interest on interim finance, was made part of ‘liquidation cost’ which is also given super priority status in the distribution waterfall. In 2020, scope of interim finance was expanded and included financing provided to keep the debtor as a going concern, thereby preserving value of assets.

• The resolution plan was made binding on all the stakeholders including the Central Government, any State Government or local authority to whom a debt in respect of the payment of the dues was owed - a key development that helped faster resolution and improved bids.

• The licenses and permits regarding the supply of goods or services critical to protect and preserve the value of the CD and manage the operations of such CD as a going concern, were not allowed to be terminated or suspended during moratorium period, provided there was no default in payment of dues arising from such supply during this period, by the CD - a vital factor for protection of value of the CD.

Evolution of Jurisprudence

Courts have played a pivotal role in modelling the insolvency law in India and one has witnessed some landmark judgments which upheld the spirit of IBC and paved way for evolving jurisprudence. Some of the important legal positions established through note-worthy judgments include:
(a) IBC passing the test of constitutional muster; 
(b) sending the message loud and clear that IBC is not intended to be substituted for a recovery forum; 
(c) safeguarding the supremacy of the overriding provisions of IBC which shall have to be interpreted in the widest terms possible, so that any right of the CD under any other law does not come in the way of its implementation and upholding principle of natural justice - audi alteram partem, despite no express provisions being present; 
(d) upholding the supremacy of commercial wisdom of CoC; 
(e) explaining the requirement of providing equitable treatment to various kind of creditors and balancing their interests, redefining the roles of RP and CoC during CIRP and highlighting the limited judicial review available to the Adjudicating Authority in a CoC approved resolution plan under IBC; and 
(f) clarifying the position that there is no provision under IBC which requires that the bid of the RA has to be at least the liquidation value.

**DRIVERS FOR EFFECTIVE RESOLUTION**

While there have been various proactive steps taken, both legislatively and judicially, to enhance the insolvency regime, some of the key drivers which can be considered to further assist in effective resolution are:

**Avoiding delay between CoC approval and National Company Law Tribunal (NCLT) approval:** There have been times where the application for approval of resolution plans have been pending before the NCLT for over 12-15 months. Considering such delay will severely affect the feasibility and viability of resolution plan and given that the scope of judicial intervention is minimal in a resolution plan approved by the CoC, in its commercial wisdom and the RP is duty bound to check the compliance of resolution plan with applicable laws, endeavor should be made by NCLTs to approve/ reject the resolution plan in a time bound manner.

**Pro-activeness of RP:** While CIRP regulations provide timelines for RP to accept/ reject claims, it is often observed that there is considerable delay in RP’s response thereby leading to initiation of multiple suits. Therefore, RPs need to ensure timely (i) evaluation of claims to avoid last minute challenges and (ii) communication to all the stakeholders regarding the acceptance / rejection of claims. Further, though not statutorily mandated, RPs may be encouraged to send specific communications to the statutory authorities for filing of their claims to avoid last minute claim filing and delay in the process.

**Balancing interests of OCs:** While minimum statutory protection of liquidation value has been accorded to OCs, there are still challenges on account of litigations initiated by them citing that their interests have not been adequately taken care of. In order to effectively counter such allegations, following measures may be encouraged: (i) introduction of specific scoring criteria in the objective evaluation matrix for payments to OCs and (ii) due recording in the CoC minutes of the discussions amongst the CoC members regarding OCs’ claims, along with specific negotiation points being raised by CoC with the RA regarding their payments.

**Introduction of CoC approved Sub-Committees for administrative convenience:** In line with the Essar Judgment, formation of sub-committees may be encouraged to monitor administrative matters, such as supervision of CIRP costs and business of CD as a going concern. This will assist in avoiding prolonged delays in operational and administrative matters.
Continued support from judiciary in settling the law: Given that the insolvency jurisprudence in India is constantly evolving, it is imperative that Courts continue to be pro-active in settling debated legal positions and its associated interpretational issues. For instance, the issue on initiation of simultaneous IBC proceedings against the borrower and guarantor still remains unresolved. The judiciary should provide its views on such contested matters to ensure speedy and effective resolution in a time bound manner.

Decongesting NCLTs: As per the quarterly reports published by the IBBI, as on March 31, 2020, a total of 3774 CIRP cases have been initiated, out of which OCs accounted for 49.65 per cent of the total CIRPs triggered, followed by FCs with 43.61 per cent. Such high number of cases has exponentially increased the burden on the NCLTs. The Report of the Insolvency Law Committee, submitted in February, 2020 suggests that one of the major reasons contributing to such high number of IBC cases is the low default threshold of Rs. 1 lakh. However, the move by the Central Government to increase the minimum default threshold for initiating CIRP to Rs. 1 crore vide its notification dated March 24, 2020, is expected to ease the pressure on NCLTs in dealing with IBC cases. Various other measures may be taken to ease the burden and decongest NCLTs, such as establishing additional benches and introducing specialised benches exclusively for IBC matters.

THE WAY FORWARD

It is imperative that a systematic approach be followed and IBC’s hold over the economy is not lost. Creditors need to show more maturity in changing their mindset and viewing IBC as an avenue for resolution rather than merely for recovery. Data shows that majority of the cases which have slipped into liquidation are either erstwhile Board of Industrial and Financial Reconstruction cases or companies with eroded assets. Therefore, efforts should be made to resolve companies without much tangible assets (especially in sectors such as Engineering, Procurement, Construction, Electricity etc.) outside IBC as such companies generally attract fewer RAs. This would also free up the bandwidth of NCLTs to deal with cases where IBC is indeed a suitable solution.

While this legislation has proved its efficacy, coronavirus pandemic has given the country another opportunity to consider stepping back and looking at various legislations to provide further fillip to economic growth of the country. This is a good time to consider capacity building. A few such aspects to consider further could be:

• Launch a Public Outreach Program to create awareness amongst various stakeholders like State Agencies, Developmental Corporations, Port Authorities etc. This would enable smooth implementation of resolution plans.

• Take measures to build capacity of IPs with domain knowledge (currently there are limited number of organisations which are competent to provide insolvency services).

• Facilitate formation of Zonal Appellate Benches at metro locations for quicker resolution of appeals.

• Using technology for case management by NCLTs, including Artificial Intelligence, to ensure cases of similar nature filed before various benches are dealt in a consistent manner so that judicial risk of uncertainty is reduced, would be a welcome move for business and facilitate development of the distressed asset market in India.
It is also time to introduce Online Dispute Resolution (ODR) especially for retail / individual insolvency matters. ODR, being the modern counterpart of rendering online Alternate Dispute Resolution (ADR) methods such as arbitration, mediation and conciliation, which are cost effective, less time consuming and have a global access and impact, should be encouraged to supplement the personal insolvency framework. This move would also assist in reducing the workload on the concerned tribunals.

Another interesting aspect which may be considered is to explore providing a framework for pre-packed deals in India whereby the CD or shareholders approach the NCLTs with a pre-negotiated corporate reorganisation plan prior to the initiation of insolvency process. This would, inter-alia, ensure

(a) continuity of the business of the CD;
(b) preservation of value and maximisation of recovery; and
(c) resolution of the company in a shorter time frame while saving court’s time.

It is further note-worthy to mention that the framework in relation to group insolvency and cross border insolvency is already under consideration which will further provide the required stimulus to the growth of insolvency regime in India.

CONCLUSION

Having stated the above, the IBC has certainly matched up to the challenge of reinvigorating the insolvency regime in India. Not only has it been able to tackle the menace of non-performing assets, but it also has been effective in contributing to the economy in various indirect ways such as improving credit discipline in the market owing to the fear instilled in the minds of promoters of losing their control in the companies, creating foreign investment opportunities in light of increased confidence on account of the structured and time bound approach and saving jobs by preventing companies from going into liquidation.

The thought provided by Orison Swett Marden, an American inspirational author, is quite relevant in this regard-

Success is not measured by what you accomplish but by the opposition you have encountered, and the courage with which you have maintained the struggle against overwhelming odds.
NOTES


2 However, the provision relating to repeal of these two Acts is yet to be notified.

3 The Insolvency and Bankruptcy Code (Amendment) Act, 2018.

4 The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018.

5 The Insolvency and Bankruptcy Code (Amendment) Act, 2019.

6 The Insolvency and Bankruptcy Code (Amendment) Act, 2020.


9 Innoventive Industries Ltd v. ICICI Bank & Ors., AIR 2017 SC 4084.


Four key reforms in India were passed in 2016. First, a bankruptcy and insolvency code was enacted, making it easier to close failing businesses and recover debts. Second, rules governing FDI underwent sweeping liberalization, allowing for 100 percent ownership in previously restricted sectors. Third, the Goods and Services Tax (GST) Amendment Bill was passed; …….Fourth, the government and the Reserve Bank of India agreed on a monetary policy framework that includes setting up a monetary policy committee…

Manufacturing Better Resolutions
A Practitioner’s Perspective

Anurag Das

Don’t judge each day by the harvest you reap but by the seeds that you plant.
- Robert Louis Stevenson, Admiral Guinea, 1884

The enactment of India’s Insolvency and Bankruptcy Code, 2016 (Code) planted long-necessary seeds of deep, structural reform of its credit ecosystem. A mere four years in, there is no doubt the legal jurisdiction stands radically reformed, and wider fundamental change is taking root. Coupled with the courage of political conviction, bold and creative steps such as the introduction of section 29A have led, almost unimaginably, to large debtors such as Bhushan Steel, Essar Steel and Binani Cement changing hands. India’s erstwhile commercial paradigm is also undergoing a revolution engendered by reforms such as a clear default test for admission into insolvency proceedings, including for operational dues. In my hometown in central India, it was a common quip that we needed twice the workforce – as many to collect dues as to sell product. Gladly, that India of dreary business practices is also becoming of yore.

Over two decades prior to the enactment of the Code, Indian bankruptcy discussions dwelt wearily upon its jurisdictional quagmire, uniting the foolish and the brave. As a new wave of participants entered the newly reforming arena, the agenda shifted mostly to the minutiae of procedure and rules; substantive aspects such as capital investment, value recovery, and resolution outcomes remained relegated to the sidelines.

That India’s insolvency arena is finally coming of age is perhaps most evident in that the dialogue is advancing into a distinctly higher qualitative stratum. Alongside the topical issues of the day such as the Code’s limited suspension, the resolution of financial institutions, and alternative resolution mechanisms, the locus has recently shifted to include insolvency outcomes.

In the context of this shift, here we will evaluate the importance and potential impact of achieving such better outcomes in the insolvency resolution process. We will also attempt to address, from the perspective of a practitioner, based on qualitative judgments and observations of the present state of insolvency rescue, how such superior outcomes might be achieved.
RESOLUTION OUTCOMES: IMPORTANCE AND IMPACT

_The market is not a very accommodating machine; it won’t provide high returns just because you need them._

- Peter Bernstein

Quite simply, India needs excellent resolution outcomes. A sizable problem of non-performing assets (NPAs) and the predominance of public-sector banks mean the nation's exchequer and businesses suffer the brunt alike, with worrisome socio-economic consequences. Relative to the need, reported insolvency data as of the end of March, 2020 looks troublesome at first sight. It points to approximately 57 per cent of the 914 closed insolvency cases under the Code ending up in liquidation, compared to approximately 14 per cent achieving a resolution following the bankruptcy process.

Breaking the cycle requires both better lending and better resolution. As a priority, India's banking system must begin to dramatically reduce its going rate of NPA creation per unit of credit extended. Even before COVID-19 disruptions, this was both necessary and important. It is now critical to prevent the problem from compounding.

Equally, a backdrop of better bankruptcy resolution outcomes is highly desirable. It is well understood that a resolution normally delivers a superior outcome relative to a liquidation. Beginning with a better recovery for creditors, it leads on to a more efficient redeployment of resources. The impact of better resolution outcomes, thus, runs deep and wide, via the mathematics of banking, and into the broader financial system. The ensuing feedback loop lowers interest rates and increases the consistent supply of credit. Indirect effects ripple farther, fueling sustainable economic growth.

TO LIQUIDATE OR PREVARICATE

_Take the money and run!

- Unknown

It is worth noting that liquidations, while typically providing lower recoveries and dissipating business value, are yet the right answer in many instances. This may well be the case in the context of the hitherto bankrupt cohorts whose performance was reported recently. A simple analogy is illustrative. If we imagine bankrupt companies as oranges, very little juice extraction from a batch may be due to lazy, weak or inexpert fingers; or a bad juicer; or simply fruit that had run dry.

The bankruptcy cohorts in question included a preponderance of zombie companies, with over 70 percent of these defunct or former BIFR cases. Stripped bare over years before entering the insolvency process under the Code, these may simply have met their delayed, yet deserved, fate.

A high liquidation rate is still bothersome, though, for a few important reasons. One is its deterrent effect on the supply of rescue capital. This is due to both the less frequent occurrence of attractive resolution outcomes, and due to the lower recovery rate in a liquidation versus a bankruptcy reorganisation. An additional risk specific to India is that of the loss of control upon liquidation, with the estate handed over to liquidators working for no one in particular. The fear of being consigned to a rudderless vessel, or one
subject to hijack, causes investors to step away, or set their hurdles higher.

In the usual reflexivity of finance, the resultant lack of rescue capital in the event of distress is anticipated ex-ante, and factored into credit extension and pricing decisions. The negative impact on both the supply and the price of regular credit is a costly burden on the wider economy. Additionally, and very importantly, the lack of a sufficiently competitive market for the control of insolvent businesses, or for their most optimal liquidation for that matter, leaves room for improvement in outcomes even when a resolution does occur.

BETTER FIXES IN INSOLVENCY

The universe is full of magical things patiently waiting for our wits to grow sharper.

- Eden Philpotts, A Shadow Passes, 1919

There is a more important aspect of resolution that goes relatively unnoticed: the quality of resolution outcomes relative to their intrinsic potential. It is, of course, difficult to gauge this potential accurately, and its measure is invariably subjective. There are, however, two qualitative aspects to this dimension that make it quite likely that the resolution outcomes being achieved have fallen well short. The first relates to the structural underpinnings of economic growth in India, buttressed by demographics that should support virtually indestructible medium-term growth in demand. By contrast, in economies and sectors with excess capacity or declining demand, it is disproportionately difficult for a reorganised company, once displaced during distress, to regain its footing. Clawing back market share from competitors is much easier when there is new business to win. India's higher secular growth potential should thus provide an attractive context for better resolution outcomes, and fuel a stronger appetite for distressed entities and assets. The second aspect is the low level of active interest in insolvency assets. As of March, 2020, approximately 57 per cent of 715 debtors that were in liquidation (or had been liquidated) saw no buyer interest during the resolution process, with a decision to liquidate taken in another 37 percent during the resolution process itself. Fewer than 6% of the cases involved the rejection of a resolution bid.

Anecdotally, a large majority of successful resolutions see only a single bidder. These bids are also oftentimes set up to prove illusory. Realisations are incredibly promised to arrive years later, with only negligible payment in the near term.

In summary, based on both structural considerations, and benchmarked against expectations, the insolvency resolution process appears to be delivering less attractive resolution outcomes than one might have hoped for.

Is this performance due to any specific characteristics of India’s insolvency ecosystem?

Before we return to assessing the ecosystem’s suitability for the creation of better resolution outcomes, we will briefly survey the salient characteristics of the distressed debt and rescue capital investment arena.
THE ESSENCE OF RESCUE FINANCE

The herd applies optimism at the top and pessimism at the bottom… we must be…skeptical of the pessimism that prevails at the bottom.

- Howard Marks, Touchstones, 2009

Complexity and uncertainty are natural companions in rescue and distressed investments. Also, successfully investing in the arena demands responsiveness to problems, an ability to swing between the smallest detail and the big picture, a careful balance between strategic and tactical approaches, and of course solid execution. These characteristics are particular, but not unique to the arena.

Several aspects of distressed debt and rescue capital investment, though, make it a relatively unique end of the investment and business spectrum. The uniqueness leads to it being compared, at times, with trauma surgery. The comparison is illuminative. Trauma triage in road or other accidents must prioritise patients for treatment, transport and venue. If lives are to be saved, it is necessary that the right surgeon, the right treatment venue and a patient must speedily come together. The exercise enjoys an error rate in selection that could be better; but is far better than the alternatives. So, it is with corporate distress or bankruptcy. If companies are to be brought back from the brink, or even if underlying productive assets are to be effectively redeployed, rescue efforts must be prompt, and applied with the requisite resources and expertise.

In contrast with trauma triage, in rescue investing, a keen instinct for avoiding type 1 error prevents dissipation of valuable effort and preserves investment performance. After all, as fiduciaries, who must steward capital to profitably solve problems, selecting situations is less dilemmatic than when directly saving lives. Again, in another parallel with trauma surgery, the rescue investment arena is also highly specialised, and inherently inter-disciplinary and cross-functional. This holds true both for the design and execution of a distressed investment, and for the overall revival effort.

Successful insolvency investments are thus rarely forged without three essential ingredients – a contrarian mindset; new capital; and specialised, inter-disciplinary and cross-functional expertise.

By its very nature, distressed investing is contrarian, focusing on situations regular investors shun, where the wider market has given up hope. Distressed investors tend to favor the deep value, or large discounts to intrinsic value, that come with embracing underlying problems and out-of-favor situations. As a logical extension, they pay greater attention to alternative means to realise value, including the redeployment or even liquidation of assets.

The second significant characteristic of rescue investments is that successful fixes almost always involve the injection of new capital into an asset or business. As a company slips into making losses or towards insolvency, most capital providers choose to stay away. The denial of liquidity creates its own problems, and compounds others. Investing incremental capital in the face of trouble is psychologically challenging, and overcoming this hurdle is a key element of investing in distress.

Distressed debt investing thus entails a curious version of super-specialisation, or of two three-legged stools and a market. The distressed investor's ken is not unlike a trauma surgeon's, enabling the practitioner to straddle disciplines and work flexibly to best suit a very specific situation. Just as general
healthfulness is not the predominant determinant of outcomes following trauma, so it is typically with the rescue of a troubled company. Outcomes are frequently less dependent on the company's industry or geography, and more on idiosyncratic factors linked to the company itself.

The first tripod traverses three disciplines. Almost every successful distressed investment is conceived and executed at the intersection of law, economics and finance. Regular companies live in a context of relatively normal business operations and strategy, corporate and investment finance, and corporate and commercial laws. Insolvency involves an anomalous twist in each discipline, respectively towards bankruptcy reorganisation; business rescue, turnaround or liquidation; and financial restructuring. Negotiating these twists in the context of a capital allocation decision is a defining element of the specialty.

The second tripod is of three distinct players performing three specialised functions. A distressed investor will then incorporate these players – a bankruptcy lawyer, a restructuring adviser, and management – among others, into a cross-functional rescue or revival effort. Alternative strategies and tactics are then dynamically assessed through a market-based lens to allocate capital along the way.

The essence of distressed or rescue capital investing, incorporating the above elements, thus lies in its idiosyncratic, contrarian, and specialised nature, and its reliance on a niche market. Investing in such situations requires both agility and speed, as well as flexibility in order to provide customised rescue effort and capital.

As fiduciaries, typically allocating discretionary capital, and given the inherent risks and uncertainty in the arena, investors entering an insolvency jurisdiction expect access to information, a reliable legal process, flexibility in how they choose to solve problems, and control over their investments. A lack of these key contextual factors repels capital providers.

We will now move on to an evaluation of the design and performance of certain key elements of the insolvency ecosystem.

EVALUATING THE INSOLVENCY ECOSYSTEM

Nature, to be commanded, must be obeyed.
- Sir Francis Bacon, Novum Organum, 1620

Can our insolvency ecosystem manufacture better resolutions? In the last section, we surveyed the rescue and distressed investment arena, and enumerated its core characteristics. We also visited the requirements for success in such investing, and the expectations this creates among investors if they participate in any jurisdiction.

Given the inherent uncertainties, and the importance of flexibility and speed, distressed investors worry up front about the many risks to their investments if things go wrong along the way. At this stage, the merits of India’s insolvency reforms are well understood. Our objective here is to evaluate the functioning of the ecosystem in its different elements, relative to its ability to manufacture superior insolvency resolution outcomes. In particular, we will bring a practitioner’s perspective to visit the state of the law itself, related regulations applicable to participation in rescue and resolution, and the practicalities attaching thereto. We will thus attempt to assess if specific elements of the ecosystem are supportive of or potentially detracting from the achievement of better insolvency outcomes.
As we look back to the initial mega-auctions, it was heartening to see the game-changing impact of even a small ‘market-of-two’ on auction prices; large companies changed hands at attractive prices following an insolvency resolution process. More participants bring a diversity of solutions to the problem at hand and thus can bid higher. At a general level, as discussed earlier, the lack of wider participation in insolvency resolution efforts is therefore a disappointment.

Overall, there are some hurdles that are based on the nascency of the ecosystem, while others have appeared due to its rapid, and skewed, evolution. These practical considerations deter investors, and thus impede efficient resolution outcomes.

First, the insolvency resolution process has evolved around the large initial cases, with successive layers of process burdens added over time. As these procedural demands have multiplied, the entire exercise has assumed a rigid and mechanical form, preoccupied with process for its own sake. This comes at the expense of the substantive work investors need to undertake in the rescue and revival of inherently difficult situations with real capital at risk. The entry toll may have been acceptable for the few strategic investors interested in mega-assets. However, specialised distressed investors who tend to evaluate and invest in a multitude of situations cannot afford to deal with such impediments.

Second, a major lacuna lies in the quality and quantity of information available in the insolvency process. More information is sometimes sought in an expression of interest than is provided in return in the information memorandum! Absent reliable and comprehensive information, recovery prospects decline as investors price in a discount or refrain altogether from participation.

Third, good resolution outcomes demand a multiplicity of voices at the table. When investors compete creatively with their best ideas, and bet with their pocketbooks, better solutions emerge, as do better prices for exiting creditors. As more original lenders exit from a debtor they are tired of, their bias towards liquidation – anchored in their original loan at face value – takes a back seat. With banks selling only to a limited extent, the original lenders’ liquidation bias predominates, and deters resolution.

Finally, system capacity has quite some distance to go. For now, there is still a systemic bias against troubled companies that makes effective resolution difficult. An example is the unavailability of working capital facilities to supplement rescue investments. Another is the lack of experienced management teams willing to take the plunge to run companies acquired out of distress, though clear positive movement can be seen on this front in recent times.

Moving on to regulations, the backdrop for distressed debt purchases and restructuring remains cumbersome, and unduly restrictive for the small percentage of loans that fail if lending is done right. As the financial system has grown, prudential norms of bank regulation, intended to secure financial stability by protecting depositors and the wider financial system, have been adapted and extended into the regulation of the non-performing loan arena. The architecture carries over and is well known to be ill-suited to creating good resolution outcomes.

For an arena demanding speedy, creative, and tailored solutions to rescue troubled companies, the narrow, detailed and rigid parameters incapacitate many an effort. The distraction from a procedure-bound mode combines with unsuitable prescriptions to take a large toll on resolution outcomes. It also leads to lower participation rates, and lower prices for distressed debt when it does trade.

Furthermore, unsuitable restrictions limit the availability of rescue capital. For example, three to four separate entities are required to acquire the debt and fund the needs of a troubled company with an incomplete project, and foreign and domestic borrowings. Further, for a stressed loan, while banks are
not geared to provide optimal rescue solutions, other players are not permitted to acquire the debt unless it is classified as non-performing. Further restrictions limit incremental rescue capital to 25 per cent of the cost of the acquired distressed loans – virtually ruling out the investment of last mile finance for projects that are less than 80 per cent complete.

Similarly, proposed rules for the sale of bank loans impose requirements of objective measures, external valuations, etc. on investors who have won mandates based on their own varying investment approaches. Banks and regulation repeatedly refer to ‘price discovery’ as an entitlement, almost as if it were a free service to be provided by potential buyers even in the absence of a serious sale process. A preoccupation with enabling aggregation of debt and allowing rights of first refusal to existing debt holders is no longer relevant given the provisions of the Code, but continues to deter the application of effort by new entrants. A mandatory inter-creditor agreement now seeks to impose a cram-down without the benefit of a court’s supervision. Such impingements plainly deter investor participation.

As far as the law and its interpretation is concerned, a basically solid law and serial litigation followed by landmark Supreme Court decisions have cleared the path remarkably. However, some related deterrents add up to limit competition.

First, the clubbing together of creditors with potentially conflicting interests into a single creditor class. This deters participation since investors find it difficult to evaluate, ex-ante, the risks of inter-creditor conflict, and of being voted down by a majority with divergent interests. Second, cram-down becomes a serious concern in the absence of voting creditor classes. A third issue that is lurking, though as yet its impact is limited due to low recoveries for unsecured claims, is the lack of clarity around the termination of contracts and leases. Alongside these, the determination of claims remains rushed and unclear. In addition, to smoothen the process, it may now be worth incorporating effective devices such as administrative claims, critical vendor claims, etc. Finally, unclear treatment of interim finance in liquidation virtually eliminates capital availability to debtors during the resolution process, and on balance discourages the financing of a rescue prior to an insolvency. The resolution of financial institutions is also deserving of attention.

Next, we will visit certain nuances of the interpretation of law by various practitioners, and perhaps more so of regulations, that are posing hurdles to investor participation.

For good outcomes, the resolution exercise must be responsive, flexible, and driven by the commercial judgment of creditors with capital, expertise, and a stake in the outcome. Relative to this need, oftentimes the interpretations have been counterproductive. For example, while these are slowly evolving, the interpretation of a ‘going concern’, and what it is to ‘preserve and protect the assets’ and ‘continued business operations’ of the corporate debtor, has all but straitjacketed the resolution process so far. Some resolution professionals also imagine a responsibility to revive the underlying business, while ignoring the more manageable task at hand: resolution of the entity’s insolvency by determining claims, liquidating rapidly declining assets, and disseminating quality information to attract wider participation.

The liquidation cliff is another strong deterrent to the entry of rescue capital. The disbandment of the committee of creditors was intended to promote resolution within the limited time permitted. Ironically, the potential loss of control in the event of a failed rescue dissuades new investors.

The above hurdles to better resolution fall broadly into two categories, with some overlap. The first includes challenges that are relatively easily met by modifications of law, regulation, or practice. The second set is not as easily amenable to a fix in the near term, and requires that we wait for the ecosystem to evolve further.
ECOSYSTEM 2.0: TIME FOR AN UPWARD RESET

House-keeping ain’t no joke.
- Louisa May Alcott, Little Women, 1868

The context and need suggest that it is time for Ecosystem 2.0 so that superior resolution outcomes, a core objective of the reforms, may be achievable. The requisite changes fall into three categories.

First, potential amendments to the Code to catch up with the increased sophistication of the ecosystem and its related needs. With advancements in India’s insolvency jurisprudence, and in the practice of insolvency, it is important to equip the regime to better handle the distressed situations currently at hand. Solving for the issues discussed above, and lowering barriers to entry for investors, will enable greater participation and improve the efficacy of resolution outcomes.

Second, a fundamental shift towards a light-touch regulatory approach to distressed debt investment is required. Effective insolvency resolution requires the creation of a real market for distressed debt, and for the control of troubled companies. Being a complex arena with the characteristics discussed earlier, a bank-oriented compliance burden dramatically lowers both efficiency and efficacy. While oversight is desirable in the context of a non-performing loan problem centered on public-sector banks, the efficient resolution of insolvencies requires flexibility and speed. In fact, in line with international practice, the optimal approach should permit wide latitude as long as a high bar is set on who may participate, and as long as end-investors are qualified buyers, and reasonably protected.

Finally, the more difficult part. It is critical that Indian banks begin to adapt, and recognise the merits of specialisation, with stressed assets trading into the right hands at an early stage. Accompanied by a lower compliance burden, and consequently greater flexibility, the banking system would benefit from more competition among specialised investors willing to supply the capital and the expertise that are critical in achieving a reset in the quality of resolution outcomes. Desirable improvements in system capacity would naturally follow these developments.

For now, it is possible to argue that a core problem in insolvency resolution today is not that of market failure, but of the failure to create a market. And absent such a market, the rest is a veritable charade relative to the realisation of superior outcomes. As we noted earlier, a market does not deliver an outcome just because you need it. However, in a truism, finding faith in markets, with appropriate controls for market failure, should deliver better outcomes than any top-down alternative.

In conclusion, it is time to unleash the magic of markets in delivering better resolution outcomes. Over time, the wider financial system and economy will benefit greatly from a consistent, and appropriately priced, supply of credit to sustain high growth; and a self-sufficient, and stable banking system.
IBC: Some Issues in the Processes and Improvements

Balvinder Singh

The Insolvency and Bankruptcy Code (IBC/Code) enacted on May 28, 2016, was enforced from December 1, 2016. It has been interpreted and amended according to the changing needs based on experience of its operations. Parliament enacted this law and put in place time limits for compliances in processes at various stages in line with the common saying ‘A Stitch in Time Saves Nine.’ All the institutions involved in the process have contributed in adherence of timelines so far. Even where timelines could not be adhered to, commitment to raise the bar to meet such timelines was sufficiently demonstrated. There is no doubt that in a short span of its functioning of over three years, the IBC has left its mark on the way businesses are to be run in future. However, the IBC is also being used as a tool for recovering debts as opposed to a tool for revival and rehabilitation of businesses. This mind-set should change for the overall development of the economy and effective diversion of the resources from the sick companies to more viable and feasible ones. Keeping viable businesses operating is among the most important goals of the insolvency systems around the world.

ESSENCE OF TIME UNDER IBC: SUGGESTIONS ON IMPROVEMENTS

Time has a value and money has a time value - this is firmly established by the IBC under various provisions and rules made therein. The corporate insolvency resolution process (CIRP) under the law does not commence suddenly. Neither the financial creditors (FCs) nor operational creditors (OCs), would desire to spoil business relationship with the corporate debtor (CD) unless one is pushed to an extreme situation in which it becomes clear that the CD will not be in a position to honour its commitments. Here are some suggestions on how timelines of the processes under the IBC can be improved.

**Contract improvement - FCs**

‘Default’ is defined to mean nonpayment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not paid by the CD. If a firm’s date(s) of payments due and payable is established in the contracts, it would be easy to determine the default when it occurs. An example of the same could be cases of financial debt transactions where detailed contracts are in existence and timeline of default is easy to determine and possibility of insolvency initiation date could well be anticipated.

**Contract Improvement - OCs**

In the matters relating to operational debts, there is a possibility of disputes among the parties. Provision for notice to be given by OC to debtor is to ensure that if payment is not forthcoming, given that there is no dispute among parties, a sufficient time is given before filling for insolvency resolution. If there is dispute in fact, effective steps must have started to resolve the issue among parties through legal
course available, such as, arbitration or suit for recovery. If the contractual clauses could put timelines for raising disputes and terms of payment specified in the contract, it would make the process to initiate insolvency faster while business is still viable. Generally, complaints relating to short supply, defective supply, breach of terms and conditions should be detailed in the contract terms with clear timelines, to avoid any confusion.

**Delivery of Notices**

The issue of non-receipt of notices especially in cases initiated by OC have been played too often to delay the process and these delay tactics do not help when the need for insolvency resolution did exist. Multiple number of insolvency applications against one CD does show that insolvency resolution is needed. In the corporate world where companies have registered offices and addresses available in public domain, it is difficult to believe of cases of non-receipt of notices. It would be a good practice if all kinds of notices are issued through e-mode which is instantaneous and has a facility of having a trail.

**Power of NCLT to initiate CIRP**

It may be noted that Companies Act, 2013 (CA, 2013), under section 73 or 76, allows a CD to make an application to the National Company Law Tribunal (NCLT) for failure to repay the deposit or part thereof or any interest due thereon. The NCLT, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, may allow further time as considered reasonable to the company to repay the deposit. This power may not be exercisable by the Tribunal if application for insolvency against the CD stands admitted. Under the IBC, as soon as an application for insolvency is admitted and Insolvency Resolution Professional (IRP) is appointed, powers of the Board of Directors stand suspended. This is quite in contrast with the CA, 2013 where a default in repayment of deposits or debenture and interest thereon only makes a case for ineligibility of a Director. Thus, a considerable improvement in responsibility on the part of Directors have been made through the IBC as well. Even otherwise, if this stage does come and such application is filed, there is need to exercise restraint to sanction a scheme and the failure to repay is a clear case that the company may need insolvency resolution. Accordingly, there may be a need to make a provision for initiating insolvency proceedings at the recommendations of the NCLT while deciding matters under company jurisdiction having financial implications which suggest that the need for insolvency resolution in the matter is imperative.

**Default should not be mandatory for filing voluntary CIRP**

As insolvency proceeding can be initiated by a CD also, however, such application can be made only in case of default. The duties and responsibilities of Directors of a CD envisage avoidance of such defaults. It is not in doubt that it is the management/ Directors of the CD who would first know the financial stress building up in the organisation. Even if financial stress exists in the CD, waiting for a period till defaults are made either to the FCs or OCs, leads to loss of valuable time. This period may be crucial for preserving the value of business.

**Early preparation by RPs**

Resolution Professional (RP) can make a positive contribution with early start of his preparation for insolvency resolution when he/she gives consent to act as such and the insolvency application is admitted by Adjudicating Authority (AA). Considerable information is available about the CD in public domain as to its financial status and if such information reveals that there does not seem to be a case for insolvency, early settlement among parties before admission in terms of rule 8 of the Insolvency
and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 or immediately after admission in terms of section 12A of IBC could be a good resolution outcome, though strictly it may not be termed as resolution. However, if financial status of the CD is not readily available or does not contain what should ideally be available, it may be a case where preparation for resolution has to be planned for ensuring timely resolution. Thus, RPs can enhance their professional value by playing an active role at the appropriate time.

**Strict adherence to timelines**

As per the IBC, the procedure involved in the CIRP should be completed within 180 days. Keeping in mind certain externalities affecting the smooth functioning of the process, section 12 (3) of IBC, provides for an extension of 90 days to be granted by the AA in completing the process. However, as provided under the proviso to section 12(3) under the IBC, the process of insolvency resolution must be completed in a period of maximum 330 days. The request for extending the corporate resolution process beyond 180 days can be made by the RP on passing of a resolution by at least 66 per cent of the voting shares of the committee of creditors (CoC). The RP will file an application with the AA who if satisfied that the CIRP cannot be completed within the period of 180 days, may extend the time period, but the same shall not exceed 90 days.

The Supreme Court gave a significant judgment in the matter of *M/s Surendra Trading Company. v. M/s. Juggilal Kamlapat Jute Mills Co. Ltd And Ors.*, wherein it held -‘Time is the essence of Insolvency and Bankruptcy Code’. It was observed by the Supreme Court that non-completion of the proceedings within the stipulated time given under section 12 of the IBC will result in liquidation proceedings under section 33.

**Orderly and effective insolvency procedures**

We need to investigate our processes conducted during insolvency resolution phase or liquidation phase. While no doubt, these processes have been elaborated in great detail, efficiency can still be improved, resulting in shortening the time taken without compromising thoroughness and comprehension of the process.

**Information availability**

As soon as the insolvency application is admitted and IRP/RP is appointed and takes charge of the company, apart from other duties, he/she has to collect all information relating to the assets, finances and operations of the CD for determining its financial position, receive and collate all the claims submitted by creditors to him, pursuant to the public announcement made under sections 13 and 15 of IBC.

Sources of information in relation to the assets, finances and operations could dominantly come from books of accounts maintained by the CDs and other sources from which access of information is envisaged. The governance framework envisaged under the CA, 2013, creates a mandatory duty on the part of the Board of Directors to maintain books of account under section 128, prepare the financial statements in terms of section 129, get the books of account and financial statements audited and lay it before the shareholders for being adopted at the Annual General Meeting (AGM) once in a year for the financial year immediately preceding the date of the AGM and thereafter file the financial statements with the Registrar of Companies (RoC).

In this governance framework, two important assurances are available. Firstly, the Directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the
provisions of CA, 2013 for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities. Secondly, the assurance comes from the auditors of the company who have right of access to the books of account and vouchers of the company.

The CA, 2013 does not provide this right of access only for the purpose of audit or during the time of audit. Rather, section 143 of CA, 2013 declares that the auditors always have a right of access, irrespective of whether the books of account and vouchers are at the registered office of the company or at any other place whatsoever. The auditors are duty-bound to apply accounting standards as well as auditing standards and they have to report to the shareholders that the books of accounts and financial statements disclose a true and fair view of the state of affairs of the company and that there are no material departures from the applicable accounting standards.

At the insolvency commencement date (ICD) such information should be available up to immediately preceding financial year, accordingly, these records need to be updated up to ICD. The claims or liabilities stated in this information would be the starting point of claims against the CDs.

**Claims verification in CIRP Stage**

To receive and collate all the claims submitted by creditors to RP pursuant to the public announcement made under sections 13 and 15 of IBC, detailed regulations have been made for filing of claims along-with proofs by OCs (Form B), FCs (Form C), creditors in a class (Form CA), workmen and employees (Form D) and by other creditors (Form E). Separate forms have been provided so that requisite details of claims are available with RP by the date notified for lodging claims or latest by, on or before the ninetieth day of ICD.

The process of verification could be considerably improved if information available with the IRP/RP from the books of accounts or from other authorised sources, becomes the basis of admission of claims against the CDs. This information can be put in public domain so that claimant can have a look at it and only where the claimant disputes the claim amount, he may provide proof of substantiation of the claims.

A limited study in this aspect shows that there are not substantial gaps in claims by FCs, creditors in a class or workmen and employees if interest component on such claims is not substantial. Even in other claims except where disputes exist with the claimants, there do not seem to be material understatement or overstatement of claims. It would not be out of place to bear in mind that it would be too dangerous to ignore claims within knowledge, except if the claims have not been lodged or proof of substantiation is wanted, especially when internal records show a clear claim payable by the CD. It may be a good practice if a statement of reconciliation is prepared between claims as depicted in books of accounts and claims filed and processed by the IP. Such reconciliation statements may point out crucial gaps in transactions which may need to be examined in detail and if investigation is needed on the basis of facts and circumstances. Thus, at the stage of resolution process when focus is on resolution plan which is to ensure that macro imbalances are addressed, it could be a considerable gain in efficiency in the process even if 50 per cent of this exercise is saved and timeliness of process is improved.

**Claims in Liquidation Stage**

As pointed out above, it may be a good practice if a statement of reconciliation is prepared between claims as depicted in books of accounts and claims filed and processed by the IP. Under the present scheme of things, all transactions happening during the CIRP will be taking place in accordance with the instructions of the RP. Claims finalised in the resolution stage continue to be due and not paid due
to moratorium on payment being in force. Claims contracted during the resolution period would, if not paid, become a part of resolution process/liquidation cost and would be part of ‘super priority’ payable in full in terms of section 53(a) of IBC. Accordingly, if unfortunately, the CD is going into liquidation, there is practically no need for inviting claims, afresh once again. In most of the cases, the same RP will only be appointed as Liquidator. Therefore, the Liquidator could commence his job immediately without going through the formalities of inviting claims, segregation of claims and putting them in different buckets in accordance with the waterfall mechanism provided in section 53 of IBC. Following this procedure will reduce the timelines in liquidation.

Identification of Preferential, Undervalued, Fraudulent and Extortionate Transactions

Presently, a lot of time and money is spent in relation to identification of preferential transactions, undervalued transactions, transactions defrauding creditors and extortionate credit transactions. In this regard, an amendment to section 143 of the CA, 2013 and consequently in the Auditor’s Report Order, 2020 may be made, mandating the auditor’s report to specifically state as to whether the company is likely to lose its going concern status during the financial year succeeding the reporting period. Such reporting will not only serve as a cautionary statement but will also help the management to initiate necessary corrective steps to overcome the situation and take care of the interests of all stakeholders. The amendment could also provide that in case in a reporting period, effectively if the reporting entity is no longer a going concern, the auditors will have a ‘relook’ for the two immediately preceding financial years and state if there are transactions of the nature falling under section 43, 45 and 50 of IBC. In case the Board of Directors and auditors declare that the company is a going concern and if it is found that the company is unable to pay its debts to its creditors as a result of which the CIRP gets triggered, *ipso facto*, action should be launched against the Directors and auditors of the company for failure to report true state of affairs of the company.

With the setting up of the National Financial Reporting Authority (NFRA), adequate steps to improve reporting by the auditors could help in protecting the interest of the creditors and other stakeholders and persons responsible for the same could face the consequences as per law. These improvements will go a long way in ensuring a framework in governance of companies which will bring a sense of discipline and will also eventually create a better framework for resolution of insolvency.

Compromise or Arrangement during Liquidation

Under section 33 of the IBC, the AA may pass an order of liquidation if it finds that even prior to the expiry of the period provided for the CIRP, the CoC with 66 per cent voting, decide to liquidate the CD. Similarly, when the maximum period permitted for completion of CIRP ends and the AA has not received any resolution plan, it should pass an order for the liquidation of the CD. Suppose the AA receives a resolution plan as approved by the CoC but it finds that the resolution plan received by the AA under section 31 of the Code is liable to be rejected for non-compliance of the requirements specified in that section, the AA shall pass an order for the liquidation of the CD. In each such case, the liquidator will take charge of the assets and affairs of the CD.

In the matter of SC Sekaran v. Amit Gupta & Ors, the National Company Law Appellate Tribunal (NCLAT) held that the Liquidator may before taking steps to sell the assets of the CD take steps in terms of section 230 of the CA, 2013. If there is any scheme of arrangement under section 230 of the CA, 2013 the AA may pass an order sanctioning the scheme. If such measures do not result in revival, the liquidator will proceed to sell the assets firstly as a whole and if it is not possible, in part.
The essence of the above decision of the Appellate Tribunal is that instead of putting the assets of the CD on sale, the Liquidator could first make efforts to see if the provisions of section 230 of the CA, 2013 could be gainfully used. Thereafter, with effect from July 25, 2019, regulation 2B was introduced as an amendment to the IBBI (Liquidation Process) Regulations, 2016, stating that the Liquidator is expected to explore the possibilities of striking a scheme of compromise or arrangement within the meaning of section 230 of the CA, 2013 and provided the Liquidator with 90 days from the order of liquidation under the IBC. It may not be out of place to mention that such practice has been allowed in cases of winding up of companies under the CA, 2013.

The IBC has introduced a broader framework to explore the possibilities of resolution of all kinds including in the nature of compromises, arrangement or mergers. This provision has mandatorily constituted a process which does not seem to deliver anything substantial. Hardly any success has been achieved in this experiment and except for one or two cases, all liquidation processes have been delayed only to follow the mandatory process of exploration of compromise or arrangement under section 230 of the CA, 2013. As CoC has the power to take a decision even during CIRP stage to liquidate the CD, going through such a process again during the liquidation process may not be worth trying and discretion to not to follow this phase may also be made permissible.

**CoC Constitution**

It is important that the CoC should be constituted within a month. If there is any delay in its constitution, then it will erode the value of the assets of the CD. It has been observed that the appellants/promoters are approaching before the Appellate Tribunal to not to constitute the CoC taking the plea to explore the possibility of settlement between the parties. In some cases, the matter is lingered on for three to four months and there are few settlements which have taken place for even a longer time. There is a need to remain conscious as the delay will destroy the value of the CD and accordingly, the order to not to constitute the committee shall not be passed.

It is a practice not to pay the amount without any reasons even when there is no dispute over the payment. This settlement mechanism is said to be a recovery procedure, since whenever a settlement takes place, it is a recovery in the resolution plan and the amount is distributed to the creditors. This is same as distribution in the case of liquidation under section 53 of IBC. Accordingly, an order for non-constitution of CoC for settlement will lead to no distinction between resolution phase or the liquidation phase.

While ‘resolution’ is written in the preamble of the IBC, the term ‘liquidation’ is not. Looking into this aspect, ‘resolution’ should be used more particularly and in case there is no possibility of resolution of CD as a going concern, it is to be liquidated so that the assets occupied by the CD can be handed over to someone who can put it into alternative uses. ‘Liquidation’ is not a bad word because in this process also the resources are released for uses which are more productive.

**IMPACT OF COVID-19 ON INSOLVENCY LAW**

The impact of COVID-19 has been incorporated in the IBC by raising the minimum default amount to Rs. 1 crore with effect from March 24, 2020³ and suspending initiation of CIRP initially for six months with effect from March 25, 2020 extendable up to one year for defaults during the said period⁴. This window may be a good opportunity to attend to pending cases and becoming ready to deliver better results once the insolvency resolution processes under the IBC start in future. But this may be a double-
edged sword as these amendments may on one side provide relief to certain micro, small and medium enterprises (MSMEs) from initiation of CIRP, but at the same time will disable various MSMEs occupying the position of OCs with claims of trade debts, salary, or wage claims, which are often lower than Rs. 1 crore, from initiating CIRPs. India took years to establish an effective insolvency regime and improve its global ranking in World Bank’s Ease of Doing Business Report and these amendments, necessitated by the pandemic, must not push us back to start all over again.

CONCLUSION

One of the guiding principles of the IBC is to ensure that the company’s viability is determined at the earliest and then the appropriate process be followed for its resolution. It is a good practice on the part of the Directors if they attempt to restructure informally, prior to entering the formal process under IBC. However, this should not be used as a means to delay initiation of the IBC process.

Creditors are key participants in insolvency proceedings, as the maximised value of assets is closely tied to the recovery of creditors, whether financial lenders, employees, or trade creditors. The higher the value of CDs assets, the more claims creditors should get back at the end of proceedings. Greater active participation by creditors in the insolvency process allows them to be part of the decision-making process and balance the actions of debtor and/or insolvency administrator for a mutually beneficial outcome.

It is clearly recognised that speedy resolution is the essence of the IBC and observed that extensions should be considered only in exceptional circumstances. All the authorities involved in the process should adhere to the timelines set out under the Code. These strict timelines make it one of the scrupulous laws. The aim and object of the Parliament, while enacting the Code, was to consolidate and amend the laws relating to insolvency resolution of corporate persons, partnership firms and individuals and to ensure results in time bound manner. However, time bound feature of the IBC is just one side of the coin and the other side of the coin, which is ‘justice’, should also not be handicapped. Thus, there is a need to maintain a balance between both speedy disposal and the delivery of ‘justice’.

NOTES

1 Civil Appeal No. 8400 of 2017.
2 Company Appeal (AT) (Insolvency) No. 495 & 496 of 2018.
4 The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020.
Doing business has become easier in India due to Insolvency and Bankruptcy Code. The banking system has also got strengthened.

- Shri Narendra Modi, Hon'ble Prime Minister of India in his address at the First Uttarakhand Investors' Summit in Dehradun, October 7, 2018.
Secured Creditors under the Insolvency Code:
Searching for Equilibrium

Vinod Kothari and Sikha Bansal

Secured lending is the very basis of business finance today and is unarguably seen as the device to bring down the cost of credit\(^1\). A secured transaction is essentially a debtor-creditor contract and becomes an inter-creditor contract when the security interest is perfected by public registration. The essence of insolvency laws is to preserve contractual freedom\(^2\). However, since insolvency proceedings are collective in nature, the realisation of secured creditors’ interest is subject to protection of collective interests. For instance, during reorganisation or resolution process, the law generally imposes a prohibition on creditors’ enforcement actions. However, in terminal processes such as liquidation or bankruptcy, a secured creditor is given the liberty to either enforce security interest outside the process, using such law as may be available\(^3\), or relinquish security interest and join the queue in process with other creditors.

This article focuses on the provisions of the Insolvency and Bankruptcy Code, 2016 (Code), which, almost silently ushered in a paradigm shift insofar as the priorities of secured creditors are concerned. It is important to note that the escalation of relinquishing secured creditors’ rights from the equivalent of an unsecured creditor to the senior most position, did not seem to have been discussed at length in either of the two reports of the Bankruptcy Law Reforms Committee (BLRC)\(^4\). The objective of the BLRC, viz, to encourage secured creditors to relinquish and be a part of the collective process rather than to stay alone\(^5\), may be appreciable, but this is a major shift, both from erstwhile Indian law as also the position in lot of other jurisdictions.

However, realisation vs. relinquishment are two alternative modes of realisation of security; the two cannot be so drastically different as to lose their alternative mutuality. The self-help realisation of a secured asset by a secured creditor may be a good guide to understanding the sweep and extent of a relinquishing secured creditors’ priority in the common hotchpot, viz., the liquidation estate.

Additionally, the carve-out of the *pari passu* share of the workmen, and its computation, has intrigued liquidators and winding-up courts over the years. Will this computation be the same under the changed scenario of the law?

There is yet another enigma in the world of secured credit – the floating charge. This interesting device that emanated around 1730s in England has over the years been used by practitioners blurring the distinction from fixed charges. The Code does not have any explicit provision about floating charges, but the moot question remains – whether the mutual subordination of floating charges to fixed charges remains under the Code?

Thus, the article discusses three significant questions– relinquishment vs. realisation, workmen’s *pari passu* share, and the ranking between fixed and floating charges.
REALISATION VS. RELINQUISHMENT

Conventionally, in terminal processes, the secured creditors have been given the right to choose any of the following:

- **Realisation**, that is, enforce the security outside winding up. The secured creditor takes away the secured asset from the liquidator and realises the asset independently (though a part of it may be subject to pari passu charge in favour of workmen). In case, there is a surplus, the same is tendered to the liquidator; and in case there is a deficit, the creditor stands in queue with unsecured creditors with respect to the unfulfilled claim.

- **Relinquishment**, that is, surrender the security. The secured creditors put the secured asset into the common pool of assets for the general benefit of the creditors and becomes an unsecured creditor for the whole of the debt.

- **Substitution**, that is, converting the right from the secured asset to the value thereof. In this case, the secured creditor would consent to the sale of assets in liquidation and transition his security interest on the value of the secured asset, instead of the secured asset itself. This was often a preferred alternative, as it would save the secured asset from being severed from the rest of the asset block, bringing better value realisation, while at the same time protecting the interest of the secured creditor. This option is contained in section 47(3) of the Provincial Insolvency Act, 1920 (PIA) and corresponding provisions of the Presidency Towns Insolvency Act, 1909 (PTIA). The practice has not been uncommon, as evident from the rulings in State Bank of Mysore v. Official Liquidator & Ors., Gujarat Steel Tube Employees Union & Anr. v. O.L. of Gujarat Steel Tubes Ltd. & Ors., quoted with approval by the Supreme Court in ICICI Bank Limited v. SIDCO Leathers Ltd. & Ors.

Relinquishment of security interest, would therefore, be a disadvantageous proposition as compared to other options, as it would push the secured creditor to the end of the priority ladder. Sir R. M. Goode, in his celebrated work, Principles of Corporate Insolvency Law, also observes that surrender of security and proving for the debt is a procedure rarely used since it appears to have no possible advantage.

Under pre-Code insolvency regime, as also under insolvency laws of many jurisdictions, relinquishing secured creditors are treated as unsecured creditors, thereby eliminating any distinction between secured and unsecured creditors. However, the Code shifts from the convention, and accords priority right to relinquishing creditors. On the face of it, it seems self-contradicting, because someone who has relinquished security interest has actually given up the same, and therefore, cannot claim to be a secured creditor even after relinquishment. However, it seems that the BLRC, as it made departure from earlier law and gave a superiority to relinquishing secured creditors was possibly inspired by practice of ‘substitution’ referred to above, such that even if the secured creditor relinquishes its asset, the creditor will not be treated at par with other unsecured creditors of the debtor, but will be paid in priority to unsecured creditors under section 53(1)(b) of the Code.

On the other hand, the position of secured creditors who choose to realise has not changed much. Such a secured creditor can realise the security interest out of the liquidation proceedings, though, subject to certain conditions as stated under regulation 21A of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, tendering proportionate payment towards workmen dues as in case of relinquishment under section 53(1)(b) within 90 days of the liquidation commencement. The secured creditor’s decision to stay out of liquidation proceedings is a time-bound option, and if he fails to do so within 30 days, the secured asset is presumed to be a part of the liquidation estate.
Besides, regulation 37 of the Liquidation Regulations, in a way, imitates the provisions of section 47(3) of PIA. The regulation, though, applies only to such a secured creditor who realises security, other than under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) or the Recovery of Debts and Bankruptcy Act, 1993 (RDBA). In any case, regulation 37 cannot be read sans regulation 21A. Irrespective of the law under which the asset is realised, the statutory pari passu charge in favour of workmen will subsist.

Now, except in case of peripheral or stand-alone assets which have identifiable value, it is difficult to see much reason for a secured creditor to opt for realisation – thus, the Indian practice may be complete opposite to that of UK or other jurisdictions, where relinquishment has been said to be rarity. But then, relinquishment cannot allow the secured creditor to go beyond the value of his own secured asset and give him a disproportionate right in the common hotchpot – the liquidation estate. In essence, we get a strong view that priority under section 53(1)(b) in case of relinquishment is not substantially different from a ‘substitution’ option – that is, making the asset a part of the common pool and claiming priority over the value of the asset. But then, the key element in case of relinquishment also is the value of the asset. In essence, the option of realisation under section 52 or relinquishment under section 53(1)(b) will both have to be delimited by the value of the secured asset.

The issue may not be felt if all secured creditors share a pari passu charge over the assets of the corporate debtor. But in the complex world of secured credit, there are specific charges on specific assets. There may be multiple silos and verticals where different secured creditors have different security interests – which may be in terms of contractual priority (first vs. second charges) and/or nature of the security interest (fixed vs. floating charges). In such cases, once the assets become part of a common pool, it is not that the underlying collateral values of the secured assets become meaningless. We feel that this issue has not been discussed in its elaborate dimensions. To examine the issue at length, let us first state the problem.

**PROBLEM STATEMENT**

The numbers in the example below are illustrative but will represent most bankrupt liquidations (though, the value of unsecured assets may be way lesser, the same has been included to elaborate the point of view).

Example:

As is visible, and may also be experienced in most cases, at the time of lending credit, the loan would be adequately secured with a ‘margin’; however, in due course of time, as the liquidation commences and as the asset is eventually realised, the value of security stands depleted. Therefore, commonly,

\[ V > C > L > R \]

Now, as L is lower than C as on the liquidation commencement date, our first issue is, when the secured creditor files the claim on the LCD, will he be submitting two parts of his claim? Form D of the Liquidation Process Regulations, though necessitates putting details of ‘value of security’, however, there is no explicit requirement of segregating the entire claim (that is ‘C’) into secured and unsecured parts. The question of splitting the debt into two parts arose, because the value of security has fallen short of the claim of the secured creditor, and as we discuss below, the priority entitlement of a secured creditor [u/s 53(1)(b)] is limited to the extent of ‘value of security’ only.
Notations and respective (hypothetical) values can be taken as follows –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Notation</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of loan given and outstanding: (for the sake of simplicity, we are assuming the loan originally given and outstanding on the liquidation commencement date (LCD) is the same; we also assume the interest has regularly been serviced. This would represent the secured creditor’s Claim.)</td>
<td>C</td>
<td>100</td>
</tr>
<tr>
<td>Value of the collateral at the time of giving the loan: (every lender will expect a certain asset cover ratio – hence, the value of the asset is admittedly higher than the loan amount)</td>
<td>V</td>
<td>125</td>
</tr>
<tr>
<td>Value of the collateral on as on commencement of Liquidation (on LCD) (based on valuation)</td>
<td>L</td>
<td>80</td>
</tr>
<tr>
<td>Actual value Realised on disposal of the collateral (we assume that the realisation on account of the collateral can be segregated and ascertained; in many cases sales happen as a part of a larger block of assets)</td>
<td>R</td>
<td>70</td>
</tr>
<tr>
<td>Realisations from Unencumbered/Unsecured assets</td>
<td>U</td>
<td>100</td>
</tr>
<tr>
<td>Total claim of Workmen's dues for past 24 months</td>
<td>W</td>
<td>40</td>
</tr>
<tr>
<td>Amount to be ceded by secured creditors from the realisation of the security interest in favour of workmen, and also in relinquishment(^\text{13}), that is, workmen’s Portion</td>
<td>P</td>
<td>?</td>
</tr>
<tr>
<td>Amount actually distributable to the Secured creditor in priority u/s 53(1)(b)(ii)</td>
<td>S(^p)</td>
<td>?</td>
</tr>
<tr>
<td>Distribution to Workmen in priority u/s 53(1)(b)(i)</td>
<td>W(^p)</td>
<td>?</td>
</tr>
</tbody>
</table>

Next question is, for the purpose of determination of the workmen’s share, which is *pari passu* with the secured creditors, is the proportion based on C, or L, or R?

Clearly, the realisation from the asset is R. There might, of course, be several other assets forming part of liquidation estate from which realisation may be done. Hence, we are not saying the total distributable amount in the liquidation estate is R. There can be certain unencumbered assets as well, the realisations from which can form a part of the liquidation estate. Can such realisation be distributed between secured creditors and workmen?

This leads us to the following sequential questions:

(a) First, what is the part of secured creditors’ claim, subject to workmen's share that takes priority of section 53(1)(b)? Is it C, or L or R?

(b) Secondly, based on the answer to the above question, what will be the amount to be ceded in favour of workmen (that is, workmen portion) --

- \(P = R \times \frac{W}{C+W}\), or
• \( P = R \cdot W / (L + W) \), or
• \( P = R \cdot W / (R + W) \)?

(c) Thirdly, based on the answer, the next question is, if the workmen realise \( P \) from the collateral, what happens to the rest of their claim, that is, \( W - P \)?

(d) Fourthly, the secured creditors realise \( R - P \) from the collateral. Now, the total deficit which a secured creditor suffers is a sum of two components, viz., (i) \( C - R \) (that is, deficit in the value of security), and (ii) \( P \) (workmen portion). The same can be established with the help of an equation:

\[
C = (C - R) + (R - P) + P
\]

How are these two parts of the deficit dealt with? Whether \( (C - R) \) should go as a part of the unsecured financial debt under section 53(1)(d)? Whether \( P \) should be treated as a secured claim, claiming priority under section 53(1)(b) from the total liquidation waterfall?

These intriguing questions arise in every liquidation, and their answers are not straight. The following discussion tries to search for the answers.

**VALUE OF SECURITY AND ITS IMPACT ON DISTRIBUTION WATERFALL**

**To what extent is the secured creditor entitled to priority u/s 53(1)(b)?**

The first question relates to that part of the secured creditor’s claim which would get priority under section 53(1)(b), *pari passu* with workmen dues. Can a secured creditor claim priority under section 53(1)(b) irrespective of the value of the collateral that he puts into liquidation estate? This would need a little deliberation, though the issue, to some extent, stands clarified in the Insolvency Law Committee Report, 2020. The report adequately observes that the priority for recovery to secured creditors under section 53(1)(b)(ii) should be applicable only to the extent of the value of the security interest that is relinquished by the secured creditor.

The observation is in sync with well-established principles of setting boundaries of ‘security’ of a secured creditor. Years ago, the Supreme Court in *Jitendra Nath Singh v. Official Liquidator & Ors.* accorded a right over the particular property offered to him as security and all the creditors have equal rights over the other properties comprising the estate of the person adjudged insolvent. In this regard, one may also note section 110 and section 123 of the Code, both of which call for segregation of secured and unsecured parts of the debt of a creditor as separate debts. The creditor has to estimate the unsecured part of the part and he can exercise voting rights (in insolvency resolution process) and can file application (for bankruptcy of the debtor) only in respect of such unsecured part of the debt. Such is the case of a so-called, ‘undersecured creditor’.

The concept has been explicitly dealt with under the US insolvency law - section 506 separates an undersecured creditor’s claim into two parts: the creditor has a secured claim to the extent of the value of his collateral; and he has an unsecured claim for the balance of his claim. While the Code envisages an explicit segregation of the secured creditor’s claim into a secured part and an unsecured part, it does not contain such explicit provisions for corporate insolvency/liquidation. However, this principle must hold good as a matter of equity, since a secured creditor relinquishing security interest over a specific collateral cannot be demanding more on account of the collateral than the value of the collateral itself.

Therefore, if a secured creditor, or even all secured creditors, relinquish security interest, their collective claim for pay-off under section 53(1)(b) would be limited to the value of the secured asset or secured
What shall be the relevant time at which ‘value’ of security is to be fixed?

Once we understand that the priority right of a secured creditor is tied to the value of the asset, it is important to determine such value and the point of time at which such value shall freeze. The value was ‘V’ at the time of lending credit, became ‘L’ at liquidation commencement date (LCD), and ultimately became ‘R’, when the asset is realised.

Therefore, though the claim of a secured creditor is frozen on LCD, the value becomes frozen only when the asset is actually realised. Ultimately, the secured creditor can only have ‘R’ (that is, the value which is actually realised) as its ‘priority’ entitlement. Depending upon the realisation from the asset, the claim may be repaid in full or remain insatiate. The insatiate part of the claim becomes an unsecured debt. Therefore, using the notations above, while the total claim is ‘C’, the priority entitlement of the secured creditor (subject to the ceding a part of it in favour of workmen), would be ‘R’. As a result, (C – R) becomes the unsecured part of the claim, for which the secured creditor cannot claim priority under section 53(1)(b). The value of security as on liquidation commencement date, that is ‘L’, becomes irrelevant for the purpose.

How shall one determine distribution between secured creditors and workmen?

Section 53(1)(b) accords pari passu status to relinquishing secured creditors and workmen (past 24 months’ dues). Therefore, after paying off costs under section 53(1)(a), the proceeds of secured assets are to be distributed between relinquishing secured creditors and workmen proportionate to their respective claims. The question can be – how does one determine the proportion? As in, if ‘R’ is to be distributed between secured creditors and workmen, the ratio would be ‘C : W’ or ‘R : W’?

Since the pari passu share for workmen is inherited from the Companies Amendment Act, 1985, one may be guided by the statutory illustration used in section 529 of the Companies Act, 1956 (1956 Act) for computing ‘workmen’s portion of the security’ as follows:

The value of the security of a secured creditor of a company is Rs. 1,00,000. The total amount of the workmen’s dues is Rs. 1,00,000. The amount of the debts due from the company to its secured creditors is Rs. 3,00,000. The aggregate of the amount of workmen’s dues and of the amounts of debts due to secured creditors is Rs. 4,00,000. The workmen’s portion of the security is, therefore, one-fourth of the value of the security, that is, Rs. 25,000.

In the context of the provisions of section 529 of the 1956 Act, the Bombay High Court, in *Maharashtra State Financial Corporation v. Ballarpur Industries Limited*, explained the position of workmen vis-à-vis secured creditors as co-chargees. The High Court applied the ratio of *Privy Council in Sunitibala Devi v. Dhara Sundari Debi*, and held that the same would substantially apply to two charge-holders who have a pari passu charge for the recovery of their dues, and that –
The sale proceeds are required to be divided proportionately between them in the same proportion as their dues. Hence, when a sale takes place, it is for the simultaneous recovery of all claims of all pari passu charge-holders. [emphasis supplied]

The Supreme Court in International Coach Builders Limited v. Karnataka State Financial Corporation19, discussed the observations of the Bombay High Court in Maharashtra State Financial Corporation v. Ballarpur Industries Limited as well as the meaning of the term pari passu and held as follows, besides taking note of section 100 of the Transfer of Property Act, 1882 –

'Pari Passu' means "with equal steps, equally, without preference" (Jowitt's Dictionary, Vol. II, 1959 Edition 1294). Black's Law Dictionary, 6th Edition, 115 defines it as "By an equal progress... used especially of creditors who, in marshalling assets, are entitled to receive out of the same fund without any precedence over each other." It is also defined as "With equal steps, that is to say, proceeding side by side at the same place" (Prem's Judicial Dictionary, Volume III, 1964 Edition, page 1217) The rights of the pari passu charge holders would run equally, temporally and potently, with the rights of the secured creditors. [emphasis supplied]

See also, Bank of Maharashtra v. Pandurang Keshav Gorwardkar & Ors20., wherein the Supreme Court also held that,

The relevant date for arriving at the ratio at which the sale proceeds are to be distributed amongst workmen and secured creditors of the debtor company is the date of the winding up order and not the date of sale.

As such, the ratio in which the proceeds are to be distributed is the ratio of respective claims of the secured creditors and the workmen as on the LCD. Further, in Allahabad Bank v. Canara Bank & Anr.21, the Supreme Court elaborately discussed the illustration under the 1956 Act.

The rulings above make it clear that, once the law creates a charge in favour of workmen on the assets which are already encumbered to secured creditors, the workmen dues would stand at par with the secured creditors' dues. Any realisation from the secured asset, would therefore, be divisible between secured creditor and workmen in the ratio of their actual claims. The illustration under the 1956 Act, adequately captures the principle. Though, in the context of the Code, the formula shall apply in both cases – realisation as well as relinquishment.

Thus, in our case, ‘R’ will have to be divided in the ratio C : W, and not R : W. Therefore, workmen portion will be calculated as:

\[ P = \frac{R \times W}{C+W} \]

Here, an alternative interpretation is also possible – one may say that the realisation should be distributed in between secured creditors and workmen, not using total claim of the secured creditor in the denominator, but only the secured part of the claim of the secured creditor. In the author's view, the same would not entail a justifiable treatment towards the secured creditors. The law has chosen to treat secured creditors and workmen as pari passu charge-holders (as the rulings also indicate, and the position, effectually, remains the same under the Code). For determination of proportion of share between the pari passu charge-holders, if the depletion in the value of security affects one charge-holder (here, secured creditor), but not the other one (here, workmen), then the same would be injustice towards the former. Therefore, both the pari passu charge-holder should, in equal proportions, bear the burden of depletion of security – which is only possible if the realisation is apportioned in the
What happens to the part of claim remaining unpaid to a secured creditor u/s 53(1)(b) or to a secured creditor who opts for realisation?

The amount remaining unpaid to a secured creditor can fall in two categories –

First, deficit in the value of security ('security deficit'). In our case, it is (C – R).

Secondly, deficit arising because of the value ceded in favour of workmen ('statutory compromise') which is the statutory portion ceded in favour of workmen. In our case, P is the workmen portion (as determined above). This P is the amount which the secured creditor has compromised on account of statutory compulsion.

So, the question is – what happens to these two types of deficit?

As regards ‘security deficit’, note that if the secured creditor opted to sell the asset outside liquidation, he will still, presumably, realise R. Therefore, the security deficit would still be the same, and the claim for this amount will be filed in terms of section 53(1)(e) of the Code, as explicitly stated under section 52(9). Note that section 53(1)(e)(ii) refers to ‘debts owed to a secured creditor for any amount unpaid following the enforcement of security interest’. However, what happens to the security deficit of a secured creditor who relinquishes security interest? There are two possible answers: first, as financial debts owed to unsecured creditors under section 53(1)(d), and secondly, as any remaining debts and dues under section 53(1)(f). It will be logical to contend that the security deficit portion may be claimed as unsecured financial creditor, assuming that the creditor in question is a financial creditor. In case it was secured operational creditor, the security deficit will come under section 53 (1) (f).

Therefore, if security interest is realised, (C – R) has to be positioned at section 53(1)(e). On the other hand, if security interest is relinquished, (C – R) has to be positioned at section 53(1)(d), or (f), as the case may be.

As regards the ‘statutory compromise’, that is, deficit arising because of proportionate payment to workmen, note that the same cannot be said to be ‘unsecured part’, because the deficit is not related to value of the secured asset. Instead, it is actually the statutory apportionment of proceeds of secured asset, which otherwise belonged to secured creditors. Section 529A of the 1956 Act recognised priority rights of secured creditors to the extent of value of security and accorded overriding preferential status to such part of the security which was compromised in favour of the workmen, though the same was applicable to secured creditors realising security interest. This is clear from an array of past rulings.

However, the Code lacks clarity in this regard. But a harmonised and justifiable interpretation is possible if one invokes the principle imbibed in section 529A of the 1956 Act, read in sync with section 53(1)(b). If the liquidation estate has unencumbered assets available for the general pool of creditors, then both the priority claimants under section 53(1)(b), viz., workmen and secured creditors, will have to be paid proportionately from such realisations until their dues are paid in full – (a) secured creditors to the extent of value of security, and (b) workmen dues for 24 months.

Therefore, if P is the statutory compromise made from R in favour of W, then the balance due to secured creditors on this account is P, and that to workmen is (W – P). In case there is any realisation from unsecured asset, the same, to the extent of W, will be distributed to secured creditors and workmen in the ratio P : (W – P). That is, 'U' will first be divided between secured creditors and workmen in that
ratio, however, not in excess of W. If anything remains (that is, U-W), the same will be distributed to stakeholders stationed in section 53(1)(c) onwards\textsuperscript{22}.

Note that the interpretation above is applicable in case of relinquishment. In case of realisation, there seems to be a gap in the law. No category under section 53, except the residuary clause (f), can seemingly be extended to cover the statutory compromise made by the secured creditor who realises security interest. Section 53(1)(e) deals only with that part of the debt which could not be realised by enforcement, and not that part of the realisation which has been statutorily compromised.

The propositions above blend into a pictorial representation [Figure 1].

![Figure 1: Distribution between secured creditors and workmen](image)

**What if there are different categories of secured creditors – say, one having exclusive charge on a particular asset, one having first charge on the second asset, and all creditors having *pari passu* charges on all other secured assets?**

In such cases, there would be multiple realisation streams, say, R1, R2, and R3 allocable to each type of secured creditor, having claims, say C1 (exclusive charge-holder), C2 (first charge-holder), and C3 (*pari passu* charge-holders) respectively. R1 is to be apportioned between C1 and W in the same manner as
explained above. As regards, R2, after the workmen portion is taken out, the remaining part shall go to C2 first. For R3, the same shall be divided between the *pari passu* charge-holders in equal proportions.

In case there are realisations from unsecured assets, payments shall be made to secured creditors as above, in the ratio of value of their respective security to the total value of the secured assets realised, and to the workmen, subject to the limitation of W, in aggregate. However, while making such disbursement too, the *inter se* priorities shall be respected. Reliance has been placed on ICICI Bank Ltd.

**CASE STUDY**

Basis the foregoing discussion and the notations/formula coined above, we try to find the value of the unknowns in our example above, that is, P, S\(r\), and W\(r\):

**a) Maximum priority entitlement of secured creditor under section 53(b)(1)**

If R=70, then the balance, that is (C - R) = 30, is an unsecured claim to be covered under section 53(1)(d)/(f) [for relinquished security interest] or section 53(1)(e) [for realised security interest].

**b) Distribution of R between secured creditors and workmen**

\[ R = 70 \text{ is to be distributed to workmen and secured creditor in the ratio } W : C, \text{ that is, } 40 : 100 \]

Therefore, \( P = 20 \). Payment to secured creditors = \( R - P = Rs. 50 \)

Balance claim of secured creditors = \( P = 20 \)

Balance claim of workmen = \( W - P = (40 - 20) = 20. \)

Total of these balances is \( W = 40 \)

[The above is applicable in both realisation as well as relinquishment]

**c) Realisation from unsecured assets and distribution**

Here, \( U = Rs. 100 \)

As stated above, U is to be distributed in the ratio \( P : (W-P) \), subject to the limitation of W.

Payment to secured creditors, say, \( U_s = \text{Min} (P, U * P/(P+(W-P))) = Rs. 20 \)

Payment to workmen, say, \( U_w = \text{Min} ((W - P), U * (W - P)/ (P+(W-P))) = Rs. 20 \)

Note that the balance of U, that is, Rs. \((100-20-20) = Rs. 60\) is to be paid off to employees, and not to unsecured claim of the secured creditor.

In case, the realisation from unsecured assets was lower, it could have led to a deficit in the pay-out to secured creditors and workmen too.

**d) Distribution to secured creditors and workmen**

Based on foregoing workings, total distribution to secured creditors and workmen would be:

\[ S_r = (R-P) + U_s = (70-20) + 20 = 70. \text{ This would be paid under section 53(1)(b)(ii), and the balance amount of 30 remains unpaid.} \]

\[ W_r = P + U_w = 20+20 = 40. \text{ This would be paid under section 53(1)(b)(i).} \]
AN ODE TO FLOATING CHARGES: FINDING A PLACE IN WATERFALL

It is a common knowledge, by now, that floating charges are charges hovering over the properties of the debtor – it assumes the form of a shed – any property that comes under the shed becomes subjected to the charge, and any property that leaves the shed becomes free of the charge. Being characterised as such, a floating charge provides liberty to the debtor to deal with the property, generically described to be covered by the charge.

Undoubtedly, floating charge is a ‘charge’ and is a form of ‘secured interest’. However, is it the same as a fixed charge? Will it share the same status as that of a fixed charge? Applying all possible parameters of commercial wisdom as well as extant jurisprudence, it is difficult to answer the questions in affirmative. A creditor having fixed charge and a creditor having floating charge are not (and cannot be) equally placed, even after the floating charge crystallises.

The courts have, time and again, acknowledged the prominence of fixed charges over floating charges. Where a specific charge is created on immoveable property, an equitable charge or a floating charge if any, created cannot have priority. Some rulings do speak about the impact of a floating charge carrying a restrictive clause, that, a registered floating charge carrying a restrictive clause to the effect that the same property shall not be subjected to any charges whether specific or floating will rank before any subsequently created specific charge if the specific chargee had knowledge or notice of the clause. English & Scottish Mercantile Investment Trust. Ltd. v. Brunton.

To speak about laws, floating charges have even been subordinated to preferential claims in winding up, though the floating charge holders do rank above general unsecured creditors. Under the UK laws, besides being lower in ranking to preferential claims, the floating charge holders even have to cede a prescribed part in favour of unsecured creditors - see section 176A of the UK Insolvency Act, 1986.

However, the Code makes absolutely no reference to floating charges, neither the BLRC has discussed about priorities of floating charges. There can be two possibilities – (a) the omission is deliberate so as to incentivise all charge holders to relinquish the secured asset and accord priority to floating charge holders as well, above all, or (b) the omission is inadvertent. In either case, it cannot be said that the inherent demarcation between fixed and floating charges has been blurred. Floating charges merely provide an intermediate way of security to the charge holder. Therefore, if a creditor has floating charge on every description of property of the company (which, generally is the case), it can only be paid subject to the priority rights of fixed charge holders. Irrespective of the fact that the law is not explicitly worded on this, the contractual rights of creditors will be upheld during insolvency – be it the intraclass priority between first and second charge holders, or the priority of fixed charge holders over floating charges.

CONCLUSION

The field of study in security interest and rights of secured creditors is vast and expansive, as well as interesting. With an unconventional treatment given to the secured creditors under the Code, which is different from the conventional Indian laws as well as the laws of other jurisdictions, the intrigue surrounding the interpretation of the provisions and the questions arising from the same cannot be said to be unreasonable. Also, possibilities of alternative interpretations cannot be ruled out. The article tries to touch upon some very basic questions with the help of simplistic examples.
Also, the focus in this article has been to analyse the priority waterfall *vis-à-vis* secured creditors. Nevertheless, including the above, there are still some areas, which can be identified, where the lawmakers can possibly endeavour to provide more clarity on. As discussed above, at present, the priority (position) of the debt of a secured creditor arising out of statutory compromise in favour of workmen is not entirely clear from the provisions, especially in case of creditors realising the security. The same might need some clarification akin to that under the 1956 Act. The law either shall clarify that such deficit too, is covered under section 53(1)(e) of the Code.

With the kind of objective the law seeks to achieve by prioritising relinquishing secured creditor, the law must endeavour to achieve equilibrium between realisation and relinquishment, or say create some advantage in relinquishment over realisation. With certain gaps as above, and some cribbing questions as discussed above, we are yet to attain clarity on the provisions.

Given that the law is still in the process of evolution, one will have to rely on established principles and judicial precedents until the law comes up with explicit clarity.

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**NOTES**

1. UNCITRAL Model Law on Secured Transactions: Guide to Enactment. ‘To the extent that a secured creditor is entitled to rely on the value of the encumbered asset for the payment of the secured obligation, the risk of non-payment is reduced and this is likely to have a beneficial impact on the availability and the cost of credit’ [Para 5].

2. *Ibid.* ‘It is extremely important that the insolvency law recognizes the effectiveness of a security right, its priority and its enforceability in the case of the grantor’s insolvency’ [Para 9]. Also see, UNCITRAL Legislative Guide on Insolvency Law. ‘Clear rules for the ranking of priorities of both existing and post-commencement creditor claims are important to provide predictability to lenders, and to ensure consistent application of the rules, confidence in the proceedings and that all participants are able to adopt appropriate measures to manage risk. To the greatest extent possible, those priorities should be based upon commercial bargains and not reflect social and political concerns that have the potential to distort the outcome of insolvency. According priority to claims that are not based on commercial bargains therefore should be minimized’. [Part One, I, B-8].

3. For instance, section 13 of the SARFAESI Act, or under the Indian Contract Act, 1872 in case of pledges, or common law/agreement.


6. Section 529 of the 1956 Act read with section 47 of the PIA, or paragraphs 9 to 17 of the Second Schedule to the PTIA; see section. 326/327 of the Companies Act, 2013; Rule 14.19 of the UK Insolvency Rules, 2016]. Such conventional right is

7 Proviso to section 529(1) of the 1956 Act; Regulation 21A(2) of the Liquidation Regulations. However, under section 529A of the 1956 Act, so much of the value compromised by the secured creditors in favour of workmen was to be paid as overriding preferential payments. There is no such super-priority under the Code.

8 1985 (58) Com Cases 609.


10 2006(10) SCC 452.


12 The Reports of the Insolvency Law Committee, of 2018 and 2020 have dealt with the issue to a certain extent and has clarified that inter-se priorities of secured creditors would remain intact.

13 In case of relinquishment, there would be a distribution of realisations from secured assets to secured creditors as well as workmen under section 53(1)(b).

14 (2013) 1 SCC 462.


16 While saying this, we are fully aware that in many cases, an individual asset may be sold as a part of a larger block, or in a slump sale, where the value attributable to a single asset may be difficult to assess. These are nuances of actual liquidation which will have to be resolved based on the framework we discuss here.


18 AIR 1919 PC 24.

19 2003 AIR SCW 1524.

20 (2013) 7 SCC 754.


22 This actually fits into a larger scheme that the workmen's dues are actually taken as a priority payment from unsecured assets. If the unsecured assets are either not there, or are inadequate, workmen's dues take a proportionate share from the secured creditors' claims.

23 A plethora of rulings have gone into the discussion of what exactly floating charges are, and how they are distinct from a fixed charge. For instance, In Re Yorkshire Woolcombers Association Limited, [1903] 2 Ch 295, National Westminster Bank and others v. Spectrum Plus, [2005] UKHL 41.

See detailed discussion in an Indian ruling H.V. Low And Co., Ltd. v. Pulinbiharilal Singha and Ors., AIR 1933 Cal 154.


26 Section 530(5) of Companies Act, 1956 Act, and section 327(3) of the Companies Act, 2013.
The early harvest through the IBC process has been extremely satisfactory. It has changed the debtor-creditor relationship. The creditor no longer chases the debtor. Infact it is otherwise.

- Shri Arun Jaitley, Hon’ble Minister of Finance and Corporate Affairs on ‘Two years of Insolvency and Bankruptcy Code (IBC)’
  Facebook, January 3, 2019
December 1, 2019 was a significant milestone for the Insolvency and Bankruptcy Code, 2016 (IBC) as it marked the day on which Part III of the IBC, which deals with the insolvency and bankruptcy of individuals and partnership firms, came into effect with respect to one category of individual debtors – personal guarantors (PGs). Insolvency proceedings can now be initiated against PGs of corporate debtors (CDs) in the same bench of the National Company Law Tribunal (NCLT) as the CD’s insolvency or liquidation proceedings. While this notification was welcomed by lenders and strongly criticised by some other stakeholders, there appears to be general agreement that there is much in the process that remains to be clarified, particularly on the interplay of proceedings against the CD and its PGs.

Much of this ambiguity regarding PGs has arisen from the meandering and often contradictory jurisprudence that has emerged on corporate guarantors and guarantees under the IBC. In this article, the author proposes to review the treatment of personal and corporate guarantors under the IBC to identify areas of discord and ambiguity. In particular, the article considers two broad issues that evolving jurisprudence in this area has been dealing with: (a) simultaneous proceedings and treatment of claims against the CD and guarantor, and (b) rights of a guarantor and its creditors post-approval of a resolution plan for the CD. Finally, the article also considers certain gaps in the regulations that may come to the fore, particularly in the context of PGs.

THE IBC ON GUARANTORS AND GUARANTEES

The IBC discusses the treatment of guarantors and guarantees in a few different contexts. First, a guarantee is treated as a financial debt under section 5(8)(i) of the IBC and, by extension, the beneficiary of a guarantee is a financial creditor (FC) of the guarantor. The treatment of a guarantee as a financial debt stems from the principle in section 127 of the Indian Contract Act, 1872 (Contract Act) that the liability of a surety or guarantor is co-extensive with, and independent of, the liability of the principal borrower. In other words, in case of a default by the principal borrower, a creditor may proceed against the guarantor without first having to exhaust its remedies against the principal borrower.

Second, section 14 of the IBC provides that in case a corporate insolvency resolution process (CIRP) is admitted against the principal borrower, the moratorium under section 14 will not apply to the guarantor or the guarantor’s assets. It is worth noting that the clarification to section 14 was brought in through the IBC (Second Amendment) Act, 2018, based on the recommendations of the Insolvency Law Committee, given that different Tribunals and Courts had taken contradictory positions on this point. The clarification to section 14 makes clear that beneficiaries of the guarantee may initiate separate enforcement actions against the guarantor (including initiating a CIRP) while the CIRP of the CD is ongoing.
Third, section 60(2) of the IBC states that where a CIRP or liquidation against a CD is in process before a particular bench of the NCLT, the application for CIRP or liquidation of a personal or corporate guarantor of such CD must also be filed before the same bench. Similarly, under section 60(3) of the IBC, if the CIRP or liquidation of a PG or corporate guarantor is pending before a different bench of the NCLT, the proceeding is to be transferred to the NCLT bench hearing the CIRP or liquidation of the principal borrower.

Lastly, section 31 of the IBC provides that a resolution plan, upon approval by the adjudicating authority, shall be binding:

\[
\text{on corporate debtor and its employees, members, creditors, }^2 \text{ [including the Central Government, any State Government or any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed,]} \text{ guarantors and other stakeholders involved in the resolution plan.}
\]

This provision, particularly as to the resolution plan's binding effect on guarantors, has been interpreted extensively by Courts and Tribunals as to what it means for claims by and against guarantors once a resolution plan with respect to the principal borrower has been approved.\(^3\)

This broad framework for the treatment of guarantors under the IBC reflects that the obligations of guarantors are independent of the liability of the principal borrowers and that FCs should be able to proceed against the guarantor in the same way as they would against the principal borrower. At the same time, there is an acknowledgement, particularly through sections 60(2) and 60(3), that the CIRP or liquidation proceedings of the principal borrower and guarantor need to be coordinated in some respects, though the process for this has not been set out in the IBC or the regulations.

The implementation of this framework for guarantors and the claims against them has led to various ambiguities in interpretation and contradictory decisions by different benches of the NCLT as well as gaps in some areas and questions that remain unanswered. These ambiguities are only likely to be further exacerbated, with insolvency proceedings against PGs (the process for individual is quite distinct from the CIRP) coming into the picture.

**AREAS OF AMBIGUITY**

**Simultaneous Proceedings Against Guarantors and Principal Borrowers**

The IBC allows simultaneous proceedings to be commenced against the principal borrower and guarantor given that the moratorium under section 14 explicitly carves out the guarantor and its assets from the ambit of the moratorium. Various benches of the NCLT as well as the National Company Law Appellate Tribunal (NCLAT) have recognised this and have held that a FC may commence a section 7 proceeding against a corporate guarantor without first having to commence a proceeding against the principal borrower and may also, if it chooses, initiate proceedings against the guarantor and the principal borrower in parallel.\(^4\)

However, while there is clarity on the fact that a creditor may initiate IBC proceedings against both a guarantor and the principal borrower, how the two proceedings will pan out is fraught with ambiguities. In *Vishnu Kumar Agarwal v. Piramal Enterprises* (hereinafter ‘Piramal’), which involved simultaneous proceedings against two corporate guarantors, the NCLAT held that once a section 7 application against one of the guarantors is admitted, the section 7 application against the other guarantor for the same claim cannot be maintained:
There is no bar in the ‘I&B Code’ for filing simultaneously two applications under Section 7 against the ‘Principal Borrower’ as well as the ‘Corporate Guarantor(s)’ or against both the ‘Guarantors’. However, once for same set of claim application under Section 7 filed by the ‘Financial Creditor’ is admitted against one of the ‘Corporate Debtor’ (‘Principal Borrower’ or ‘Corporate Guarantor(s)’), second application by the same ‘Financial Creditor’ for same set of claim and default cannot be admitted against the other ‘Corporate Debtor’ (the ‘Corporate Guarantor(s)’ or the ‘Principal Borrower’). Further, though there is a provision to file joint application under Section 7 by the ‘Financial Creditors’, no application can be filed by the ‘Financial Creditor’ against two or more ‘Corporate Debtors’ on the ground of joint liability (‘Principal Borrower’ and one ‘Corporate Guarantor’, or ‘Principal Borrower’ or two ‘Corporate Guarantors’ or one ‘Corporate Guarantor’ and other ‘Corporate Guarantor’), till it is shown that the ‘Corporate Debtors’ combinedly are joint venture company.

The principle outlined in Piramal has since been relied on in several subsequent cases before various benches of the NCLT as well as by the NCLAT in State Bank of India v. Visa International Limited, where the NCLAT stated that a CIRP against a guarantor could not be admitted as a CIRP against another guarantor for the same claim had already been admitted. The one case that does not follow the Piramal line of reasoning is the decision of the NCLT, Chennai Bench in Indian Bank v. Jeppiar Cements Private Limited, which allowed the CIRP of a guarantor to be admitted after a CIRP against the principal borrower had been admitted for the same claim. In Edelweiss Asset Reconstruction Company Pvt. Ltd. v. Sachet Infrastructure Pvt Ltd. and Others, the NCLAT, attempted to differentiate the case at hand from Piramal on the grounds that it involved a consortium of CDs which had extended guarantees to each other. The NCLAT agreed with the plea of the resolution professional and Edelweiss that, as the land for developing the township was held by five different entities, a group insolvency process against all five CDs had to be initiated as the resolution process would otherwise not be successful. The Piramal decision itself is now pending in appeal in the Supreme Court (SC) and it remains to be seen how it will be decided.

At first blush, the logic of the NCLAT in Piramal appears sound in that it stems from the principle of no double dipping. If a creditor recovers its claim against one of the obligors, it cannot also recover from another obligor for the same claim. However, it is important to remember that admission of a CIRP does not in itself mean that the creditor who initiated the application will recover the entire amount of its claim. In fact, as the CIRP progresses, the specific default that initiated the proceeding becomes irrelevant to the collective insolvency resolution process as all creditors are given the opportunity to submit their claims against the CD. Further, the decision on how to proceed with the CIRP rests not with the individual creditor who initiated the application but with the committee of creditors (CoC). Given this scenario, the NCLAT’s decision in Piramal is premature as mere admission of the CIRP against both obligors does not necessarily mean that the creditor would be recovering more than the original amount of its claim. As the NCLT, Chennai bench stated in Indian Bank v. Jeppiar Cements Pvt. Ltd.: Two same claims against one insolvent is not possible, but same claim before insolvent borrower and before insolvent guarantors is not prohibited under Rule against Double proof or under the Contract Act or under the Insolvency laws. The only rider is the creditor should not continue against any one of the obligants or against the obligant, once the obligation is fully discharged by any of the obligants.

Prohibiting a CIRP proceeding for a guarantor from continuing following admission of the application against the principal borrower and vice versa goes against the very principle of a guarantee and the rationale for lenders to obtain one. The fact that the liability of a guarantor is co-extensive and
independent of the liability of the principal borrower means that a lender must have the choice of proceeding against either or both of them. The Piramal judgment not only takes away this right of lenders under contracts of guarantees, but also leads to various anomalies.

For example, as the moratorium clearly does not apply to the guarantor, a beneficiary of a guarantee is free to proceed against the guarantor during the moratorium period. The only catch in view of the Piramal judgement is that the beneficiary cannot proceed against the guarantor under the IBC (assuming that the beneficiary has commenced an IBC proceeding against the principal borrower which has been admitted). However, the beneficiary may proceed to take enforcement action against the guarantor under any other law, including by invoking the guarantee or acting under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. This leads to a peculiar result that a lender may pursue simultaneous proceedings against the guarantor and the principal borrower as long as they are both not under the IBC. On the contrary, it would likely allow for greater coordination and preservation of value if both proceedings were under the IBC.

It is, of course, important to ensure that the two parallel CIRP proceedings against a principal borrower and a guarantor or against two guarantors are coordinated and no creditor receives an amount in excess of what it is owed. This problem can be addressed by additional regulations or a market practice on consolidating or coordinating such related proceedings and is (as discussed in more detail below) an issue that needs to be considered. However, not permitting simultaneous proceedings against the CD and guarantor goes against the principle of guarantees and contradicts the position of guarantees under the IBC. The NCLAT in Edelweiss has already suggested that the Piramal ratio would not hold in situations where the entities are so inter-related that a consolidated CIRP would be required for a successful resolution. It is hoped that the SC goes beyond this to state that simultaneous proceedings against a guarantor and principal borrower can continue in other circumstances as well.

**Extinguishment of Claims by or against Guarantors**

Another issue that has arisen is the fate of claims by or against a guarantor once the CIRP has been completed and a resolution plan for the principal borrower has been approved. In this situation, there are potentially two questions. First, once a resolution plan has been approved, can a personal/corporate guarantor whose guarantee has been invoked seek to recover its claim against the CD, based on principles of subrogation? Second, can a FC which receives a portion (but not the entire amount) of its original claim through the resolution plan, make a claim against the guarantor for the remaining portion of its claim?

The first question has by and large been clarified through the NCLAT’s decision in Lalit Mishra & Ors. v. Sharon Bio Medicine Ltd. as well as the SC’s decision in State Bank of India v. V. Ramakrishnan, and also more recently in the SC’s landmark judgment in the Committee of Creditors of Essar Steel Limited v. Satish Kumar (hereinafter ‘Essar Steel’). In all these cases, it was held that a guarantor cannot exercise its right of subrogation against the CD once a resolution plan has been approved. In the Essar Steel judgment, the Court relied on section 31 of the IBC to hold that the resolution plan was binding on the guarantor, which was, therefore, barred from proceeding against the CD post-approval of the resolution plan. The SC points out that the goal of a resolution process is to give the resolution applicant a fresh start and, accordingly, a guarantor’s claim under subrogation gets extinguished once a resolution plan is approved. This principle is consistent with the idea that once the CIRP is completed, the debts of the CD are discharged in full and its creditors cannot bring claims against it for dues that arose before the commencement of the CIRP. The IBC (Amendment) Act, 2020 which added section 32A to the IBC, further reiterates the importance of ring fencing the CD from liabilities for past dues once a resolution plan has been approved.
The second question was answered in the affirmative by the Calcutta High Court in *Gauri Shankar Jain v. Punjab National Bank & Anr.*, which involved the question of whether a FC can invoke a personal guarantee after a resolution plan with respect to the principal borrower had been approved. However, this issue came up more recently before the SC in the Essar Steel matter, wherein it appears to have deliberately left this question unanswered on the basis that the banks in Essar Steel Limited were pursuing independent actions against the PGs. Technically, there is no bar under the IBC for a creditor continuing to pursue a claim against the guarantor once the CIRP of the principal borrower has been completed and a resolution plan approved. Further, as section 127 of the Contract Act provides that the liability of the guarantor is independent of the obligation of the principal debtor, it can be argued that the claim against the guarantor remains even though the creditor can no longer make any claim against the principal borrower.

The guarantor could, however, argue that as its right of subrogation under section 140 of the Contract Act is no longer available once a resolution plan has been approved for the principal borrower, it should similarly have no liability to the creditors of the CD. Another defence that a guarantor could take is that as the creditor has voluntarily (through the resolution process) agreed to take a haircut on the amount owed to it by the principal borrower, that the claim against the guarantor gets extinguished as well. Given the grey area in this regard, it is important that this issue on extinguishment (or not) of claims against a guarantor, post approval of a resolution plan, is clarified by Courts.

**GAPS IN THE LAW AND PRACTICE**

As alluded to above, there is currently no guidance on how proceedings against personal or corporate guarantors and their principal borrowers are to proceed in parallel, though section 60(2) and 60(3) provide that they are to be heard before the same bench of the NCLT. Similarly, rules and regulations relating to PGs, viz. Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Rules, 2019, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Regulations, 2019, and Insolvency and Bankruptcy Board of India (Bankruptcy Process for Personal Guarantors to Corporate Debtors) Regulations, 2019 (collectively, Personal Guarantor Rules and Regulations), provide that in situations where a CIRP has already commenced against the CD associated with the PG, the application for the PG must be filed with the same bench of the NCLT where the CD’s case is being considered. In other situations, insolvency applications for the PG must be filed before the relevant bench of the Debt Recovery Tribunal. However, neither the Personal Guarantor Rules and Regulations, nor the IBC or CIRP Regulations specify whether the proceedings must go on simultaneously or must be coordinated with each other at all. This issue is particularly relevant for PGs given that the resolution process for PGs follows an entirely different scheme from that of corporate applicants. For example, there is no CoC for individual insolvency and any repayment plan for a PG would have to be done only with the consent of the PG (in stark contrast to the resolution plan approval process for CDs).

This lacuna in the IBC gives rise to several questions. Can an IBC application against a personal or corporate guarantor be filed at any time during the CIRP of the principal borrower or do the proceedings need to start within a certain number of days of each other? How will the overlapping claims against the principal borrower and the guarantor be managed and coordinated? If the CIRP of the principal borrower is completed, does this automatically bring the CIRP of the guarantor (or insolvency resolution process in the case of a PG) to an end? Some of these questions will no doubt be resolved through market practice and case law. However, for stakeholders to realise the full potential of being able to bring IBC
proceedings against the principal borrower and guarantors and to maximise value for the benefit of all stakeholders, there is a need for regulations on how these proceedings are to be coordinated. The rules in this regard would be different for personal and corporate guarantors.

THE ROAD AHEAD

Guarantees are one of the most common tools relied on by lenders when extending credit and have specific meanings and rights associated with them both under the Contract Act as well as market practice. Further, the SC’s February, 2020 decision in the insolvency of Jaypee Infratech Limited (JIL-JAL Case)\(^{11}\), has resulted in a clear distinction in treatment between guarantors and other third-party security providers under the IBC. While a beneficiary of a guarantee is a FC of the guarantor under the IBC, the holding in the JIL-JAL Case makes clear that a beneficiary of third-party security, such as a mortgage, would not be considered a FC of the third-party security provider. In light of this judgment, guarantees, both personal and corporate, are likely to become even more popular in financing structures. However, the jurisprudence on guarantees under the IBC has, to date, been contradictory in several cases. Further certain ambiguities and gaps in the process remain. It is hoped that these are clarified in the coming months through a combination of case law and regulatory interventions.

NOTES

1 The author would like to thank Ms. Ramya Katti, Associate, Samvad Partners for her research assistance for this article.

2 In State Bank of India v. V. Ramakrishnan and Veeson Energy Systems, Company Appeal (AT) (Insolvency) No. 213/2017, NCLAT and Sanjeev Shriya v. State Bank of India, 2017 (9) ADJ 723, Allahabad High Court, it was held that the moratorium applies to guarantors of the CD as well. However, subsequently, the SC in State Bank of India v. V. Ramakrishnan, AIR 2018 SC 3876 reaffirmed the position that a moratorium applies to guarantors of the CD as well. However, subsequently, the SC in State Bank of India v. V. Ramakrishnan, AIR 2018 SC 3876 reaffirmed the position that a moratorium applies to its guarantor.

3 Yet another reference to guarantors in the IBC is that one of the categories of persons that are not eligible to submit resolution plans under section 29A of the IBC are guarantors of CDs, to the extent that the guarantee has been invoked and remains partly or wholly unpaid. This last context relates to guarantors as resolution applicants and is not dealt with in detail in this article as it is not as relevant to the treatment of guarantors and guarantees in CIRPs (or insolvency resolution processes in the case of PGs) or liquidation or bankruptcy process.

4 Company Appeal (AT) Insolvency No. 346 of 2018.

5 Company Appeal (AT) Insolvency No. 179 of 2019.

6 IBA/685/2019.


8 Company Appeal Insolvency no. 164 of 2018.

9 Civil Appeal No. 8866-67 of 2019 and others.

10 W.P. No. 10147(W) of 2019.

Capital is either in the form of equity or debt. Equity providers enjoy control and rights over profit after tax. Debt providers, in turn, earn a fixed interest income and have a definite repayment timeline for their capital. Both carry risk on return of varied degree, but a business must pay back its creditors first and only the residual return is vested to the equity providers. This principle is enshrined in business customs and laws across the world. Even within each type of capital, there could be different levels or classes with differential rights and obligations emanating both from contractual arrangement and legislative requirement.

In insolvency (i.e. inability to meet all its dues on time), businesses may have to prioritise payments bypassing customary, contractual and legislative order. This may lead to differential treatment within similar creditors group. In such situations individual creditors would start taking unilateral remedial actions, including non-supply, interest or penal charges, security enforcement, etc. to protect their interest, which further aggravates the solvency, and threatens the survival of business. Such a situation calls for a collective action which may be enforced by change of control from equity holders to creditors and such action is guided by bankruptcy laws and rules, which tries to maintain a balance between rescue of business, and honoring order of the rights and obligation of all stakeholders as enshrined contractually or legislatively.

This article shall discuss the importance of protection of creditors' rights and treatment of classes of creditors during insolvency resolution and regulatory guidelines and jurisprudence under Insolvency and Bankruptcy Code, 2016 (IBC) regime in this regard.

**IMPORTANCE OF CREDITORS’ PROTECTION**

Debt capital is a significant source of corporate finance and is essential for economic growth. The chart below illustrates the importance of debt as a major source of capital, even in more developed economies. The Debt-Equity (DE) ratio of BSE 500 companies (excluding banks) is 0.84 in FY17. For economies like 36 OECD countries, the DE ratio for non-financial corporations is mostly higher than 1 with some countries at much higher level like Canada (7.7), and France (6.7) in 2018.

**Chart 1: Debt to Equity Ratios of non-financial corporations in FY18**

<table>
<thead>
<tr>
<th>Region</th>
<th>DE Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>7.70</td>
</tr>
<tr>
<td>France</td>
<td>6.70</td>
</tr>
<tr>
<td>Advanced 36 OECD countries</td>
<td>&gt;1</td>
</tr>
<tr>
<td>India BSE 500 companies</td>
<td>0.84</td>
</tr>
</tbody>
</table>

*Source: OECD website, Mint article, A&M Analysis; *BSE 500 company data is for FY17*
Debt capital comes in many forms, viz. bank term loans, bond subscription, working capital financing, trade finance, operational credit etc. with or without encumbrance on assets. Therefore, debt in all its forms need to be protected and treated fairly, otherwise the discriminated source of financing will dry up which would likely inhibit economic growth. The protection of creditors’ rights and legal certainty are key criteria debt providers use to evaluate lending in any jurisdiction.

The Indian legislative framework has so far ensured protection of creditors’ rights through the enforcement of security. However, such rights are available to select class of creditors and are not absolute. For instance, Banks and Financial Institutions (FI) could recover their dues under Recovery of Debts and Bankruptcy Act, 1993 (RDBA) through Debt Recovery Tribunal (DRT), a quasi-judicial body, once such dues are declared non-performing assets (NPA). These recovery mechanisms are not available to other creditors like bond holders, Operational Creditors (OCs), etc. Civil action suits or winding up petition have resulted in lengthy judicial process. Each such recovery actions emanates from multiple laws with differing objectives driven by multiple agencies, leading to either business shut down, lop sided recovery or poor recovery. Prior to the IBC, collective resolution framework for creditors did not exist and resolution or recovery actions were limited to actions by individual or group of creditors. Hence, creditors in India have been less powerful and with little control over the outcome of insolvency situation.

**BANKRUPTCY LAW AND CREDITORS’ RIGHTS**

Bankruptcy laws around the world tend to tackle multiple objectives, at times conflicting ones, like rescue and rehabilitation of business, recovery to creditors, employee welfare, consumer welfare, liquidation and redistribution of capital. Different jurisdictions have different approaches to insolvency resolution, some being debtor-friendly, while others being creditor-friendly. No stakeholders can assume superior priority for treatment under insolvency. However, for reasons discussed above, creditors’ protection continues to remain a prominent theme in all insolvency laws. Provisions are included to maintain balance between differing objectives. For instance, some laws grant secured creditor right to enforce security against insolvent company but puts a stay on such proceedings during the period of insolvency proceedings. However, due to the complexity of credit instruments with differential rights and purpose of credit, the insolvency laws tend to struggle to maintain the balance of all such creditors’ interest, vis-à-vis other objectives. In the same light, IBC in India has the following objective:

An Act to consolidate and amend the laws relating to reorganization 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, and for matters connected therewith or incidental thereto (emphasis added).

The objective of ‘availability of credit’ and ‘balance the interests of all the stakeholders’ embodies the need for creditors’ protection in tandem with the maximisation of value of assets, and accordingly relevant provisions have been drafted keeping this in mind.

**CREDITORS UNDER IBC**

The word ‘Creditor’ in not defined under Companies Act, 2013, however it is defined in section 3(10) of IBC as: ‘any person to whom a debt is owed and includes a financial creditor, an operational creditor,
a secured creditor, an unsecured creditor and a decree-holder’. It clearly establishes various classes of creditors, i.e. financial creditor (FC), OC, secured creditor and unsecured creditor, and defines each of the class in a specific manner. It may be noted that existing laws like the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act) has defined ‘secured creditor’ and ‘security interest’, and IBC also defines it in a similar manner.

Section 3(30) defines secured creditor as ‘a creditor in favor of whom security interest is created’. Section 3(31) defines security interest as:

right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person: Provided that security interest shall not include a performance guarantee.

IBC also, for the first time in Indian legislation, introduced the concept of FC / financial debt and OC / operational debt to create differential voting powers for conducting creditor-in-control, corporate insolvency resolution process (CIRP). It is evident that there could be multiple classes of creditors, each distinct from the other.

Each of the above class of creditors enjoys certain rights under IBC or otherwise vis-à-vis creditors of other classes and the corporate debtor (CD). Some of these provisions and treatment of creditors’ issues has been litigated heavily in Indian Courts over last few years. The article shall discuss such key issues and its status under the IBC regime.

KEY ISSUES PERTAINING TO CLASSES OF CREDITORS

**Rights of financial and operational creditors**

*Right to initiate IBC*

Any FC or an OC can initiate CIRP in case of default. While an FC needs to furnish the name of Insolvency Professional (IP) proposed to be appointed as Interim Resolution Professional (IRP), it is not mandatory for an OC.

*Committee of creditors and voting rights*

The committee of creditors (CoC) shall comprise of FCs (excluding related parties) only, who shall have voting rights proportionate to the financial debt owed to them. Where there are no eligible FCs, the CoC shall consist of 18 largest OCs and one representative of workmen and employee each. The voting rights shall not be affected due to any charge, security or mortgage.

*Treatment of dissenting FC and OC in resolution plan and in liquidation*

Due to involvement of large number of creditors with differing interests, creditors ‘holdout’ is likely to happen for any resolution efforts. Therefore, it is incumbent on the statute to provide provisions to disincentivise unfair holdouts or make assenting creditors’ majority decision binding on all creditors. Additionally, the law should also provide safeguards for the protection of dissenting creditors to avoid misuse by assenting creditors to jeopardise the dissenting creditors.

IBC provided 75 per cent voting by CoC members for any action of the CoC, including approval of resolution plan. This was further reduced to 66 per cent for all specified major decisions like appointment
of RP, approval of resolution plan, and 51 per cent for all other decisions, through an amendment dated June 06, 2018 in line with various Courts’ pronouncement and Reserve Bank of India’s (RBI) existing framework for restructuring of loans.

While IBC did not envisage any rights to dissenting FCs, the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP regulations) (pre-amendment) defined dissenting FC as an FC who voted against the resolution plan or abstained from voting for the resolution plan, and who must be paid liquidation value before any recoveries are made by the assenting FCs. Section 30, however, requires payment of liquidation value to the OCs. National Company Law Appellate Tribunal (NCLAT) in Central Bank of India v. Resolution Professional of the Sirpur Paper Mills Ltd. and Ors ruled that the preferential payment to dissenting FC is inconsistent with the Code and the Insolvency and Bankruptcy Board of India (IBBI) did not have power to issue regulations to that effect. Subsequently, IBBI brought amendment to CIRP regulations dated October 5, 2018 removing the concept of dissenting FCs and payment of minimum of liquidation value to dissenting FC. However, Government/IBBI introduced the concept of dissenting FCs under section 30(2)(b) and CIRP regulation 38(1)(b) through an amendment dated August 16, 2019 and November 27, 2019, respectively. It now simply requires dues of OCs and of dissenting FCs under resolution plan be paid in priority to the FC dues which voted in favour of the plan, prescribing a minimum value payable to such creditors to the extent of liquidation value or distribution as may be calculated under section 53. It leaves the decision on amount of recovery to OC and dissenting FC, whether they are secured or unsecured, to the collective wisdom of the assenting FC, which may be secured or unsecured.

Prior to the amendment, the law did not protect the interests of secured FCs who may want to dissent and enforce their security, the way it protects the interest of secured OC by prescribing a minimum payout of liquidation value. In cases where CoC majorly consists of unsecured FC, such FC, due to binding nature of CoC approval, may end up with very low recovery than otherwise in liquidation. Accordingly, the Government has amended the law to safeguard the interest of secured creditors by mandating a minimum payout of liquidation value.

Treatment of OC / FC dues to related parties
Proviso to section 21(2) states that FCs which are related party shall have no right of representation, participation or voting in CoC. Similar specific provision does not exist for OC related party where CoC is formed with OC under regulation 16 of the CIRP Regulations. It is apparent that the intent of the law is to disenfranchise the related parties of CoC membership.

While related parties may not have voting rights, they still have the rights to file a claim and settle as part of resolution/liquidation process. IBC does not specifically allow any differential treatment to related parties creditors vis-à-vis normal creditors, but most resolution plan do not provide for equitable payment of RP dues. There is no settled legal jurisprudence to suggest equitable treatment of related party creditors, however several judgements indicate that similar situated creditors cannot be discriminated under the resolution plan or under section 53. (NCLAT’s order in Binani Industries Ltd. & Anr. v. Bank of Baroda & Anr and Supreme Court’s (SC) order in Rajputana Properties Pvt. Ltd. v. Ultratech Cement Ltd. & Ors.)

Constitutional validity of FC and OC
The differential right of FC and OC under IBC has been challenged by several stakeholders in Courts, calling sections 21 and 24 as ‘discriminatory and manifestly arbitrary in that operational creditors do not have even a single vote in the committee of creditors’ (Swiss Ribbons Pvt. Ltd. & Anr. v. Union of
India\(^3\). It is worthwhile noting that such differential right is unique to India and not present in most other more developed insolvency regimes like US, UK, Singapore etc.

The final report of Bankruptcy Law Reforms Committee (BLRC) had explained the rationale of only allowing FCs the right to form a CoC. It reasoned that ‘members of the creditors committee have to be creditors both with the capability to assess viability, as well as to be willing to modify terms of existing liabilities in negotiations.’

SC settled the debate in Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India\(^3\) and held, ‘Classification between financial creditor and operational creditor neither discriminatory, nor arbitrary, nor violative of article 14 of the Constitution of India’, explaining that

financial creditors are, from the very beginning, involved with assessing the viability of the corporate debtor. They can, and therefore do, engage in restructuring of the loan as well as reorganisation of the corporate debtor’s business when there is financial stress, which are things operational creditors do not and cannot do….financial creditors are clearly different from operational creditors and therefore, there is obviously an intelligible differentia between the two which has a direct relation to the objects sought to be achieved by the Code.

**Treatment of statutory dues**

The statutory or government dues are not defined as a separate class of creditors. Section 5(21) defines operational debt as ‘a claim in respect of the provision of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority’. NCLAT in DG of Income Tax v. Synergies Dooray Automotive Ltd.\(^4\) held,

‘As the ‘Income Tax’, ‘Value Added Tax’ and other statutory dues arising out of the existing law, arises when the Company is operational, we hold such statutory dues has direct nexus with operation of the Company. For the said reason also, we hold that all statutory dues including ‘Income Tax’, ‘Value Added Tax’ etc. come within the meaning of ‘Operational Debt’.

Also, for the purpose distribution of proceeds in liquidation proceedings, the Government dues are ranked junior to secured creditors, workmen's dues, employee dues, and unsecured financial creditors dues. The intention of legislature of deprioritising statutory dues over other dues is expressly stated in the objective section which includes ‘alteration in the order of priority of payment of Government dues.’

Statutory authorities tend to take sequestration actions emanating from powers under respective statute disregarding the CIRP or liquidation process and even after the approval of the plan. Such powers are not available to non-statutory OCs. Various court judgement has upheld protection available to companies under section 14 of the Code against recovery actions by creditors. This is applicable to statutory creditors as well. Although Rajasthan High Court in case of Ultra Tech Nathdwara Cement Ltd. v. Union of India\(^5\), held that demand notices by GST authorities after the approval of the plan ‘are ex-facie illegal, arbitrary and per-se and cannot be sustained’, there continues to be sequestration actions in the form of demand notices, penalties and other enforcement actions. Resolution applicants tend to seek certain reliefs and concessions from such actions while submitting their resolution plan, which may or may not be binding on the authorities despite approval of plan by the adjudicating authorities. Considering this concern, an amendment dated December 28, 2019 was brought to absolve the CD for any such past dues, as was also opined in the Insolvency Law Committee (ILC) report of February 2020.
Treatment of home buyers

The definition of financial debt and operational debt have limited boundary where certain dues of a business may neither be classified as financial debt or operational debt. In large number of cases, a third class of creditors, i.e. home buyers in case of real estate companies found themselves having no control despite having a sizeable ratio of overall debt of an insolvent company and being a source of financing for the real projects. IBC did not have home buyers as a separate class of creditors and, by definition, it was neither a financial debt nor an operational debt. Similarly, public depositors in financial service provider (FSP) insolvency through IBC are neither FC nor OC, which becomes relevant for cases like DHFL, where the regulator decides to resolve FSP. IBBI later introduced new Claim Form F for submission of claims by creditors other than financial and operational creditors, which re-emphasised that home buyers are neither FC nor OC.

The ILC deliberated on the subject in detail and concluded that due to intrinsic nature of the home buyers’ advance to builder, it may fall under the definition of financial debt. It is also desirable to have such wider interpretation to marry the objective of consumer protection under Real Estate (Regulation and Development) Act, 2016 (RERA) and creditors protection under IBC to elevate it to the position of financial debt.

Considering this, an explanation was inserted to section 5(8)(f) of the IBC through an amendment dated June 6, 2018 treating ‘amount raised from an allottee under a real estate project’ as deemed to be an amount having the ‘commercial effect of a borrowing’ hence becomes financial creditors with voting rights in COC. It was challenged by real estate developers in multiple forums, but eventually in case of Pioneer Urban Land and Infrastructure v. Union of India, SC upheld the constitutional validity of the same. The rights of home buyers to initiate CIRP was recently curtailed through an amendment dated December 28, 2019 necessitating a joint application ‘by not less than one hundred of such allottees under the same real estate project or not less than ten per cent. of the total number of such allottees under the same real estate project, whichever is less’. However, this threshold of application has also been challenged at SC and is currently subject to judicial review.

Treatment of Secured (including differential rights) and unsecured creditor

It is an established principle of insolvency law that the rights and ranking of creditors existing prior to insolvency situation must be recognised and honored during the insolvency resolution. This principle is also enshrined in the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law. The key objectives of an effective and efficient insolvency law include, (i) recognition of existing creditor rights and establishment of clear rules for ranking of priority claims and (ii) ensuring equitable treatment of similarly situated creditors. Further, the World Bank’s Principles for Effective insolvency and Creditor/Debtor regimes also include ‘Recognize existing creditor rights and respect the priority of claims with a predictable and established process’ as one of essential principles. Such treatment brings certainty and predictability in the credit market and help creditors to manage their risk based on transparency.

While section 53 provides clear waterfall ranking for distribution of assets under liquidation, the Code does not specify how proceeds from resolution shall be distributed and is left to the discretion of the CoC.

Section 30(4), as amended in November 23, 2017, requires that the manner of proposed distribution in a resolution plan ‘may take into account the order of priority amongst creditors as laid down in sub-section (1) of section 53, including the priority and value of the security interest of a secured creditor’. Section 53 does give secured creditors priority over unsecured creditors; it makes no mention
about treatment of creditors with differential rights over security. Considering existing law in force and sections 52 and 53 of the IBC, there remains some unanswered questions regarding the rights of secured creditor vis-à-vis other secured creditors junior to them. The issue has not been fully settled yet, but there are established legal principles and case laws both outside IBC and in IBC that deals with the issue.

**Inter-se rights of secured creditors**

Common law and corporate finance teach us that senior debt has a higher priority than subordinate debt. An enterprise can raise funds against same collateral from multiple creditors by way of giving preferential charge to one over another, and by obtaining consent from the superior charge holders for any sharing of collateral. It is, therefore, common to understand that the creditor with first charge over same collateral would be paid first from such secured asset followed by second charge holders and so on.

In legal parlance this is best represented as the doctrine of priority of rights, i.e. *qui prior est tempore potior est jure* (whomever is first in time is first in right or one who is prior in time has a superior right in law). Section 48 of the Transfer of Property Act, 1882 embodies this principle:

> Where a person purports to create by transfer at different times rights in or over the same immoveable property, and such rights cannot all exist or be exercised to their full extent together, each later created right shall, in the absence of a special contract or reservation binding the earlier transferees, be subject to the rights previously created. [emphasis added]

Despite such clarity, preferential rights over property has been a subject of debate in various court judgements specific to situations. Whether preferential charge / rights of creditors shall be treated as such during liquidation and winding up as well is something on which consensus has yet not been arrived, especially when it comes to insolvency cases under the IBC.

**Provisions and jurisprudence under IBC**

Section 52(1) gives rights to the secured creditors to either relinquish its security interest to the liquidation estate or realise its security. Further sub-section 4 allows that the creditors ‘may enforce, realise, settle, compromise or deal with the secured assets in accordance with such law as applicable to the security interest being realized and to the secured creditor and apply the proceeds to recover the debts due to it’. Section 53(1) of IBC lays out the priority waterfall for distribution of proceeds from sale of assets under liquidation as below. It opens with a non-obstante clause overriding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force.

> It is important to note that the section 53(1)(b)(ii) places secured creditors *pari-passu* with workmen’ dues, it makes no mention of the inter-se rights of the secured creditor and how shall differential rights be treated for distribution of proceeds. It is a matter of debate whether absence of such clear distinction and insertion of non-obstante clause tantamount to disregard inter-se rights as envisaged in section 48 of Transfer of Property Act, 1882 as discussed above.

One school of thought puts emphasis on the choice of the secured creditor who voluntarily relinquishes its security interest in favour of common pool of liquidation estate. Accordingly, any creditor who wishes not to forego her preferential rights over the collateral would not relinquish under section 52(1)(a) and realise its security interest under section 52(1)(b). The secured creditor would therefore agree to be
part of liquidation pool only when she thinks recovery under collective liquidation process is higher than enforcement of security outside of it. However, this school of thought may often discourage secured creditors to come into liquidation for common interest as it disregards its valid preferential rights over the secured assets, thereby defeating the possibility of collective recovery action which any insolvency and liquidation law envisage.

The other school of thoughts suggest that the legislature would not have intended to curtail a very essential and fundamental rights of the secured creditor and put all secured creditor in the same class. If such were the intention, the legislature would have mentioned it clearly. To counter this argument, it may be said that all insolvency law would limit the levels of distribution waterfall to the minimum, which is eight levels in section 53. And the absence of specific level for preferential rights would mean it has to be disregarded. Further section 53(2) apparently disregards all contractual arrangement including differential rights with these texts: ‘any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under that sub-section shall be disregarded by the liquidator’. Also, some insolvency laws globally indeed tend to restrict rights of secure creditors to safeguard common interest of all creditors, or rescue of business enterprise.

However, such interpretation can be further extended to disregard the whole concept of security, or any rights for that matter not mentioned in the law. If this argument is relied on, then all forms of differential rights including rights of shareholders, and unsecured creditors may be disregarded. A proposition such as this which abridges the rightful preference on the collateral shall create uncertainty for credit market. Creation of charge is extremely important to protect the rights of the secured creditors. Even in Companies Act, 2013, section 77(3) makes it mandatory to register all charges:

Notwithstanding anything contained in any other law for the time being in force, no charge created by a company shall be taken into account by the liquidator or any other creditor unless it is duly registered under sub-section (1) and a certificate of registration of such charge is given by the Registrar under sub-section (2) [emphasis added].

This underpins the importance of ‘Charge’ (of all ranks) and its registration thereof, for being considered by the Liquidator during liquidation proceeds under the Companies act. It may be incongruent to conclude that provisions of IBC would treat such charge any differently during liquidation process.

Further, it may be worth noting the observations in the Report of the Expert Committee on Company Law. The Report's observation in the heading “Claims Resolution : Treatment of Stake Holders Rights and priorities on liquidation” states that ‘Rights and priorities of creditors established prior to insolvency under commercial laws should be upheld to preserve the legitimate expectations of creditors and encourage greater predictability in commercial relationship’. Further para 21.4 states ‘the number of priority classes should be kept to minimum so that rights and expectations of classes created prior to insolvency are not diluted.’ This gives a cue why the legislature may have deemed it not necessary to specifically mention treatment of differential rights within the liquidation waterfall.

The same principles also seem to be enshrined in the UNCITRAL's Legislative guide on Insolvency Law, which are recommendatory in nature. The Part II of the guide contains principles for treatment of ‘Assets included in the insolvency estate’. Para II.A.2. (b) discusses the treatment of encumbered assets. Some laws mandate the inclusion of encumbered assets to liquidation estate as is desirable for greater recovery where such assets are critical for running the business. Therefore, wherever law mandates inclusion of encumbered assets in liquidation estate, it must provide certain protection to the secured creditors. To quote from the same paragraph,
An insolvency law should make it clear that such an inclusion will not deprive secured creditors of their rights in the encumbered assets, even if it does operate to limit the exercise of those rights (e.g. postponed by operation of the stay) and should specifically ensure the protection of the rights of secured creditors in encumbered assets.

Having said that, some insolvency laws do provide that encumbered assets are unaffected by insolvency proceedings and secured creditors may proceed to enforce their legal and contractual rights. The IBC marries both principles and allows the secured creditor to exercise its discretion to either enforce security outside liquidation or pool its assets in liquidation estate for collective recovery. It therefore leaves room for interpretation as to the real intention of the law makers.

Hon'ble SC in **SIDCO Leathers Limited & Others**\(^8\) dealt with similar issue under section 529A of Companies Act, 1956. It stated,

> Merely because Section 529 does not specifically provide for the rights of priorities over the mortgaged assets, that, in our opinion, would not mean that the provisions of Section 48 of the Transfer of Property Act in relation to a company, which has undergone liquidation, shall stand obliterated.

However, evolving jurisprudence in IBC does not necessary conclude a similar view of inter-se rights in the resolution plan. NCLAT in **Central Bank of India v. RP of Sirpur Paper Mills Ltd**\(^6\), held that the distribution ranking under section 53 would not apply to distribution under resolution plan in absence of specific mention in the law, which now has been made optional under section 30(2)(b). It therefore indicates that priority of distribution will be a function of choice of resolution applicant and its interplay with negotiating creditors in CoC. However, this interplay must be guided by the overall objective of balancing the interests of all stakeholders, and there need to be a firm legislative or judicial guidance. Also, NCLAT in **Employees of Jyoti Structures Limited v. DBS Bank Ltd**\(^9\), did not recognise the DBS' first charge to be superior to junior charge holders under resolution. While the court did recognise **Sidco case** and UNCITRAL principles, but it ruled that ‘Financial Creditor claims are decided as per provision of the IBC. All the ‘Financial Creditors’ are treated to be similar, if similarly situated’. An appeal to SC was rejected on similar ground. Further, in case of **DBS Bank Ltd. Singapore v. Mr. Shailendra Ajmera RP of Ruchi Soya Industries Limited**\(^10\), DBS Bank has appealed at SC against NCLAT order that the plan has been approved without considering the security value based on sole first charge held by it over some of the fixed assets. If DBS were to enforce its security, it would fetch 90 per cent recovery but under the resolution plan it is getting lower recovery, and that imprudent lenders have been rewarded at the cost of DBS Bank. SC is still to adjudge on the issue, although it has approved the plan and ordered the amount claimed by DBS Bank to be kept in an escrow account. But in an earlier case, **Essar Steel India Limited v. Satish Kumar Gupta & Ors**\(^11\), SC has held, on the issue of distribution between FC and OC, that ‘equitable treatment is to be accorded to each creditor depending upon the class to which it belongs: secured or unsecured, financial or operational.’ While it did not pass a judgement on the inter-se rights of creditors per se, but this observation gives a peek into the SC’s opinion on this issue. All the above-mentioned rulings have touched upon the issue of inter-se creditors right for resolution purpose but for liquidation scenario, it is to be seen how courts opine.

While the arguments in favour of honoring differential rights of creditor seems more compelling based on common law principles, the other viewpoint, as taken by NCLAT, cannot be totally ruled out. Some stakeholders would continue to feel that the real intention of the law is to disregard preferential rights in view of providing priority to the collective liquidation recovery. Since recovery under collective liquidation
would in many cases provide a higher recovery as compared to singular actions, there remains incentive for legislature to force the secured creditors to forego its preferential rights in favour of all secured creditors. It may however be counter-productive if many creditors feel their rights are being deprived and would rather choose for enforcement outside liquidation process. Both legal and practical stand are open for scrutiny and clarification is awaited, but we can watch the actions of creditor in many ongoing IBC cases and take some cue as to which school of thought leads to higher realization, which ultimately is the objective of the insolvency resolution process and any creditor.

**Treatment of creditor’s / obligee’s dues in principal borrower’s / surety’s books once guarantee is invoked**

In the context of guarantee’s contract, there are four key issues which have remained contentious over IBC regime, some of which has been dealt and resolved by courts/regulators, while some remain unresolved.

**Liability of surety / guarantor towards obligee / creditor with respect to the Obligor / principal borrower which is under CIRP**

Several judgements have established that as per section 128 of Indian Contracts Act, 1872, the surety’s liability and obligor’s liability towards obligee is co-extensive, i.e. the creditor can proceed against either or both, with or without proceeding against the other, including insolvency resolution of both parties.

**Applicability of moratorium to surety when principal borrower is under CIRP**

NCLAT in *State Bank of India v. Ramakrishnan and State Bank of India v. Rajendra Kumar* held that both the guarantor and the CD would have protection of moratorium under section 14. This would freeze the surety liability till principal borrower is resolved under CIRP, making the guarantee contract infructuous. In subsequent rulings, Bombay High Court in *Sicom Investments and Finance Limited v. Rajesh Kumar Drolia* held that there is no automatic protection to the guarantor, that moratorium will be available to a guarantor only if insolvency resolution is initiated against such guarantor. This means a creditor can parallelly initiate IBC proceedings against the principal borrower and invoke other non-IBC recovery action against surety, and vice-versa.

Based on recommendation of ILC, a clarificatory section 14(3)(b) was inserted through an amendment dated June 06, 2018 to specifically exclude a surety from the protection of moratorium. This apparently allows parallel CIRP proceedings against the surety. To supplement, the same, section 60(2) and section 60(3) has been amended on 6 June 2018 to allow petition or transfer of ‘insolvency resolution or liquidation or bankruptcy of a corporate guarantor or personal guarantor’ before relevant NCLT of the CD. However, NCLAT in case of *Dr. Vishnu Kumar Agarwal v. M/s Piramal Enterprises Limited* has held that the creditor cannot file insolvency application against both CD and the surety for the same claim, although IBC does not specifically restrict simultaneous filings. This has been challenged at SC, but till then the NCLAT judgement has complicated the settled principle of co-extensive of surety and obligor’s liability and rendered the initiation of CIRP against the surety impossible.

**Subrogation of Creditor’s right onto the surety and extinguishment of guarantee**

NCLAT in *Lalit Mishra & Ors. v. Sharon Bio Medicine Ltd.* denied the promoters the automatic subrogation of rights of the creditors against the principal borrower to ‘prevent promoters from rewarding themselves at the expense of creditors and undermining the insolvency processes’. Accordingly, promoters cannot expect any provisions in the resolution plan towards their liability to the creditors by virtue of guarantee contract. Also, in case of *Essar Steel India Limited v. Satish Kumar Gupta & Ors.*,
SC held that the surety’s claim on account of subrogation against the successful resolution applicant (SRA) as untenable, since section 31 states resolution plan as ‘binding on all stakeholders, including guarantors’ and ‘SRA cannot suddenly be faced with “undecided” claims after the resolution plan submitted by him has been accepted’. SC did not adjudge upon the right of the creditors to act against the personal guarantors of Essar Steel to recover the remaining portion of their debt. But in a separate case of State Bank of India v. V. Ramakrishnan¹⁶, SC set aside NCLAT's judgment that extinguished the rights of creditors against personal guarantor.

The co-extensive nature of surety’s liability and subrogation of rights of creditors / obligor go hand in hand. If subrogation of rights is denied under insolvency resolution process, then guarantor should also be discharged of the residual unrecovered liability of the creditors as part of the same process. This however is not fully settled yet, as there is no legal clarity whether the other leg of a guarantee contract, i.e. surety’s liability to creditor under section 135 of Indian Contract Act, 1872 stand discharged vis-à-vis a resolution plan.

**COMPARISON OF CREDITOR RIGHTS IN INDIA WITH US AND UK**

Keeping in mind the Indian context and evolving considerations under IBC regime there could still be certain amendments in law that need to be brought in force. It is relevant to draw parallels from more developed bankruptcy jurisdictions on how certain issues regarding creditors' rights are treated. The same is tabulated below.

<table>
<thead>
<tr>
<th>Issue</th>
<th>Treatment in US</th>
<th>Treatment in UK</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Treatment of OC at par with FC</td>
<td>No distinct concept of OC and FC. All creditors whose dues are impaired shall enjoy voting rights, with secured creditors having superior priority over unsecured creditors over distribution of proceeds.</td>
<td>Similar to that of US</td>
</tr>
<tr>
<td>2</td>
<td>Inter-se rights of creditors with differential security ranking</td>
<td>Insolvency laws and common law acknowledges differential ranking of security, and superior ranked debt are paid in priority to subordinate secured debt</td>
<td>Similar to that of US</td>
</tr>
<tr>
<td>3</td>
<td>Treatment of home buyer as a FC</td>
<td>No separate class of creditors as home buyers or any other type of creditors</td>
<td>No separate class of creditors as home buyers or any other type of creditors.</td>
</tr>
<tr>
<td>4</td>
<td>Treatment of OCs / FCs dues to related parties</td>
<td>No distinction of related / connected parties. Connected parties are entitled to vote like unconnected creditors.</td>
<td>No distinction of related / connected parties. Related parties are entitled to vote like regular creditors. But the plan shall be approved only when at least 50 per cent of connected creditors gives approval.</td>
</tr>
<tr>
<td>5</td>
<td>Lack of clarity over treatment of creditor’s / obligee’s dues in surety’s books once guarantee is invoked</td>
<td>The creditors shall take both obligor and the surety into bankruptcy proceedings for unpaid dues. The liability of surety is not discharged because of resolution / liquidation of obligor alone.</td>
<td>The creditor / obligee has right to recover unpaid dues from surety for the unpaid portion after the resolution/liquidation of surety.</td>
</tr>
</tbody>
</table>

**CONCLUSION**

Jurisprudence under IBC regime is evolving fast due to active participation from all the stakeholders, namely, government, regulator, judiciary, and practitioners. Without losing momentum gained in last four years, there should be continued efforts, and perhaps with renewed vigor, to tackle potentially bigger stressed assets crisis as a result of impact of COVID-19. There is a need for entrepreneurship and credit availability in Indian economy than ever before, which also forms part of core objective of the Code. Hence, all necessary steps and course correction should be taken to strengthen IBC regime, amending the Code to clearly demonstrate the intention of some of the unresolved issues as discussed above.
### NOTES

2. Company Appeal (AT) (Insolvency) No. 82 of 2018.
It is often difficult to tangibly measure the contribution of an efficient insolvency system in national prosperity. Direct measures of the impact tend to underestimate its importance as they may fail to account for the 'enabling' and 'preventive' role played by the insolvency system. While the sustainable impact of the IBC will be known in due course, green shoots have already emerged and some significant benefits of the IBC are visible.

- Economic Survey 2018-19, Ministry of Finance, Government of India
INTRODUCTION

The final holding of the Supreme Court in *Committee of Creditors of Essar Steel v. Satish Kumar Gupta* (Essar Steel Appeal), delivered on November 15, 2019, has nullified quite a few major points of the ruling of the National Company Law Appellate Tribunal (NCLAT) in *Standard Chartered Bank v. Satish Kumar Gupta* (Essar Steel). It also dealt with certain constitutional challenges raised against the Insolvency and Bankruptcy Code (Third Amendment) Act, 2019 (Third Amendment). Earlier, the Supreme Court (SC) had heard constitutional challenges to the Insolvency and Bankruptcy Code, 2016 (IBC/Code) in *Swiss Ribbons v. Union of India*, and challenges to the Second Amendment in *Pioneer Infrastructure v. Union of India*.

This essay seeks to analyse the points of divergences between the manner of handling of the Essar Steel insolvency by both the NCLAT and the SC, and the principles enunciated thereunder and further to examine what the impact of the SC’s final decision on the Essar verdict is going to be in terms of schematic analysis of the IBC, and where it stands vis-à-vis the Apex Court’s own past pronouncements.

Further, the essay also seeks to scrutinise the constitutional validity of various provisions of the IBC as amended by the Third Amendment, in the context of the SC verdict in the Essar Steel Appeal while also presenting new arguments which have not been addressed overtly by the Court, and some persistent issues of the past that have not been resolved beyond doubt even now.

This essay primarily deals with the treatment and entitlements of different classes of creditors under the IBC, including arguments on the constitutional validity of applicability of section 53 to the resolution process and how the SC deals with it. This paper also looks at, in some depth, whether there is genuinely a possibility of a conflict of interest despite the pronouncement of the SC and discusses whether discrimination is indeed prohibited under the IBC, and if so, what its constituent considerations are. The scope of this paper is limited to a discussion on the jurisprudence on discrimination against different classes of creditors and the applicability of section 53 to the corporate insolvency resolution process (CIRP), and does not cover the other issues discussed by the SC either in *Swiss Ribbons, Pioneer Infrastructure* or the *Essar Steel Appeal*, or the NCLAT in *Essar Steel or Binani Industries*. It assumes background knowledge of the processes involved in the IBC, and the various parties involved in the CIRP.

Section 1 deals with the law laid down by the SC in *Swiss Ribbons*, as applied by the NCLAT in *Essar Steel*, and Section 2 discusses the law as reinterpreted by the SC in the *Essar Steel Appeal*. Section
3 discusses the argument on conflict of interest in the committee of creditors (CoC) being able to decide the manner of distribution of proceeds, by looking at whether CoC is ‘state’ under Article 12, and whether principles of natural justice are applicable to such a decision-making process which has consequences for third parties. It also deliberates upon the SC’s discussion on what a reasonable classification is, and the net effect of the cases in Section 1 and 2 on the definition of operational creditors (OCs) and on the general scheme of the IBC.

OVERVIEW- JURISPRUDENCE ON DISCRIMINATION UNDER IBC

The constitutionality of the IBC was upheld by the SC in *Swiss Ribbons v. Union of India.* Among other issues, the SC had to decide on whether the distinction between OCs and financial creditors (FCs) falls foul of Article 14, why only FCs are permitted to be in the CoC, and whether section 53 of the IBC, which provides the waterfall mechanism during liquidation, is violative of Article 14. The Apex Court upheld the Code in its entirety.

**Swiss Ribbons (Supreme Court)**

Before *Swiss Ribbons*, the NCLAT had ruled in *Binani Industries v. Bank of Baroda* that the CoC could not merely maximise returns for themselves, but had to maximise the value of the assets of the corporate debtor (CD) as the CoC’s function was only to look at the feasibility and viability of a resolution plan, and did not extend to discriminating against OCs. The NCLAT in *Binani Industries* had also held that FCs had been included in the CoC, quoting the Bankruptcy Law Reforms Committee (BLRC) Report, because it was expected that banks would be more willing to restructure their debts whereas OCs were more likely to merely care about their own dues and leave the resolution of the corporate debtor (CD) in an unlikely position.

The SC in *Swiss Ribbons*, speaking through Nariman J., upheld the same reasoning (though without referring to *Binani Industries*) that the CoC was meant to look into the feasibility and viability of a resolution plan and hence banks and financial institutions were far more capable of making such a decision. The Apex Court also held that the distinction between FCs and OCs does not fall foul of Article 14 on the grounds, besides ease in determining default for financial institutions and lack of setoff opportunities in most cases, that the NCLAT had ensured that FC and OC were given ‘roughly the same treatment’. The SC said:

> NCLAT has, while looking into viability and feasibility of resolution plans that are approved by the Committee of Creditors, always gone into whether operational creditors are given roughly the same treatment as financial creditors, and if they are not, such plans are either rejected or modified so that the operational creditors' rights are safeguarded. It may be seen that a resolution plan cannot pass muster under Section 30(2)(b) read with Section 31 unless a minimum payment is made to operational creditors, being not less than liquidation value ...  

**Essar Steel (NCLAT)**

Following *Swiss Ribbons*, the NCLAT delivered its verdict in *Essar Steel*, modifying the resolution plan after finding that discrimination against OCs and certain FCs had indeed occurred. The NCLAT relied heavily upon the *Swiss Ribbons* judgement to conclude that the role of the CoC was limited to assessing the viability and feasibility of the resolution plan, and verifying the eligibility of the resolution applicant. It also held that FCs were at par with other creditors like OCs, and it would thus be a conflict
of interest if the CoC comprising solely of FCs arrogated to itself the power to decide how funds were to be distributed among various classes of creditors.\textsuperscript{14}

The NCLAT also relied on section 30(2) of the IBC and regulation 38(1A) of the IBBI (Insolvency Process for Corporate Persons) Regulations, 2016 (CIRP Regulations, 2016) to arrive at the conclusion that discrimination was not permissible among FCs and OCs, and they could not be excluded from the resolution plan.

Two arguments were raised by the respondent representatives of the CoC. Firstly, and primarily, they argued that the priority order of section 53 of the Code was not violated. Secondly, it was contended that the CoC should have the power to deal with the commercial aspect of the resolution plan. Section 53 of the Code provides for the order of preference to be granted to various classes of creditors while distributing assets of the CD in the case of liquidation. It does not provide for OCs, and consequently, they are covered sixth-in-order under clause (f): ‘any remaining debts and dues’.\textsuperscript{15} In any case, a resolution plan was required to mandatorily provide the liquidation value due to OCs, in order to comply with section 30(2) of the Code. This argument has remained a contentious issue because in most cases, liquidation value for OCs is usually nil, thereby giving resolution applicants a free hand to provide as little as they can to OCs.\textsuperscript{16}

The NCLAT dismissed both the arguments. It held that the preference order in section 53 would not be applicable to the CIRP, given that the section was placed in the Code under the liquidation part and not in the part on insolvency resolution. Furthermore, the NCLAT held that section 53 was applicable when assets of the CD were to be distributed among various creditors, not when the payment was to be made by the resolution applicant to resolve the ongoing insolvency.\textsuperscript{17} The bare minimum guarantee of liquidation value was to ensure that bids are not excessively low, and not that OCs could not be provided more than that amount.\textsuperscript{18} It also held that the CoC had some freedom to recommend changes to a resolution plan in case there was discrimination in the treatment of creditors; however, this did not allow the CoC to discriminate itself, and hence the CoC could not take up that defense in this case. The duty of submitting a resolution plan rested with the resolution applicant.

The NCLAT then proceeded to modify the manner of distribution in the resolution plan according to an equitable formula that it had developed on its own. According to the formula, all creditors received 60.7 per cent of the debt owed to them (other than the workmen and employees, who received 100 per cent).\textsuperscript{19} This took away from FCs a substantial chunk of what they were initially entitled to receive under the original resolution plan. It was this part of the verdict which created a heavy uproar, and which prompted the Parliament to pass the Third Amendment.\textsuperscript{20}

**IBC Third Amendment**

The Third Amendment, as approved by the Parliament, sought to add multiple new dimensions to the Code. However, the scope of this paper remains restricted to section 6 of the Third Amendment, which amended section 30 of the Code. This allowed the CoC to look into the manner of distribution proposed in a resolution plan before approving it.\textsuperscript{21} It allowed section 53 to be made applicable to CIRP as well. Hence, it modified the entitlement of OCs– from the minimum value they were entitled to being the liquidation value, to the minimum entitlement being liquidation value given that the same order of priority can be applied in cases of resolution as well.

**Essar Steel Appeal (Supreme Court)**

The NCLAT verdict in *Essar Steel* had created quite an uproar.\textsuperscript{22} The banks immediately approached
the SC, which ordered status quo ante to be maintained till the final verdict would be delivered. In the meanwhile, the Parliament enacted the Third Amendment discussed above. All signs indicated that the NCLAT’s decision would be set aside. The SC, speaking again through Nariman J., reversed the verdict of the NCLAT on all the counts discussed above. Following is a discussion on the three major points which were overturned:

**Requirement of Equitable Treatment of Different Classes of Creditors**

The SC set aside the NCLAT’s ruling which prohibited discrimination between OCs and FCs. It held that the NCLAT had misinterpreted *Swiss Ribbons* when it said that OCs and FCs are given roughly the same treatment, and if they are not, the NCLAT modifies the resolution plan. Without delving into why the NCLAT got the express statement of the SC wrong, it was held that the reference in *Swiss Ribbons* to UNCITRAL Legislative Guide to Insolvency’s paragraph 7, which stated that similarly situated creditors must be given equitable treatment, was sufficient context which the NCLAT overlooked.

The SC further held that it was not required to classify creditors into operational and financial only while preparing the resolution plan, and that it was sufficient if ‘the resolution plan provides for distribution of amounts payable towards debts based upon a classification of various types of creditors.’ Hence, any classification has now been deemed permissible by the SC, provided it takes into account the security interest of the creditors into account.

**Application of section 53 to Resolution Proceedings**

The SC held that application of section 53 to resolution proceedings does not violate the scheme of the Code. It held that the amended section 30 will apply to ending cases, and under the amended provision, section 53 is not directly applicable, it may be used by the CoC to decide the minimum entitlement of different classes of creditors. It further held that the amended section 53 is only a beneficial provision for OCs, since it provides them the higher between either of the two cases mentioned in section 30(2) (b)– either liquidation value, or if section 53 was made applicable to resolution process.

**Commercial Wisdom of the CoC and Conflict of Interest in Determining Manner of Distribution**

The SC rejected the point that there was a conflict of interest in the CoC making a determination about the manner of distribution of the resolution amount. It held that CoC does not act in any fiduciary capacity to any group of creditors. It declared that the CoC has to take a business decision based on majority, which can then bind all stakeholders. This nullified the jurisprudence that had been consistently developed by the NCLAT in *Binani Industries* and *Essar Steel* cases, as discussed above.

The SC also held that the commercial wisdom of the CoC should not be interfered with by the Adjudicating Authority (AA). Determination of the manner of distribution of the resolution amount was purely an exercise of commercial wisdom, which was solely the domain of the CoC, and the only thing the AA including the Appellate Authority, could look into was whether the CoC had applied their commercial wisdom or not, and nothing more. In essence, it held that once commercial wisdom had been applied by the CoC, the Adjudicatory Authority shall have to approve of the resolution plan as per the statute’s language.

**CONFLICT OF INTEREST IN COMMITTEE OF CREDITORS: AN ANALYSIS**

While the SC emphatically established that the CoC is supposed to take a business decision through a majority and is not bound with any duty of care or any obligation to any other group of creditors in
a fiduciary capacity, it did not consider certain arguments that should have been made to address concerns of the CoC overriding the interests of other stakeholders in the insolvency process.

This section addresses the following two arguments: whether the CoC can be considered ‘state’ under Article 12 of the Constitution, and whether principles of natural justice can be made applicable to the proceedings of the CoC. These arguments, considering the SC verdict, stand negative, however, this essay argues that they must have been considered at the very least. These are critical arguments in the author’s opinion before arriving at the conclusion that the CoC is permitted to discriminate with no civil consequences.

**Whether CoC is ‘State’ under Article 12**

Article 12 defines ‘state’ apropos of fundamental rights under the Constitution. According to Article 12, ‘the State includes the Government [...] and all local or other authorities within the territory of India.’ In order to construe the CoC as ‘state,’ it needs to fall under the umbrella of ‘other authorities’ as specified within Article 12.

SC has stated that the expression ‘other authorities’ is wide enough to include within it every authority created by a statute and functioning within the territory of India, if the functions being carried out by it were governmental or quasi-governmental. The SC has also laid down a test that disregards whether a corporation is a creation of statute; instead, if a corporation is an ‘instrumentality’ or ‘agency’ of the government vis-à-vis the functions performed by it, or has been brought into existence for the purposes of acting as the government’s instrument or agent, then it would be ‘state’ within the meaning of Article 12.

It is thus manifest that there is no uniform and unique test for the purposes of interpreting ‘other authorities’ under Article 12; resultantly, there are quite a few parameters to be considered when determining whether a body can be construed as ‘state.’ Firstly, we may dispense with *ejusdem generis* at the very beginning and directly determine whether a body created by statute can be said to perform governmental or quasi-governmental functions.

Prior to the enactment of the IBC, India’s insolvency framework was quite unconsolidated. However, the predominantly applicable statute to most cases of insolvency was the Sick Industrial Companies Act, 1985 (SICA). Some salient features of the SICA can be distilled from its provisions concerning the Board for Industrial and Financial Reconstruction (BIFR), established pursuant to section 4 of the SICA. The BIFR was vested with significant powers; it could inquire into the affairs of any industrial company for determining whether it had become sick, pass orders for undertaking measures against such company, order the financial reconstruction of the company, take over its management, take any action with respect to its undertakings, and others. Moreover, the BIFR could order the winding-up of a company if such company was not likely to become financially viable in the future. The functions of the CoC under the IBC cover all of these actions, however, under the purview of ‘commercial wisdom’.

While the SICA was restricted to industrial companies, a reading of the statute does not indicate that it was applicable only to public sector undertakings; all industrial companies were within the purview of SICA. If the parallels are to be compared, the CoC performs the same role that the IFR used to perform, and while the latter was a government’s instrumentality and always operated within the purview of being ‘state’ under Article 12, the latter has absolute control over the CIRP but no judicial oversight is possible on it as per the SC’s declaration.
The (Im)Permissibility of Discrimination under the Insolvency Code

Applicability of Principles of Natural Justice to the Resolution Process

The SC had stated in a five-judge bench in AK Kraipak v. Union of India that actions involving civil consequences will require observance of principles of natural justice. Civil consequences include personal as well as property rights, as per another five-judge bench of the SC in Mohinder Singh Gill v. Chief Election Commissioner.

Given that these are larger benches, and the Essar Steel Appeal is merely a three-judge bench, the Apex Court should have considered the judgement while declaring that the actions of the CoC will be construed as purely commercial decisions binding other stakeholders and thereby affecting their property rights. In the absence of any discussion by the SC of the applicability of principles of natural justice in a situation where the conflict of interest is otherwise apparent, may make the judgement per incuriam.

In essence, the CoC is empowered by a statute to resolve the insolvency of a CD in BIFR’s stead. Though it is an ad hoc body, it has the authority to bind all other stakeholders, including dissentient creditors including extinguishing their claims over a debtor through a majority decision where the majority has the opportunity to ride roughshod over everyone else’s concerns.

Effect on the Reasonable Classification under the IBC

The SC had upheld the classification between OC and FC as ‘reasonable’ for the purposes of Article 14 for three purposes:

- The ease in identifying a default in financial debts was comparatively much easier than in operational debts.
- FCs were far more suited to assessing feasibility and viability of a resolution plan and were more likely to restructure their debts to allow the CD to continue as a going concern.
- FCs and OCs are given roughly the same treatment in distribution of proceeds of resolution, and the NCLAT ensures it by modifying resolution plans wherever this is not the case.

The Third Amendment did away with the third requirement. The SC, in Essar Steel Appeal, upheld the Third Amendment without delving into the discussion of reasonable classification at all. The Insolvency Law Committee (ILC) had stated that there was no empirical evidence that OCs were not receiving a fair share under the present scheme. It was certain that the intention was not to ensure merely that banks were maximising returns, but that “all stakeholders” were getting fair returns.

The NCLAT had held in Binani Industries that if OCs are not paid their due share or are discriminated against, then they will stop supplying goods and services and this will make the economy inefficient overall. The SC held, in the Essar Steel Appeal, that those OCs who are necessary to let the CD continue as a going concern will anyway be paid off, and it was a part of commercial wisdom of the CoC.

The SC assumes in this case that the rights of OCs would be extinguished in either case, without ever being addressed, despite the CD not being liquidated. It does not consider that the CD can also be liquidated as a going concern if attempts at resolution fail. Liquidation as a going concern by the Official Liquidator is possible under the amended IBBI [Liquidation Process] Regulations, 2016.

CONCLUSION

It is the author’s view that liquidation as a going concern was not discussed by the SC in the Essar Steel Appeal, which would have solved the problem of natural justice being violated because of a conflict
of interest. Section 53 could also have been applied to such cases. The SC also did not take into account the holding of a larger bench in *Mohinder Singh Gill* that impairing property rights involve civil consequences, and that would require observance of natural justice. It failed to discuss whether CoC actually violated natural justice or not, rather it merely declared that the question was not applicable.

For these reasons, the constitutionality of the Third Amendment and the permissibility of discrimination under the scheme of the Code, perhaps, need to be reconsidered.

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**NOTES**

1. This is an Essay which won the first prize in the National Law University, Delhi-IBBI Essay Competition, in December, 2019.
5. Writ Petition (Civil) No. 43 Of 2019.
7. Supra note 3.
9. *Id*, at pp. 2–3, 15.
10. Supra note 3, p. 43.
11. *Id* at p. 46.
12. Supra note 3, para., 46.
13. *Id* at pp.158-160.
14. *Id* at p. 140.
15. Section 53(f)(f), IBC.
16. The NCLAT discussed the trend of offering no returns to operational creditors under the garb of liquidation value. See *Binani Industries Limited v. Bank of Baroda*, p. 48.
17. Supra note 2, p. 171.
18. *Id* at p. 173.
19. Supra note 2 at p. 207.
23. Supra note 1 at p. 56.
25. *Id.*, at p. 89.
26. *Id.* at p. 48 and 83.
27. *Id.* at p. 82.
28. *Id.* at p. 83.
29. *Id.* at p. 80.
30. *Id.* at p. 93.
31. *Id.* at p. 93.
32. *Id.* at p. 46.
36. Supra note 32.
Section 16, SICA.
Section 17(3), SICA.
Section 18(1), SICA.
Ibid.
Ibid.
Id. Section 20.
Supre note 35, Section 3(1)(e).
Supra note 7.
INTRODUCTION

In July, 2019, the Competition Law Review Committee, commissioned by the Ministry of Corporate Affairs (MCA), submitted its report (the Report) recommending a ‘Green Channel’ for merger approvals by the Competition Commission of India (CCI). The Report proposed that insolvency resolution plans automatically qualify for the green channel and thus avoiding scrutiny by the CCI, even if they cross the thresholds mentioned in the CCI’s Combination Regulations framed under the Competition Act, 2002 (the Act). The Green Channel is a self-certifying mechanism by which mergers which meet certain criteria will be automatically approved. However, the recommendation does not explain the criteria which ought to be used to evaluate resolution plan combinations before they are green-channelled and thus applies to all resolution plan combinations.

On August 13, 2019, a Green Channel was created through the CCI (Procedure in regard to the transaction of business relating to combinations) Amendment Regulations, 2019. The 2019 Amendment has not extended green-channeling to resolution plans. Despite this, it is worth discussing green channeling in the context of resolution plans as the Government may choose to implement the Report’s recommendation to green channel resolution plans in the future. This paper discusses the advisability of green-channeling resolution plans in India from a competition law perspective. Authors have combed through the CCI’s combination orders and found sixteen orders that were resolution plans which had been notified to the CCI because they met its combination thresholds. These resolution plan-combination orders have been analysed to ascertain whether the CCI’s approach to resolution plan combinations can be used to generate any dependable criteria for their approval, and consequently, green-channeling resolution plans.

The theoretical basis for green-channeling resolution plans is the failing firm defence, which is a set of tests used to determine whether an otherwise anti-competitive merger should be approved due to the imminent failure of a firm in the absence of the merger. This defence has been used to justify green-channeling resolution plans. The argument in favour of this is that by virtue of the resolution plan having gone through the insolvency resolution process, it can be assumed that the requirements of the failing firm defence have been met. Such an inference paints an incomplete picture of the failing firm defence. As will be discussed later in the paper, the likelihood of a firm existing in the market in the absence of a merger is only one of the tests constituting the defence.

Green-channeling removes the suspensory nature of the Indian merger regime by removing the standstill period prior to the merger’s implementation. This moves India closer to voluntary merger
regimes which are in place in jurisdictions such as New Zealand, the United Kingdom (UK), and Australia.9 Voluntary regimes face unique challenges when it comes to merger enforcement, the implications of these challenges have been discussed in the context of the Report’s recommendation for green channelling resolution plans later in the paper. This paper examines the interaction between competition law (specifically merger control) and insolvency law through the failing firm defence in the context of the European Union (EU).10 Insights from cases in the EU are used to highlight the places in which competition and insolvency objectives conflict with one another. The paper concludes with an appraisal of the recommendation to Green-Channel Resolution plans and makes recommendations for allowing the objectives of both regimes to play a proportionate role in deciding the validity of a resolution plan.

THE FAILING FIRM DEFENCE AND MERGER CONTROL IN THE EU

The EU has a single market, meaning that firms (including financially distressed ones) have to be mindful of the effects their actions can have across all EU member states. The European Commission (EC) investigates violations in EU competition law, enforces orders, conducts fact finding missions and sectoral surveys and takes legislative and policy initiatives.11 The EU’s merger control regime is detailed in EU Merger Regulation – 130/2004 (EUMR). The EUMR establishes a pre-merger notification regime like the one followed by the CCI prior to the 2019 Combination Regulation Amendment. The EUMR requires that all combinations with a ‘community dimension’ are notified to the EC. The idea of a ‘community dimension’ in the EU is akin to ‘combinations thresholds’ India.12 Whether a merger has a community dimension in the EU is based on thresholds set for the value of assets held by the merging entities and their turnovers. After a merger is notified, the EC may approve the merger, prohibit it, dissolve a merger (in case of pre-mature implementation) or approve the merger with conditions that would make it compatible with the common market.13

The EUMR proscribes market concentrations through mergers which cause a significant impediment to effective competition by establishing or strengthening a dominant position.14 The EC considers several factors to understand the full scope of a merger's impact. One of these refers to a situation in which the assets of the firm would leave the market if the merger is not allowed. For instance, the assets of a firm may exit the market for reasons other than financial distress such as a change in corporate strategy. However, this paper will focus on the ‘failing firm defence’ which refers to situations in which a firm is likely to leave the market because of financial or economic difficulties.

The failing firm defence

The failing firm defence can be used to decouple the post-merger state of the market from the merger itself. This is done by showing that the market condition is likely to deteriorate to an equal extent if the target firm were not acquired and allowed to ‘fail’ or exit the market. The ‘failing division defence’, is an extension of the premise of the failing firm defence,15 wherein, parties will contend that a division of the firm (rather than the whole firm) is likely to leave the market in the absence of the merger. The failing division defence applies the same tests as the failing firm defence, however, the approach to the failing division defence is stricter.16 The EC is yet to accept the failing division defence as the basis for approving an otherwise anti-competitive merger.17 Since the constituting tests of both these defences are largely the same, this discussion will focus on the failing firm defence. The success of the failing firm defence in the EU is based on the following tests: -

• whether financial difficulties would force the firm out of the market,
• whether there exists a less anti-competitive alternative purchase/transaction that could rescue the firm, and
• whether the assets of the firm would exit the market in the absence of a merger.

These tests were extensively discussed by the EC for the first time in Kali und Salz decision. Since then, they have been used in other cases where the target of a merger was a failing firm and have been adopted by the EU Merger Guidelines. The tests used in Kali und Salz were similar to the ones adopted in the Guidelines except for the third test. In Kali und Salz, the EC framed the third test as requiring all of the target's business to be acquired by the purchaser even in the absence of a merger. The parties were not able to satisfy the third test in the present case. Despite the transaction not meeting the requirements of the third test, the EC approved the merger based on the first two tests. This was because of the economic weakness of regions in Eastern Germany. The target company’s withdrawal from the market (which was established by the first test) would be detrimental to the objective of maintaining the Community’s economic and social cohesion. The relaxation of the third requirement in Kali und Salz was an exception, in subsequent cases, the EC applied all three tests strictly and rejected the failing firm defence when they were not met.

In Saint Gobain, the EC required that the entire share of the target should be consumed by the acquirer in the absence of the merger (third test), however, the parties were not able to prove this. The EC thus strictly applied the tests laid down in Kali und Salz to block the merger. A similar approach was taken in Blokker/ Toys R Us. In this case, the first criterion was met, i.e., Toys R Us was likely to exit the market without the merger. However, the EC noted that all of Toys R Us’ market share would not go to Blokker in the absence of the merger. Further, there existed alternative purchasers of Toys R Us that would lead to a less concentrated post-merger market. The EC mentioned that Toys R Us had chosen the strongest player (Blokker) to merge with, and that they had not explored other less competitive options. Based on this reasoning, the EC did not approve the Blokker/ Toys R Us merger.

A significant development in the application of the failing firm defence occurred in the BASF/Euridol/ Pantochim case. Here, the EC applied the failing firm defence to approve the merger. The first two tests were kept the same as in Kali und Salz. For the third test, the EC noted that it was not feasible to apply it in cases where a duopoly did not exist. The EC held that it could not expect BASF (the acquirer) to absorb all the target’s shares in the absence of a merger. The EC found that in the absence of a merger, the assets of the targets would effectively exit the market. There were high costs associated with the operation of chemical plants including high environmental risks. In the absence of an alternative purchaser, not operating the target’s plants would decrease the supply of their chemical products in the market thus raising prices and harming customers. The EC concluded that the detriment to competition would be worse in the absence of the merger and thus approved it. In BASF the test required that the assets of the firm exit the market to the detriment of consumers and not that all of the target’s market share is acquired in the absence of the merger. The new version of this test allows for a merger to be approved even if it shows that third parties may acquire some of the firm’s market share in the absence of the concerned merger.

When assessing the likelihood of a firm’s withdrawal from the market, there is no hard and fast rule for the EC to apply. Within the EU, each of the member states has a different insolvency procedure and different thresholds and procedures in place to determine when the insolvency process can be triggered and when a firm is declared bankrupt. For instance, France allows for the insolvency process to be triggered when a debtor is unable to pay their debts as they fall due, whereas Germany allows insolvency to be triggered when a firm has stopped paying it debts or when its assets no longer cover
its existing obligations. This is why being subject to insolvency proceedings is not the sole criteria to determine whether a firm is likely to be forced out of the market in the near future. However, it can be strong evidence to demonstrate this along with other criteria such as unwillingness of the parent company to continue covering losses and the magnitude of losses made in the past.

**MERGER CONTROL IN INDIA**

India’s competition regime is contained in the Competition Act. The Act regulates various types of anti-competitive behaviour including anti-competitive agreements (Section 3), abuse of dominance (Section 4) and combinations (Sections 5&6). Section 5 defines combinations as transactions (mergers and acquisitions) which meet the prescribed combinations thresholds. Section 6 prohibits combinations which cause an Appreciable Adverse Effect on Competition (AAEC) and declares these to be void. The section also requires that all combinations be notified to CCI before they are implemented. If a proposal to enter into a combination has been approved by the Board of Directors of a company or if an agreement to transfer control has been executed, the same needs to be notified within 30 days. Thereafter, the proposed combination cannot be acted upon until after 210 days (the standstill period) of the notification or the order of the CCI, whichever is sooner.

In order to determine whether a combination causes any AAEC, the CCI considers various factors. Any determination in this regard is bound to vary on a case by case basis. The factors considered by the CCI include, existing and potential level of competition in the market (including imports), extent of barriers to entry, current level of market concentration, market share of the parties in the combination, existence of substitutes and the level of countervailing power in the market, level of innovation in the market, and advantages of the combination and whether they outweigh its anti-competitive effects. The possibility of a failing business has also been mentioned as one of the factors which the CCI may consider. However, the failing firm defence has till date has only been used once by the CCI when scrutinising resolution plans (See the section on resolution plans assessed by the CCI).

**Taxonomy of resolution plans assessed by the CCI**

After the IBC’s provisions relating to corporate insolvency took effect in December, 2016, the CCI has been notified of sixteen resolution plans which contained combinations (See Annexure I for details). This section discusses CCI’s approach to assessing resolution plans and potential areas of conflict between insolvency law and competition law in the context of resolution plans.

Nine out of the sixteen resolution plan combinations concerned the steel industry, and eight of them had some horizontal overlaps. The post-merger combinations of parties ranged from 5-10 per cent to 35-40 per cent across various steel products. All orders discussed the countervailing forces present in the market in the form of other firms. Notably the CCI orders focused on unilateral effects of market concentration (such as the ability to increase prices) and not potential coordinated effects. The CCI has held that the Competition Act does not recognise collective dominance. However, it does recognise cartelisation and prohibit it, which is also coordinated effect. Thus, the fact that the Competition Act does not recognise collective dominance cannot be the sole reason for not considering the potential coordinated effects (such as raising prices) of a combination. The existence of a few other large steel producers can increase the likelihood of coordinated behaviour just as it can increase their incentive to maintain the level of competition in the market (countervailing factors). This is not to say that the resolution plan combinations have resulted in coordinated effects, however, an analysis of coordinated effects would be warranted in a rapidly consolidating industry.
In order to understand whether resolution plan-combinations were assessed differently, we have compared them to regular combinations, the nine resolution plan-combinations in the steel sector were compared to regular combinations in the sector. Resolution plan combinations in the steel sector were chosen because they comprise the majority of resolution plans assessed by the CCI, making it easy to find patterns in the assessments. There was no difference in how CCI approached the resolution plan combinations and regular combinations (Annexure I). To demonstrate the similarity in the CCI's approach, we compare two combination orders (a resolution plan combination and a regular combination) of the CCI.

All CCI orders relating to combination resolution plans followed a similar pattern, the CCI first assessed the businesses in which the parties were involved and whether there were any horizontal or vertical overlaps between them. Then looked at the market shares of each before and after the merger and (sometimes) take note of the incremental change in market share for each relevant market. Finally, it would look at the existence of countervailing factors in the form of competitors. In some cases, the CCI took note of the capacities at which other firms in the market were operating, if they were not operating at full capacity, this meant that they could expand production if the demand for substitutes increased (due an increase in the prices of the merged party).

Interestingly, the CCI referred to the failing firm defence in only one of the resolution plan combinations, but without any detailed explanation. The CCI only referred to the imminent failure of the firm (which is the first test for the failing firm defence) and how this would be a detriment to end users. The reason for such a brief reference to the failing firm defence may be that no AAEC was attributable to the merger (or any of the other resolution plan-combinations). The existence of ‘possibility of a failing business‘ in the Competition Act as a factor that can be considered by the CCI when assessing the merger shows that the failing firm defence falls within the scope of the Act. However, there is a dearth of Indian case laws on how the failing firm defence is to be applied, this is exacerbated by the lack of Indian merger guidance on the subject.

The CCI does not have any guidance on merger control per se. It has a Competition Advocacy Booklet (which is not binding) on the subject that explains the law relating to combinations and how it will be applied. However, the Advocacy Booklet is not very detailed, for this reason, the contours of the application of the failing firm defence in India remain unclear. The UK and the EU each have a separate section of their merger control guidance dedicated to the failing firm defence and its application. This is the practice in Canada and United States as well. India would be following international best practices if it updated its Competition Advocacy Booklets.

**Limitations of ‘creditors’ wisdom’ in the insolvency resolution process**

The IBC defers to the commercial wisdom of the creditors (through the Committee of Creditors or CoC) to decide whether to rehabilitate a corporation undergoing the insolvency resolution process. The Binani Cements and Bhushan Power and Steel Ltd. (BPSL) cases highlight the CoC’s priorities during the insolvency resolution process. In the Binani cements case, the first bid proposed the acquisition of Binani Cements (which was undergoing the insolvency process) by a subsidiary of Dalmia cements. The bid was rejected for being discriminatory by the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT). The plan proposed by Dalmia's subsidy paid similarly placed financial creditors different proportions of the debt due to them. However, the plan raised no concerns on the competition front as the combined market share of both parties was only 0-5 per cent. After Dalmia’s plan was rejected by the NCLAT, Binani’s CoC voted in favour of Ultratech...
cement’s plan for the acquisition of Binani Cements. Ultratech nearly doubled Dalmia’s offer to acquire Binani. This was the second resolution plan combination concerning Binani Cements scrutinised by the CCI and it was also approved.\textsuperscript{52} The combined market share of Ultratech Cements and Binani Cements was between 20-25 per cent.\textsuperscript{53} Similar circumstances arose in the case of JSW Steel’s acquisition of BPSL which was undergoing an insolvency resolution process.\textsuperscript{54} Following the precedent set in the Binani Cements case, the NCLAT held that the CoC had a duty to maximise the assets of the corporate debtor and was allowed to consider improved financial offers from bidders.\textsuperscript{55}

The Binani and BPSL cases show that creditors (who vote on resolution plans) favour larger acquirers which are more likely to be antithetical to competition. Large firms will be able to offer more money to repay the debts of financial and operational creditors.\textsuperscript{56} These cases reveal the tensions between the interests of the CoC and those of competition law. It may be recalled that in the Blokker/ Toys R Us and Saint Gobain mergers in the EU, one of the problems was that the acquirer was already a large entity in the market. Thus, competition was likely to reduce after the merger because of an increase in market concentration. In Blokker/ Toys R Us and Saint Gobain, the second test of the failing firm defence was not met and it was found that less anti-competitive (smaller) acquirers would be more compatible with the EU’s merger control regime. Undoubtedly, competition scrutiny of resolution plans can come in the way of creditors’ ability to negotiate the best deal for themselves. However, combinations with larger firms having horizontal overlaps are also more likely to create a dominant position in the market. The insolvency and competition regimes need to find an approach to balance these diverging interests.

The unification of the functions of the Competition Appellate Tribunal (COMPAT) with those of the NCLAT provides a unique opportunity to cater to the objectives of competition law and insolvency law. If Resolution plans meeting merger thresholds were put under the original jurisdiction or supervision of the NCLAT. After subsuming the role of the COMPAT, the NCLAT is well placed to balance the decisional autonomy of the CoC under the IBC and the objectives of merger control under the Competition Act. The IBC prohibits resolution plans from violating any laws in force.\textsuperscript{57} As an extension of this provision, the NCLAT can be allowed to check if an resolution plan creates any AAEC, this is a more cautious approach than approving resolution plans without even probing into the question.

**MERGER CONTROL: RELEVANCE IN COMPETITION REGIMES AND EFFECTS ON INSOLVENCY REGIMES.**

The goal of merger regulation is not restricted to preventing an abuse of dominance but to encourage competition between firms and maintain a level of rivalry and competition.\textsuperscript{58} This may be the reason for why there has been a proliferation of merger control regimes across over 100 jurisdictions.\textsuperscript{59} Suspensory merger notification regimes in particular have the ability to screen mergers which may be harmful to consumers and modify or prohibit them before they are implemented. For instance, the Federal trade Commission in the US has found that its merger control led to significant savings for consumers.\textsuperscript{60}

**Suitability of green-channelling resolution plans.**

The costs attributed to enforcing anti-competitive remedies on existing entities is significant in the context of insolvency law. The process by which a resolution plan is approved is a sensitive one. It involves creditors forgoing parts of their loans, extending additional credit, or postponing the dates on which their loans are due.\textsuperscript{61} In a situation where merger control happens after the combination is implemented, the creditors do not have the ability to look at other proposals and renegotiate the plan.
Once the merger is implemented, merger control requires the detangling of assets; unwinding mergers (including resolution plans) after their implementation increases legal uncertainty.\textsuperscript{62}

Even if no further merger control related reviews are allowed after a green-channel approval, a firm can be scrutinised under section 4 of the Act for abuse of dominance. This too may require the detangling of assets if an adverse order is made against the firm. Robust merger control will ensure that there is increased rivalry between firms and that market concentration is kept at an acceptable level. If a resolution plan is not approved by the CCI before it is implemented, the CoC can call for new proposals or vote on the next best alternative. But it such a firm is divided after the merger in complete, it may not be financially stable enough to survive given its already weak position. Thus, the costs of dividing firms with dominant positions because of resolution plans are more than the costs of dividing other firms with dominant positions. By this line of reasoning, green-channelling resolution plans and subjecting them to post merger scrutiny seems counterintuitive. To balance the interests of the stakeholders of insolvency law and competition law, a shorter standstill period for resolution plan combinations can be implemented. This period can be used by the CCI to scrutinise the resolution plan. In such a situation, the questions in the self-certifying form can be based on the failing firm defence to collect information from parties. The parties involved in the resolution plan combination can help considerably expedite the scrutiny process if they answer these questions clearly.

CONCLUSION

This paper discussed the advisability of green channelling resolution plans and whether the Indian competition regime was ready to implement them. From the EU’s experience with the failing firm defence, we find that there are some instances when rescuing a firm can be antithetical to competition. India is yet to see resolution plan combinations that cause appreciable adverse effects on competition. However, policy decisions should not heavily rely on this trend, especially given how young the new Indian insolvency regime is. India should not use its high approval rate of resolution plan combinations to change its merger control policy and do away with the scrutiny procedure all together. The CCI approached the scrutiny of all resolution plan combinations as if they were regular mergers. This means that there are no existing criteria which can be used to decide which resolution plan combinations ought to be green channelled and which ones ought to be scrutinised as regular mergers. India should proceed with care if it chooses to green channel resolution plans. It should ensure that there is robust coordination between the insolvency and competition regimes.
Annexure I

Table 1: Resolution Plan Combinations

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Order No.</th>
<th>Date of Order</th>
<th>Type of merger</th>
<th>Industry</th>
<th>Post-merger market concentration (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>C-2018/02/557</td>
<td>Mar. 7, 2018</td>
<td>Horizontal</td>
<td>Cement</td>
<td>0-5</td>
</tr>
<tr>
<td>2</td>
<td>C-2018/02/558</td>
<td>Mar. 27, 2018</td>
<td>Horizontal</td>
<td>Cement</td>
<td>20-25</td>
</tr>
<tr>
<td>3</td>
<td>C-2018/03/561</td>
<td>May 11, 2018</td>
<td>Horizontal</td>
<td>Steel</td>
<td>20-25 (Pig Iron) 5-10 (Sponge Iron)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5-10 (Billets &amp; blooms) 10-15 (TMT bars)</td>
</tr>
<tr>
<td>4</td>
<td>C-2018/03/562</td>
<td>Apr. 25, 2018</td>
<td>Horizontal &amp;</td>
<td>Steel</td>
<td>25-30 (HR-CSPs*) 15-20 (CR-CS**)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Vertical</td>
<td></td>
<td>15-20 (Galvanised products) 20-25</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(Precision tubes) 5-10 (Non-precision tubes)</td>
</tr>
<tr>
<td>5</td>
<td>C-2018/04/563</td>
<td>May 11, 2018</td>
<td>Horizontal</td>
<td>Steel (Pig Iron)</td>
<td>Insignificant (no percentage mentioned)</td>
</tr>
<tr>
<td>6</td>
<td>C-2018/06/580</td>
<td>Aug. 10, 2018</td>
<td>Horizontal &amp;</td>
<td>Edible oil &amp; Wind Energy</td>
<td>0-5 (Wind energy)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Vertical</td>
<td></td>
<td>Combined market share for edible oils was not mentioned.</td>
</tr>
<tr>
<td>7</td>
<td>C-2018/08/593</td>
<td>Sep. 18, 2018</td>
<td>Horizontal &amp;</td>
<td>Steel</td>
<td>Less than 20</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Vertical</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>C-2018/08/594</td>
<td>Sep. 18, 2018</td>
<td>Horizontal &amp;</td>
<td>Steel</td>
<td>Less than 30 (HR-CSPs, CR-CS, galvanised products, tubes &amp; pipes).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Vertical</td>
<td></td>
<td>30-35 (colour coated products)</td>
</tr>
<tr>
<td>9</td>
<td>C-2018/09/599</td>
<td>Nov. 6, 2018</td>
<td>Horizontal &amp;</td>
<td>Steel/auto-parts</td>
<td>20-25 (connecting rods)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Vertical</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>C-2018/12/624</td>
<td>Jan. 10, 2019</td>
<td>Vertical</td>
<td>Construction</td>
<td>NA</td>
</tr>
<tr>
<td>11</td>
<td>C-2019/01/631</td>
<td>Mar. 6, 2019</td>
<td>Horizontal &amp;</td>
<td>Edible oil</td>
<td>Insignificant (no percentage mentioned)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Vertical</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>C-2019/01/632</td>
<td>Jan. 31, 2019</td>
<td>No overlap</td>
<td>Construction</td>
<td>NA</td>
</tr>
<tr>
<td>13</td>
<td>C-2019/02/642</td>
<td>Mar. 7, 2019</td>
<td>No overlap</td>
<td>Telecom</td>
<td>NA</td>
</tr>
<tr>
<td>14</td>
<td>C-2019/03/650</td>
<td>Apr. 9, 2019</td>
<td>Horizontal &amp;</td>
<td>Steel</td>
<td>Less than 30 (HR-CSPs, CR-CS, galvanised products)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Vertical</td>
<td></td>
<td>35-40 (colour coated products)</td>
</tr>
<tr>
<td>15</td>
<td>C-2019/07/581</td>
<td>Aug. 6, 2018</td>
<td>Horizontal &amp;</td>
<td>Steel</td>
<td>25-30 (HR-CSPs) 20-25 (CR-CS)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Vertical</td>
<td></td>
<td>25-30 (Galvanised products) 20-25</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(colour coated products) 30-35 (precision tubes)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5-10 (non-precision tubes)</td>
</tr>
<tr>
<td>16</td>
<td>C-2019/04/659</td>
<td>Jun. 3, 2019</td>
<td>No overlap</td>
<td>Steel</td>
<td>N/A</td>
</tr>
</tbody>
</table>

*Hot rolled coils, sheets and pipes

**Cold rolled coils and sheets

***Colour coated pipes
### Table 2: Regular Combinations

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Order No.</th>
<th>Date</th>
<th>Type of merger</th>
<th>Industry</th>
<th>Post-merger market concentration (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No. C-2017/12/539</td>
<td>Jan. 22, 2018</td>
<td>Vertical</td>
<td>Steel</td>
<td>Not likely to raise competition concerns (No market share mentioned).</td>
</tr>
<tr>
<td>3</td>
<td>No. C-2018/09/597</td>
<td>Nov. 30, 2018</td>
<td>Horizontal</td>
<td>Steel</td>
<td>Specialty steel bars (15-20)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Seamless pipes (0-5)</td>
</tr>
<tr>
<td>4</td>
<td>No. C-2015/10/329</td>
<td>Dec. 30, 2015</td>
<td>Horizontal &amp; Vertical</td>
<td>Steel</td>
<td>Special Steel (0-10)</td>
</tr>
<tr>
<td>5</td>
<td>No. C-2015/06/287</td>
<td>Aug. 19, 2015</td>
<td>Horizontal &amp; Vertical</td>
<td>Steel (for the tower manufacturing business)</td>
<td>Insignificant (no percentage mentioned)</td>
</tr>
<tr>
<td>6</td>
<td>Combination Registration No. C-2018/10/608</td>
<td>Dec. 7, 2018</td>
<td>Horizontal &amp; Vertical</td>
<td>Steel</td>
<td>Less than 20</td>
</tr>
<tr>
<td>7</td>
<td>Combination Registration No. C-2016/10/447</td>
<td>Dec. 20, 2016</td>
<td>Vertical</td>
<td>Steel (for the manufacture of automotive parts)</td>
<td>Insignificant (no percentage mentioned)</td>
</tr>
<tr>
<td>8</td>
<td>No. C-2018/05/575</td>
<td>Aug. 21, 2018</td>
<td>Horizontal</td>
<td>Cement</td>
<td>Maharashtra (20, HHI delta: 120)</td>
</tr>
<tr>
<td></td>
<td></td>
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<td></td>
<td></td>
<td>Madhya Pradesh (28, HHI delta 164)</td>
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<td></td>
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<td></td>
<td></td>
<td>Chhattisgarh/West Bengal (22, HHI delta: 186)</td>
</tr>
<tr>
<td>9</td>
<td>No. C-2016/04/394</td>
<td>Apr. 4, 2018</td>
<td>Horizontal</td>
<td>Cement</td>
<td>Andhra Pradesh (16, HHI delta: 65)</td>
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<td></td>
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<td></td>
<td></td>
<td>Uttar Pradesh/Madhya Pradesh (21, HHI delta: 122)</td>
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<td></td>
<td></td>
<td></td>
<td>Uttarakhand (22, HHI delta: 126)</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>Himachal Pradesh (30, HHI delta: 400)</td>
</tr>
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</table>

### NOTES

1. This paper is a shortened version of the longer paper submitted to IBBI under its Research Initiative, 2019. The original submission can be found here: https://web.iima.ac.in/assets/snippets/workingpaperpdf/7669760742020-05-02.pdf.

2. The authors wish to thank the anonymous reviewer and Praachi Misra, whose comments greatly helped us in improving the clarity of analysis. All errors are our own.


Id.


The choice of the EU as a point of reference for the Indian regime is based on its pre-merger notification regime (which is similar to India’s when compared to the UK) less stringent use of the defense compared to the US.


Id. at Art. 2(3).


Case No. IV/M.308, Kali+Salz/MdK/Treuhan (1993), O.J. (L 186) 38. The case was appealed, and the EC's approach to the failing firm defense was upheld by the European Court of Justice in Case 68/94 French Republic v. Commission of the European Communities, 1998, E.C.R. I-1375.


Id.

Case No. IV/M.890, Blokker/Toys R Us, 1998 O.J. (L 316), 1. Blokker had a market share of 55-65% and Toys R Us had a market share of 5-10% in the relevant market. After the merger, the combined market share after the combinations would be at least 60-70%.

Id. at p. 120.


Id. p. 150.

Id.


Id.

OECD Roundtable, Supra note 15, at p. 91.

35 Section 6(1), Competition Act, 2002.
36 Section 6(2), Competition Act, 2002.
37 Id.
38 Section 6(2A), Competition Act, 2002.
39 Section 20(4)(k), Competition Act, 2002.
41 Section 3, Competition Act, 2002.
43 See Combination Registration No. C-2018/03/562 (Apr 4, 2018); Combination Registration No. C-2018/03/561 (May 11, 2018).
44 Combination Registration No. C-2019/03/650 (Apr. 9, 2019).
45 Supra note 39.
51 Combination Registration No. C-2018/02/558 (Mar. 27, 2018).
52 Id.
53 Id.
55 Id. pp. 33-36.
56 Combination Registration No. C-2018/02/558 (Mar. 27, 2018); Binani Industries v. Bank of Baroda & Ors., Company Appeal No. 81/2018.
57 Id. Section 30(2), 31.
58 Whish & Bailey, Supra note 11, at p. 817.
59 Id. p. 812.
61 Kokkoris & Olivares-Caminal, Supra note 16, at p. 104.
Insolvency and Bankruptcy Code is among the biggest and most impactful economic reforms undertaken in the country. With the coming into force of this Code banks and other financial institutions have been able to settle directly or indirectly an amount of more than Rs. 3 lakh 50 thousand crore. This code has curbed the tendency of wilfully defaulting loans taken from banks and other financial Institutions.

- Shri Ram Nath Kovind, Hon’ble President of India, during the address to the Joint Session of Parliament, June 20, 2019
The Insolvency and Bankruptcy Code, 2016 (Code/IBC) is one of the path-breaking economic reforms introduced by India. It seeks to resolve financial distress of companies within defined timelines while aiming to balance the interest of all stakeholders and maximising the value of assets of the distressed company. The Code serves as a regulator facilitating exit of unprofitable and inefficient businesses by liquidating them, and at the same time rescuing failing but viable businesses through resolution. It strives to prevent or rather minimise the adverse social and economic consequences of business failures. Corporate insolvency and bankruptcy process under the Code, works on the premise that investors are willing to expend resources by identifying and saving insolvent but viable firms that can continue efficiently. The objective is to re-allocate precious resources from unproductive use to productive use.

Under the Code, at the onset of a corporate insolvency resolution process (CIRP), a resolution professional (RP) takes over the company in distress and performs all functions as the process manager and a catalyst of the entire resolution process. He seeks to balance the interest of various stakeholders while attempting a feasible resolution of the distressed company. The RP takes over the management of the business, and the control over the assets of the company during the CIRP. The acumen, competence and commitment of the RP can result in a complete turn-around of the distressed company.

This article is a case study of the resolution of Bhushan Steel Ltd. This case was one of the 12 large NPA account cases that had been referred for resolution under the Code by the Reserve Bank of India. This case study provides a glimpse into the operational and financial performance of the company in the pre, during and post CIRP phases of its life. The case study reflects how the performance of the company turned for the better as the CIRP yielded a viable resolution plan that saved the life of the company.

COMPANY PROFILE

Bhushan Steel Ltd. was incorporated in 1983 with the name Jawahar Metal Industries Pvt Ltd. In 1987, Brij Bhushan Singal and his sons Sanjay Singal, Neeraj Singal and associate companies took over the management of the company by acquiring the entire stake. In the year 1989, the company became a deemed public limited company. In 1992, the company was renamed as Bhushan Steel and Strips Ltd. after diversifying into wide-width cold-rolled steel strips. Also, they completed the cold rolling plant during the year. In the year 1993, the company came out with its first public issue to finance their forward integration project for the manufacture of 1,00,000 tonne per annum (TPA) of continuous
annealed/ galvanised steel strips.

In the year 2000, the company approved the amalgamation of Bhushan Steel Ltd. with the Bhushan Steel and Strips Ltd. In the year 2001, the company implemented the expansion project of 2,50,000 TPA of cold rolling cum galvanising and tube complex in Khopoli, Maharashtra at a cost of Rs 4860 million. In 2003, they entered into a strategic alliance with Sumitomo Metal Industries of Japan for the process know-how for manufacturing of automotive steel sheets. During the year 2004-05, the company commissioned the cold rolled (narrow) and pipe plant at Sahibabad. During 2005-06, the company commissioned the Galume line, an aluminium and zinc coated patented product of the company, for the first time in the country, at Khapoli plant. The company changed its name from Bhushan Steel and Strips Ltd to Bhushan Steel Ltd with effect from April 12, 2007.

During the year 2007-08, the company successfully completed Phase I of the Orissa Project. The company started the production facilities of sponge iron (6,80,000 TPA), billets (3,00,000 TPA) and power plant (110 MW) thus completing Phase-I of Odisha Project on schedule. The company acquired a major stake in Bowen Energy Ltd. of Australia. Additionally, through their 100 per cent subsidiary Bhushan Steel (Australia) Pvt. Ltd, the company entered into a joint venture to develop their coking coal / thermal coal projects in Australia. The company incorporated two wholly owned subsidiaries namely Bhushan Steel (Australia) Pty Ltd. and Bhushan Steel Global FZE. During the year 2008-09, the company successfully commissioned the cold rolling mill (narrow) (50,000 TPA), tube mill (40,000 TPA) and balancing equipment viz. pass mill, cold rolled slitter, cut-to-length-line and annealing furnaces etc. at the existing Khapoli Plant.

The group grew quickly by importing sophisticated Japanese machinery to make steel for India’s nascent automobile industry. But Bhushan Steel’s control over availability, quality and cost of input steel was extremely limited. As a result, in 2003, they decided to build an integrated steel plant in Odisha. This was a time of great optimism for the steel sector. Banks were eager to lend to a company with an impressive order book of clients like Maruti Suzuki, Mahindra and Mahindra, and Tata Motors. Moreover, banks were getting into project finance for the first time. Steel is however a cyclical business, and as Chinese demand tapered after the 2008 Olympics, prices plummeted as fast as they had once peaked. For Bhushan Steel, it was a gust of headwind. Generally, during an economic slowdown, steel demand in India does not decline, while the price of steel does fall. Debt enables a company to grow bigger rather quickly. However, when bad times in terms of economic contraction befall an economy, the debt suddenly becomes a massive financial burden.

By 2010, Bhushan Steel was already shouldering loans worth Rs. 11,404 crore. Despite this the company went on a borrowing spree to finance the next phase of construction. By December, 2012, the steel industry was slipping behind on interest payments as steel prices fell to USD 300 per tonne from a 2008 peak of USD 1265 per tonne. Banks were conflicted: pull the loans and book a loss or keep lending and hope the sector revives. Bhushan’s lenders pinned their hopes on the Odisha plant reaching full capacity. It never did.

By March, 2014, it was clear the company was in trouble. The company’s, profits had shrunk to a mere Rs. 62 crore, while the company was spending more than Rs. 1,600 crore a year in interest payments alone. When Bhushan Steel was on the brink of default in March, 2014, SBI and a consortium of lenders sanctioned fresh loans. But as steel prices remained stubbornly low, and Bhushan’s interest costs escalated, the company’s total debt rose by nearly 30 per cent in two quick years: from Rs. 35,710 crore in 2014 to Rs. 46,062 crore in March, 2016.
The company's product portfolio comprises of flat products. The company is producing cold rolled close annealed coils, galvanized sheets, precision tubes, high tensile steel, hardened and tempered steel strip, wire-rods, colour-coated sheets and galume. They also produce, sponge iron, pig iron, billets and slabs.

**CIRP OF ERSTWHILE BHUSHAN STEEL LTD.**

**Facts of the turnaround**

The CIRP process of Bhushan Steel Ltd. was initiated on July 26, 2017, under the provisions of the Code. Pursuant to the initiation of CIRP, Tata Steel Limited (TSL) submitted its resolution plan for the resolution of Bhushan Steel Ltd. and was selected as the highest compliant resolution applicant by the committee of creditors constituted under the IBC. On May 15, 2018, NCLT approved TSL’s resolution plan.

TSL has acquired Bhushan Steel Ltd. through its wholly owned subsidiary Bamnipal Steel Ltd (BNL) wherein TSL has taken a controlling stake of 72.65 per cent in Bhushan Steel Ltd. and paid the admitted corporate insolvency costs and employee dues, as required under IBC.

TSL is part of the Tata Group and a public limited company engaged in the business of manufacturing steel and offers a broad range of steel products including a portfolio of high value-added downstream products such as hot rolled, cold rolled and coated steel, rebars, wire rods, tubes and wires. The equity shares of TSL are listed on Bombay Stock Exchange (BSE) and on National Stock Exchange (NSE).

BNL is a public limited company incorporated on January 19, 2018 formed as an SPV (Special Purpose Vehicle), wholly owned subsidiary of TSL, in order to facilitate the acquisition of Tata Steel BSL Ltd. (TBSL) by way of the CIRP prescribed under the Code.

TBSL formerly known as Bhushan Steel Ltd. is India’s third largest secondary steel producing company with an existing steel capacity of 5.6 million TPA. It is engaged in the business of manufacturing steel and offers products such as hot rolled, cold rolled and coated steel, cold rolled full hard, galvanized coils and sheets, high tensile steel strips, colour coated tiles, precision tubes, large diameter pipes, etc. TBSL is a subsidiary of BNL and equity shares of the company are listed on BSE and on NSE. TSL has an operating revenue of Rs. 73,016 crore which is 3.5 times more than the TBSL and further has Profit After Tax to the tune of Rs. 10,533 crore which is almost 10 times that of TBSL. Interest cost is very less in TSL as compare to TBSL. TBSL has now been able to effectively clean its balance sheet through the IBC route. This particular case is in fact a leveraged buyout that was financed largely through tax breaks and debt on the target company’s assets and minimal (around Rs. 300 crore) through equity contribution and internal accruals. This merger is a consolidation of same line of businesses. The value addition to stakeholders from this merger will pan out in the near future.

This merger had many advantages in terms of product portfolio diversification and capacity addition. This acquisition added capacity of 5.6 million tonnes per annum (MTPA) to the current TSL steel production capacity which will enable the company to reach its target of 33 MTPA by 2025. Consolidation will also give TSL access to high-quality assets of TBSL such as widest cold rolling mill in India and a complementary product portfolio with value-added products. The merger will also give TSL a presence in western India. The merger will also help in better management and effective utilisation of resources, reorganising TBSL sales and marketing with distribution channel of TSL.
Pursuant to the resolution plan, BNL subscribed to 72.65 per cent of the equity share capital of TBSL for an aggregate amount of Rs. 158.89 crore and provided additional funds aggregating to Rs. 35,073.69 crore to TBSL by way of debt/convertible debt. The remaining 27.35 per cent of TBSL's share capital will be held by TBSL's existing shareholders and the financial creditors who received shares in exchange for the debt owed to them.

The acquisition is financed by combination of external bridge loan of Rs. 16,500 crore availed by BNL and investment by Tata Steel in BNL. The bridge loan availed by BNL is expected to be replaced by debt raised by TBSL over time.

The funds received by TBSL as debt and equity have been used to settle the sustainable debts owed to the existing financial creditors of TBSL, CIRP costs and employee dues, by payment of Rs. 35,232.58 crore.

The remaining unsustainable debts of Rs. 25,285.46 crore were novated by the financial creditors to BNPL for a consideration of Rs. 100 crore. BNPL, in its capacity as the promoters of TBSL, has waived off the unsustainable debts less cost of novation and the same has been recognised as equity contribution during the year ended March 31, 2019.

10 per cent Redeemable Cumulative Preference shares of Rs.100 each amounting to Rs. 2,425.57 crore were redeemed for a total sum of Rs.4,700. Gain arising out of redemption was recorded as exceptional item in the financial results for the year ended March 31, 2019.

Operational creditors are to be paid Rs. 1,200 crores which will be paid over a period of 12 months.

**Performance Analysis**

The performance of TBSL, pre, during and post CIRP can be adjudged by measuring the impact of insolvency resolution on some of the key performance indicators of the company. The table below shows the changes in some of the important performance indicators such as sales, profitability, inventory management, cash flows, etc, as the company passed through the three different phases of insolvency, CIRP and successful resolution.

**Pre and During CIRP**

The performance of the company improved significantly in 2017-18 (during the period of CIRP) as compared to pre CIRP in terms of its turnover, sales and cash flow from operating activities. This can be attributed to the effective management of the company’s affairs during CIRP and a better control over its operations. The turnover of the company increased by 15.82 per cent and sales and production volume (in MT) increased by 12 per cent. Further, net debtors were reduced by 20 per cent and net cash flow from operating activities increased by 137 per cent as a result of better management control and operational efficiency which arrested the progressive decline in key performance indicators witnessed in the period prior to CIRP.

**During and Post CIRP**

The results of financial year 2018-19 are a testimony to the overall improvement the company has been able to achieve in a short period of time. There was an increase in revenue by 20.04 per cent in 2018-19 (during / post CIRP) over a period of one year due to a ramp up in production activities. The increase in revenue was however offset by an increase in the prices of raw material such as coking coal, hot rolled coil and other alloys. Nevertheless, the production activities picking up in the CIRP period
and continuing post CIRP is in tandem with the objective of the Code to keep the company as a going concern and restoring the health of the company.

During the financial year 2018-19, the saleable steel production of TSBL stood at 4.16 MTPA which is more than 10 per cent over FY 2017-18 (3.8 MTPA). This improvement in production can be attributed to higher mill availability with improvement in maintenance practices and uninterrupted raw material supply.

The company’s performance in terms of financial ratios also improved in the post CIRP period. The Current Ratio, which is a liquidity ratio that measures whether a company has enough resources to meet its short-term obligations, improved in 2018-19 primarily on account of reduction in the current liabilities due to reduction in long term borrowings and short term borrowings (due to repayments). The company’s EBITDA margin also improved in 2018-19 primarily on account of higher operating profits.

The Debtor Turnover Ratio which is a reflection of the effectiveness of a company in extending credit as well as collecting debts, improved in 2018-19 primarily on account of introduction of channel financing facilities across the distributor segment and discounting arrangements across the other segments.

The Interest Coverage Ratio which measures how many times a company can cover its current interest payment with its available earnings, improved in 2018-19 primarily on account of higher operating profits and reduction in finance cost on account of reduction in external borrowings.

Total amount of loans (including interest) which were outstanding during FY 2017-18 were approximately Rs. 58,000 crore with an interest rate varying from 9 per cent to 20 per cent including penal interest. The existing debts of the company were settled by paying Rs. 35,200 crore to the creditors. Therefore,
the YoY loan amount has decreased significantly in FY 2018-19 resulting in a decline in the finance cost from Rs. 6,305 crore in 2017-18 to Rs. 3,752 crore 2018-19.

**Performance in FY 2019-20**

The company announced its Q3 FY 2019-20 and nine monthly (9M) FY 2019-20 key production and sales figures (provisional) on January 9, 2020. The company achieved crude steel production of 1.154 million tonnes (MT) in Q3 FY 2019-20 compared to 1.067 MT in Q2 FY 2019-20 and 1.039 MT in Q3 FY208-19. For 9M FY 2019-20, the crude steel production stood at 3.343 MT compared to 3.132 MT in corresponding period of previous year. The company's sales stood at 1.254 MT in Q3 FY 2019-20 compared to 1.041 MT in Q2 FY 2019-20 and 0.0917 MT in Q3 FY2018-19. For 9M FY 2019-20, the sales stood at 3.159 MT compared to 2.911 MT in corresponding period of previous year. Net sales in FY 2019-20 are: Q1 – Rs. 4124.45 crore, Q2 – Rs. 4311.67 crore and Q3 – Rs. 5038.11 crore and Q4 – Rs. 4064.89 crore. The quarterly net profit at Rs. 5.93 crore in March, 2020 increased by 102.79 per cent from Rs. 212.41 crore in March, 2019.

**FUTURE OUTLOOK**

With focus on overall improvement, taking the workforce of erstwhile Bhushan Steel Ltd. along, the emphasis of the new management has been on safety, environment and social responsibility, in addition to operational and financial excellence. As part of the synergy drive between Tata Steel and TBSL, it has launched many products such as Tata Steelium, Tata Shaktee and Tata Kosh, expanding their customer base and driving new processes and product development. TBSL is expected to maintain its buoyancy and progressively improve its performance and operational efficiency on account of the following expected business scenarios which are likely to favourably impact the business of the company.

- The construction sector is witnessing a consistent revival, mainly supported by government spending on infrastructure. The construction sector is likely to maintain its current momentum with gradual rise in investment.
- The capital goods sector is showing signs of rising manufacturing capacity utilisation. The renewable energy segment is also witnessing strong demand with several new projects being launched due to strong government focus.
- Consumer durables demand emanating from refrigerators, washing machines, air conditioners and ceiling fans is likely to normalise to around 7 per cent in coming years.
- On-going freight corridor and metro rail projects will continue to support the demand in railway sector, along with the electrification of 16,540 track kms by 2022.

**CONCLUSION**

Corporate rescue has become a buzz word in the corporate world. Conceptually, corporate rescue refers to a structured method which can provide a ground for distressed but potentially viable companies to take a new breath of life, free from the deadly enforcement of debt by individual creditors. It enables the company, to negotiate with all the stakeholders and eventually rehabilitate itself to its former healthy operations. The efficiency of the insolvency and bankruptcy architecture to provide the much-needed succour to the companies in distress depends mainly on the adequacy and definiteness of law and regulations and the person handling the process. It may seem conceivable for an insolvency system to function with minimal interventions by courts or government agencies. However, it is not
conceivable for such a system to function effectively without specialists such as RPs who act as agents of reorganisation and have the capacity to lead and direct a corporate rescue process with desired socially and economically beneficial outcomes. The case study of Bhushan Steel Ltd. highlights the efficiency and effectiveness with which the CIRP was carried out by the RP which not only rescued the distressed company but also paved the way for the sustained growth of the company. The resolution of the company benefitted financial creditors immensely as they realised close to Rs. 35,571 crores of their dues. The realisation by all claimants as a percentage of liquidation value was a whopping 252.88 per cent. Going Forward, this case will stand as a case in point of one the most successful resolutions under the Code. It will serve as an exemplary example of an IBC success story.

NOTES

1 Bhushan Steel Limited, Annual Report 2009-10.
Financial gains from cleaning of the banking system are now amply visible. NPAs of commercial banks have reduced by over 1 lakh crore over the last year, record recovery of over 4 lakh crore due to IBC and other measures has been effected over the last four years, provision coverage ratio is now at its highest in seven years, and domestic credit growth has risen to 13.8 per cent.

Liquidator’s Claims against Exclusion Clauses in Contracts

Unnikrishnan A.*

INTRODUCTION

The Liquidator of a company represents the entire body of creditors of the company and its workers. He is the person to collect all dues and receivables of the company under liquidation and distribute them in an equitable manner, subject to the constraints imposed by the law. Under the Insolvency and Bankruptcy Code, 2016 (IBC/Code) numerous rights, duties, privileges and obligations of the Liquidator are set out. In terms of section 36 of the Code, the liquidation estate shall include any assets over which the corporate debtor (CD) has ownership rights as well as any other property belonging to the CD. Along with the power to recover all claims of the CD, he has the power to avoid certain transactions.

The CD, as part of its business dealings, would have entered into numerous contracts with a number of parties. The rights and liabilities of the CD and consequently that of the Liquidator will be governed by such terms. Such contracts may include those which impose certain obligations and consequent liabilities on third parties on different occasions, e.g., delivery of defective goods and lack of quality in services. When the company is in liquidation and such a liability from a third party accrues in favour of the CD - be it flowing out of explicit contractual provisions or implied terms of contract - the Liquidator has to step in and claim the dues. For collecting the receivables from a contracting party, in the normal situation, the Liquidator will proceed as per the terms of contract entered into between the CD and the third-party contractor.

Sometimes however, questions may arise on the extent to which a Liquidator can proceed to collect dues from the contracting party, if the terms of contract specifically exclude any liability or limit the liability by an explicit cap. The freedom of the Liquidator gets constrained as he is stepping into the shoes of the CD, which has entered into the contract with open eyes and free mind, and his rights and liabilities cannot be more than that of the CD in liquidation. It would be of interest and significance to consider the position of Liquidator vis-à-vis a contracting third party, whose liability has been made nil or substantially toned down by contract.

The law attaches a good measure of sanctity to a contract. It is the outcome of a consensus of two or more parties. It needs to be kept in mind that in the absence of fraud, a person who signs a document knowing that it is intended to have legal effect is bound by its terms. Though the terms of a contract have to be read in context, the words and ideas put therein are afforded great weight by judicial authorities.

There are different factors that prevail with the contracting parties when they enter into a contract. One of the parties may be in dire need of getting some work done or getting a contract. One party might be in a dominant position and would be able to call the shots and make the terms completely in its favour.
There may be other cases where impermissible tactics are used by one of the parties to the detriment of the other. Indian Contract Law declares certain contracts as voidable and certain others as per se void. There are plenty of judicial precedents to guide us on the treatment of void and voidable contracts.

When two parties in the commercial field of comparable financial strength and sophistication enter into contracts, it is difficult for any Court to conclude that one dominated the other and it was an unfair contract. In such a contract, it is common for the Courts to go by the terms of the contract and approve the same. The Liquidator will not be in a position to avail more beneficial terms than what the CD had bargained for, unless the contract falls within the avoidance clauses set out by the IBC. It is interesting to see how the Courts have dealt with conditions limiting liability through contracts.

**AVOIDABLE CONTRACTS UNDER THE CODE**

There are some provisions in the Code which enable a Liquidator to avoid certain types of contracts. These are explicitly provided in the statute itself and therefore does not pose the kind of problems which otherwise come forth in ordinary contracts. Since these are based on statutory provisions, a contract to the contrary may not have any effect on them. The importance of these provisions lies in the fact that the Liquidator is able to get an outcome from contracts and transactions, different from the one that would have ordinarily followed, in the absence of such provisions.

**Extortionate credit transactions**

IBC postulates that where the CD has been a party to an extortionate credit transaction involving the receipt of financial or operational debt and the terms of such transaction requires exorbitant payments to be made by it, the Liquidator may make an application to the Adjudicating Authority (AA) for avoidance of such transaction. One condition for invoking this provision is that the transaction should have been made within a period of two years preceding the insolvency commencement date.

** Preferential transactions**

The Liquidator can apply to the AA for avoidance of preferential transactions made during the relevant time.

** Undervalued transactions**

The Liquidator will be able to avoid an undervalued transaction made during the relevant time, by making an application to the AA.

** Defrauding creditors**

Where the CD has entered into an undervalued transaction for defrauding the creditors and the AA is satisfied about it, the Liquidator may be able to avoid its effect, partially or fully.

**CONTRACTS WHICH EXCLUDE LIABILITY**

As indicated earlier, the transaction avoidance provisions enumerated above are on the basis of clear statutory provisions. Assuming that a particular transaction does not fall within any of the categories mentioned above, but contains clauses excluding the liabilities of third party either fully or partially, a question arises as to how far the Liquidator can avoid such clauses and claim dues to the CD, which he regards as proper and legitimate. The decisions of Indian Courts are meager on this count. It is a
settled law in India that the common law rulings of English Courts on contracts can be adopted, in case there is nothing contrary under the Indian statutes. Commentators like Pollock & Mulla rely on English decisions to explain the possible consequences of such exclusion clauses.

What are ‘exclusion clauses’ and how they are treated?

An exclusion clause is one which excludes or modifies an obligation, whether primary, general secondary or anticipatory secondary, that would otherwise arise under the contract by implication of law. Parties are free to agree to whatever exclusion or modification of all types of obligations as they please within the limits that the agreement must retain the legal characteristics of a contract; and must not offend against the equitable rule against penalties; that is to say, it must not impose upon the breaker of a primary obligation a general secondary obligation to pay to the other party a sum of money that is manifestly intended to be in excess of the amount which would fully compensate the other party for the loss sustained by him in consequence of the breach of the primary obligation. Since the presumption is that the parties by entering into the contract intended to accept the implied obligations exclusion clauses are to be construed strictly and the degree of strictness appropriate to be applied to their construction may properly depend upon the extent to which they involve departure from the implied obligations.

A clause in a contract excluding liability of a party, when viewed from the perspective of the other, would be one defining his obligations. It can also be seen as a risk mitigation measure by the parties. Any challenge to a clause in the agreement excluding liability of one party may be defended on the ground of estoppel.

Contracts that exclude liability fully

If a contractual exclusion is made in such wide terms, depriving the promise of all contractual force, Courts may treat them as mere ‘declaration of intent’. One can find a fair amount of ‘judicial hostility’ to such conditions. The judicial approach seems to be that the transaction forming the foundation of the contract should remain as it is. For instance, if the contract is for the delivery of a computer, the supply of an instrument which works as a computer is absolutely essential. If the contractual disclaimer allows the supplier to deviate from this basic feature, the contract becomes meaningless. The exclusion clauses in the contract have to be subject to this basic condition.

While considering the issue of breach of contracts, for long, the English Courts have used the term ‘fundamental breach’ to describe such a contract. Explaining the scope of the term ‘fundamental breach’, the Court stated:

The phrases ‘fundamental breach’ and ‘breach of a fundamental term’ have been used interchangeably in some of the cases; but in fact they are quite different. There is no magic in the words “fundamental breach”; this expression is no more than a convenient shorthand expression for saying that a particular breach or breaches of contract by one party is or are such as to go to the root of the contract which entitles the other party to treat such breach or breaches as a repudiation of the whole contract. Whether such breach or breaches do constitute a fundamental breach depends on the construction of the contract and on all the facts and circumstances of the case. The innocent party may accept that breach or those breaches as a repudiation and treat the whole contract at an end and sue for damages generally or he may at his option prefer to affirm the contract and treat it as continuing on foot in which case he can only sue for damages for breach or breaches of the particular stipulation or stipulations in the contract which has or have been broken. But the expression “fundamental term” has a different meaning. A fundamental term of a contract is a stipulation which the parties have agreed either expressly or by necessary implication, or which the general law regards as a condition which...
goes to the root of the contract so that any breach of that term may at once and without further reference to the facts and circumstances be regarded by the innocent party as a fundamental breach......

In another case\(^\text{12}\), the Court of Appeal in the United Kingdom pointed out the rationale of the principle by stating that the question of ‘fundamental breach’ is a rule of construction which points to the fact that normally an exception or exclusion clause or similar provision in a contract should be construed as not applying to a situation created by a fundamental breach of contract. The Court further pointed out that this rule is not an independent rule of law imposed by the Court on the parties ignoring the contractual intention.

The common law does not treat contracts in a literalist way. If to give words in a contract, ‘their full and complete meaning’, would produce a result at odds with the main object of the contract then, the court will put upon those words a restricted meaning and may even ‘reject words, or even whole provisions, if they are inconsistent with the main purpose of the contract’\(^\text{13}\).

In short, as pointed out by the Supreme Court, the exclusion clause has to be ‘read down’ in order that it is not at war with the ‘main purpose’\(^\text{14}\). Effectively, the Liquidator should be able to argue successfully that a complete exclusion cannot stand the scrutiny of law and therefore, the CD should get the dues, compensation or benefit which it would have been eligible to obtain, in the absence of the exclusion clause.

Contracts which partially exclude liability

The so-called judicial hostility is much less intense, when the contract is only partially limiting the liability. The prevailing view appears to be that a clause which seeks to limit the liability of one party to a commercial contract, against the possible claims from other party, should generally be treated as an element of the parties’ wider allocation of benefit, risk and responsibility.\(^\text{15}\) Such exclusions have to be clear and unambiguous but cannot have any application of special rules of interpretation.\(^\text{16}\)

Can a case of negligence be contracted out? The English authorities on the issue seem to agree that it can be done. However, the fact that any liability on negligence also is excluded has to be clearly spelt out in the contract\(^\text{17}\) or should come out in the contractual document in a clear way. This is based on the premise that there is an inherent improbability of any party agreeing to a term that the negligence of the person who is bound to perform in a contract will not be liable\(^\text{18}\).

CONCLUSION

The Liquidator of a CD has an obligation to realise the dues to the maximum possible extent and distribute them equitably. When she takes over the affairs of the CD, not much choice is available as far as contracts that have been entered into by the company earlier are concerned. Re-writing the contract would be extremely difficult at that stage. However, she needs to be conscious of the principles laid down by Indian as well as English Courts on the issue of exclusion of liabilities in contracts, so that maximum recovery is ensured.
NOTES

* Views expressed in this article are personal.

2 Section 50, IBC.
3 Sections 43 and 44, IBC.
4 Sections 45 to 48, IBC.
5 Section 49, IBC.
6 Bhagwandas Goverdhandas Kedia v. Messrs Girdharilal Parshottamdas, AIR 1966 SC 543: [1966] 1 S.C.R. 656 (“In the administration of the law of contracts, the Courts in India have generally been guided by the rules of the English common law applicable to contracts, where no statutory provision to the contrary is in force.”).
8 Photo Production Ltd. Respondents v. Securicor Transport Ltd., [1980] 2 W.L.R. 283. The court also said that “[s]ince the obligations implied by law in a commercial contract are those which, by judicial consensus over the years or by Parliament in passing a statute, have been regarded as obligations which a reasonable businessman would realise that he was accepting when he entered into a contract of a particular kind, the court’s view of the reasonableness of any departure from the implied obligations which would be involved in construing the express words of an exclusion clause in one sense that they are capable of bearing rather than another, is a relevant consideration in deciding what meaning the words were intended by the parties to bear”.
12 UGS Finance v. National Mortgage Bank of Greece, (1964), 1 Lloyd’s Rep 446. Pearson L. J. (The court said that such a rule of construction based on the presumed intention of the contracting parties involving the implication of a term to give to the contract that business efficacy which the parties as reasonable mean must have intended it to have. Though it cannot be regarded as a new rule by any chance, it has gained prominence in recent years due to the “tendency to have standard forms or contract containing exceptions clauses drawn in extravagantly wide terms, which would produce absurd results if applied literally”).
13 Sirius International Insurance Company (Publ) v. FAL General Insurance Ltd., [2004] UKHL 54. See also the comments of Pearson LJ in UGS Finance Ltd. v. National Mortgage Bank of Greece, [1964] 1 Lloyd’s Rep 446 [Observing that it is not right to say that the law prohibits and nullifies a clause exempting or limiting liability for a fundamental breach or breach of a fundamental term, as it would involve a restriction on freedom of contract. The appropriate view is that on construction of the contract as a whole, it is found that the exempting clauses were not intended to give exemption from the consequences of the fundamental breach.]; Photo Production Ltd. v. Securicor Transport Ltd. [1980] A.C. 827. (“The doctrine of ‘fundamental breach’ in spite of its imperfections and doubtful parentage has served a useful purpose.”).
(“It is certainly true that English law has traditionally taken a restrictive approach to the construction of exemption clauses and clauses limiting liability for breaches of contract and other wrongful acts. However, in recent years it has been increasingly willing to recognise that parties to commercial contracts are entitled to apportion the risk of loss as they see fit and that provisions which limit or exclude liability must be construed in the same way as other terms.”).

17 Canada Steamship Lines LD v. The King, [1952] A.C. 192 (If the clause contains language which expressly exempts the person in whose favour it is made from the consequence of the negligence of his own servants, effect must be given to that provision. If there is no express reference to negligence, the court must consider whether the words used are wide enough, in their ordinary meaning, to cover negligence on the part of the servants of the proferens.)

Part III

Providers of Service
The Insolvency and Bankruptcy Code is success story of India's economic reforms.

- Shri M. Venkaiah Naidu, Hon'ble Vice President of India in his address at the inauguration of Insolvency Research Foundation, August 2, 2019
A Study of Insolvency Professionals in India

Abhishek Mittapally and Kokila Jayaram

The enactment of the Insolvency and Bankruptcy Code in 2016 (IBC/Code) led to the establishment of Insolvency Professionals (IPs) as a new class of regulated professionals in the market. This article attempts to understand the selection process, general profile of candidates entering the profession and an assessment of the assignment and earnings. An analysis of the eligibility criteria and selection process shows that they are robust in terms of role expected of the professionals under the Code. The general profile indicates that the profession predominantly constitutes of Chartered Accountants, males and concentrated in metropolitan cities. It is seen that professionals are engaged gainfully; however, a gender pay gap is evident. The article also attempts to understand the challenges faced by IPs and provide suggestions.

INSOLVENCY LAWS AND INSTITUTION OF INSOLVENCY PRACTITIONERS

The origin of insolvency laws can be traced back to the famous Magna Carta proclaimed in England in AD 1215. It had a clause that protected people’s lands from being seized by the Crown if they had no money to repay their debts. The change in socio-economic conditions driven by the Industrial Revolution and the deteriorating public opinion on debtors’ prisons created the need for change. A more humane approach was developed in the Bankruptcy Act of 1705 and later the State (Lord Chancellor) discharged defaulting debtors without permission of creditors. A person being responsible for administering and managing insolvency proceedings is as old as insolvency laws itself. When insolvency/bankruptcy laws were implemented through the State machinery, officers were appointed to conduct such proceedings. Later, as laws evolved, the Courts were vested with the responsibility of these proceedings. The affairs being administered/managed by the State or the Court lead to delays and higher transaction costs in resolving matters. Such delays and costs adversely affected the outcomes of the process and went against the very objective, of rescuing the enterprise, which the laws aimed.

As an alternative, the system of appointing a person - one of the State or a private individual to carry out proceedings was established. Some jurisdictions provided for corporations or other separate legal entities also to be appointed. This provided for the conduct of proceedings with lesser delays but with supervision. Insolvency laws refer to such person/entity as administrators, trustees, liquidators, supervisors, receivers, curators, official or judicial managers or commissioners etc. Such persons/entities have clearly defined roles and functions under the laws along with ways for monitoring and supervision of their actions and performance. Their relationship with the Courts, creditors and debtors vary with the approach of the law.

Recommendations of a Committee under Chairmanship of Kenneth Cork, (famously called the Cork Committee Report, 1982) established two primary principles in insolvency matters. One, the need to rescue viable businesses and two, the need for regulation of private practitioners dealing in insolvency
matters and more say to creditors in choosing such professionals. Consequently, the Insolvency Act of 1986 introduced the appointment of administrators and receivers to insolvent companies. It was done to ensure that managers of insolvent companies would act in the interests of all the creditors and directors failing to do so attracted disqualification under Companies’ Directors Disqualification Act, 1986.

INSOLVENCY PROFESSIONALS IN INDIA

The earliest provision dealing with insolvency/bankruptcy in India can be traced back to sections 23 and 24 of the Government of India Act, 1800. It was followed by Statute 9 enacted in 1828, the Indian Insolvency Act, 1848, the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920. In post-independent India, the Companies Act, 1956 (CA, 1956) was the only law dealing with corporate insolvency for all practical purposes and it provided for a process of ‘winding up’ of a company. The Sick Industrial Companies Act (SICA) enacted in 1985 aimed at identifying sickness in industrial companies and reviving them. In the 1990s and 2000s, the policy focus shifted to protecting creditors’ rights towards which the Recovery of Debts and Bankruptcy Act, 1993 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. This multitude of laws lead to significant litigation and less than optimal legal and economic outcomes for corporates seeking resolution and for creditors seeking recovery. The Bankruptcy Law Reforms Committee (BLRC) recommended the enactment of a single, comprehensive, and internally consistent law leading to enactment of the Code.

The CA, 1956 provided for an Official Liquidator (OL). The OL, appointed by the Central Government, under section 448 is under the administrative charge of the Regional Director, Ministry of Corporate Affairs and is functionally attached to the jurisdictional High Court. The OL was entrusted with conducting affairs of the companies under liquidation. With the enactment of the Code and amendments to the Companies Act, 2013 OLs are not being entrusted with fresh matters since December 31, 2016. As of October 31, 2018, there were 4,865 companies undergoing liquidation, 92 per cent of which were ‘winding up by the Courts’ cases involving appointment of OLs by the Central Government to assist the Courts. The Companies (Winding up) Rules, 2020 provides that the provisional liquidator or company liquidator appointed by the Tribunal shall be an Insolvency Professional registered by the Insolvency and Bankruptcy Board of India (Board).

The SICA established an institutional arrangement under the Board for Industrial and Financial Reconstruction (BIFR) and the Appellate Authority for Industrial and Financial Reconstruction. The role of BIFR, a Board of experts, was to manage the process of timely detection of sick and potentially sick companies, determination of appropriate measures and their expeditious enforcement. An analysis of BIFR cases, (Sengupta et al., 2016) between 1987 to 2014 shows that a total of 5,800 cases were reported to the BIFR. 53 per cent of these cases were either dismissed or abated, 22 per cent of the cases were recommended for liquidation and in 9 per cent of the cases a rehabilitation plan was implemented. The average time taken for the closure of a case in the BIFR was around 5.8 years. After enactment of the Code, cases pending with the BIFR were transferred to the National Company Law Tribunal (NCLT).

Learning from past experiences and in line with international best practices, the BLRC recommended for ‘an industry of regulated professionals who will be delegated the task of monitoring and managing matters of business by the Adjudicator, so that both creditors and the debtor can take comfort that
economic value is not eroded by actions taken by the other.’ BLRC envisioned the role of professionals as ‘critical to ensure a robust separation of the Adjudicator’s role into ensuring adherence to the process of the law rather than on matters of business, while strengthening the efficiency of the process’ and hence as one of the four key pillars of the Code.

The Code provided for the IP – as a person enrolled under section 206 with an Insolvency Professional Agency (IPA) as its member and registered with the Insolvency and Bankruptcy Board of India (IBBI) as an IP under section 207. These professionals are a presently part of corporate insolvency and bankruptcy processes. IPs act as Interim Resolution Professional (IRP)/ Resolution Professional (RP)/ Liquidator according to the process which they are part of.

Qualifications for IPs

The UNCITRAL Legislative Guide on Insolvency Law while emphasising the role of an ‘insolvency representative’ indicates that, ‘... it is essential that the insolvency representative be appropriately qualified and possess the knowledge, experience and personal qualities that will ensure not only effective and efficient conduct of the proceedings but also that there is confidence in the insolvency regime’. The BLRC, emphasising the role of IPs states that, ‘the adjudicator depends on the specialised skills and expertise of the IPs to carry out these tasks in an efficient and professional manner’ making it clear the need for high standards in these professionals in terms of knowledge, skill and character. The Code provides for all this through the eligibility conditions for registration as an IP.

The Board through the IBBI (Insolvency Professionals) Regulation, 2016 (IP Regulation) notifies the qualifications, experience etc., required for professionals to register as an IP. The role of an IP requires understanding legal processes and to deal with economic and financial aspects of businesses. The Code recognises five classes of career professionals, namely Chartered Accountants (CA), Company Secretaries (CS), Cost Accountants (CoA), Lawyers, and persons with managerial experience as being eligible for registration as IP. These professionals are expected to possess knowledge dealing aspects of law, finance, company affairs and economics. This knowledge offers the plank, on which the additional knowledge required for insolvency practice is sought to be built and they are best placed to have the necessary knowledge required in the implementation of the Code. The kind of hard and soft skills required to perform the role of IP with any degree of success is immense. The years of experience criteria - 10 years of experience as a member of the ICAI, ICSI, ICMAI or a Bar Council or 15 years of experience in management is expected to have built this in the professionals.

The Limited Insolvency Examination

The Limited Insolvency Examination covers areas of economics, finance, accounts, law in general, company affairs etc., and in depth understanding of the Code and its operation. The requirement for clearing the examination within the last one year to be eligible for registration is essentially a test of knowledge of the Code and the latest developments in processes and jurisprudence in the field. The examination acts as a filtration mechanism that assesses an individual's understanding and clarity about latest developments in the field.

The examination commenced on December 31, 2016 and has completed four phases - each one with an updated syllabus in line with the changes to the Act and jurisprudence. By end of March, 2020, 11,451 candidates appeared in the examination and 4147 were successful (36 per cent), of which 428 were women (10 per cent) and over half of them are 40-60 years old. The age, though higher than in any other profession, reflects the years of experience required to qualify and that experienced professionals
are able to perform better in the examination. The average number of attempts to clear the examination was 5.6. Around 38 per cent of these candidates are from the North India and 60 per cent are based in a metropolitan city.

The Code also provides for successful completion of the Graduate Insolvency Programme (GIP) as an alternative qualification. The Board approved the delivery of this course in the Centre for Insolvency and Bankruptcy, Indian Institute of Corporate Affairs. Post-graduates with major subjects in Economics, degree in Finance, Commerce, Management and Insolvency, CA, CS, CoA, Advocate, B.E/B.Tech degree is eligible to pursue the course. The course is designed to attract young talent, not above 28 years of age, into the insolvency profession and includes experiential learning through internships.

**Registration of IPs**

The registration of IPs is the entry point for all eligible professionals. The number of professionals registered was 96 as of March 31, 2017 and has steadily grown to 3014 by March 31, 2020. Of the 4147 professionals who cleared the examination in the same period, only 3014 have registered as IPs (73 per cent). It is seen that 55 per cent of the registered IPs are CAs followed by CSs (18 per cent) and persons with managerial experience (15 per cent). IPs are also professional members of IPA. Of the three IPAs, IPA - ICAI has about 62 per cent of the registered IPs as its members followed by IPA-ICSI with 30 per cent and the IPA- ICAI (Cost) with 8 per cent of the registered IPs as members. There is a general tendency of professionals to choose the IPAs of their parent professions to enrol as a member. Advocates seem to prefer the ICSI Institute of Insolvency Professionals, and professionals with managerial experience are mostly registered with ICAI IPA or the ICSI IPA.

Only 36 per cent of women professionals who appeared were successful (whereas 43.8 per cent of men who took the exam succeeded). Amongst registered IPs, the number of women was 275 i.e., 9 per cent. Women participation was lowest amongst IPs from managerial background (4 per cent) and participation was highest in IPs with Company Secretaries background (12 per cent). Women participation amongst IPs seem to reflect the participation rates in the parent professional streams.

**Qualities of an IP**

Successful administration of any insolvency resolution process depends on the economic actors who conduct it (Cork Committee, 1982). The responsibilities of an IP begin with the application being admitted by the adjudicating authority. The powers of erstwhile board of the corporate debtor (CD) stand suspended and managing the affairs of the company is vested with the IP. The task for a board of directors must now be done by the IP, albeit with and often without, support from the suspended management and employees. In his endeavour to preserve the value of the corporate debtor he/she must take custody of assets, raise funds as needed, appoint professionals, and ensure running of day to day operations. He/ She is key to balancing interests of the various stakeholders – he/she must remain unbiased for this to be achieved. The BLRC report identified two sources for an insolvency resolution to fail: One, collusion between parties involved and the other, poor quality of execution itself. It is, therefore, imperative that IPs maintain the highest levels of professional standards.

The first test of an individual’s character is assessed at the time of registration. The IP Regulation [Regulation 4 (g)] requires that for registration as IP individuals need to be ‘fit and proper’. For determining whether an individual is fit and proper under these Regulations, the Board may take into account any criteria as it deems fit, including but not limited to the following criteria-
• integrity, reputation, and character,
• absence of convictions and restraint orders, and
• competence, including financial solvency and net worth.

The Board has time and again reiterated and upheld this concept of ‘fit and proper’ as can been seen in various orders passed by it. Application for registration as IPs have been rejected in cases where criminal case have been filed for failing to comply with orders of Company Law Board, for being party to a conspiracy to cheat the Government, for offences like cheating, dishonesty as reflected when papers were signed without contents being verified. The conduct of the professional in the personal fronts are also accounted for. Rejections have occurred where allegations/cases are pending in matters like Dowry or outraging the modesty of a women.

Once registered, the IP is bound by the Code of Conduct while on or off assignments. The IPAs and the Board have the mandate to monitor the conduct of IPs and have instituted due processes to investigate any misconduct by the IP [Regulation 11 of IP Regulations]. The Code provides penalties for certain actions of the IP which are not in conformity with the Code [Chapter VII of the Code] and acceptable standards of behaviour.

The Courts have also clarified that the Board is competent to constitute a disciplinary committee, constitute Investigating Authority [Section 220 of the Code] and if after such investigation the Board finds that a criminal case has been made out against the insolvency resolution professional then IBBI has to file a complaint in respect of the offences committed by him.

**Workload and earnings for IPs**

As of March, 2020, there were 3774 corporate insolvency resolution processes (CIRP) that had commenced. Each CIRP provides two assignments – one as IRP and one as RP. The same IP could serve as both IRP and RP or there could be a change. As of March 2020, there were 914 liquidation orders and each liquidation provide one assignment for an IP to serve as Liquidator. The total assignment available during the three years since enforcement of the Code for IPs was 8,462. The IPs in addition to the above roles envisaged in the Code have been providing advisory and consultancy services. At least 155 IPs disclosed providing such services in the year 2018-19.

The Adjudicating Authority (AA) has noted that the workload of the IP is a factor that will affect the progress of the time-bound resolution process. In the Lanco Infratech Limited case, the AA did not approve appointment of one IRP with an observation:

> Therefore, we agreed with the submissions of the respondents considering his previous three assignments to large companies and the current corporate debtor itself is a large company we are of the prima facie view that the proposed IRP would not find sufficient time to act as IRP for the respondent Company. Most of the activities prescribed in the IBC code are time bound. Therefore, we had suggested to change the aforesaid IRP, accordingly the financial Creditor viz. IDBI proposed another IRP and accordingly, we appointed him as an IRP for the Corporate Debtor.

A similar observation was also made in the LML Limited case. The Board has observed that ‘a few IPs are handling too many assignments under the Code, which is detrimental to the institution of IP in the long run’ and has opened consultations to answer relevant questions on restriction on number of cases handled by an IP at a time, criteria for such restrictions and the threshold for such restrictions etc.
The IPs are required to disclose their fees after the completion of every assignment and annually. Information available from such disclosures\textsuperscript{15} for the year 2018-19 show that the average earnings per assignment for an IRP was Rs. 5.20 lakh, for a RP was Rs. 31.6 lakh and for a Liquidator was Rs. 10.2 lakh. Average earnings from advisory and consultancy services was Rs. 9.43 lakh in the year 2018-19.

Earnings of IPs is highly skewed in favour of male IPs as against female IPs. It can be seen that while a male IP, on an average, earned Rs. 5.35 lakh for an assignment as an IRP a female IP earned just Rs. 3.85 lakh on average. Similarly pay gaps are visible in roles of RP and liquidator. The Monster Salary Index\textsuperscript{16} published in March 2019, women in India earn 19 per cent less than men. IT services showed a sharp pay gap of 26 per cent in favour of men, while in the manufacturing sector, men earn 24 per cent more than women. In the case of IPs the pay gap (based on average earnings for all assignment) is 37 per cent in favour of men.

**In the eyes of the Courts**

The role of IPs has been under scrutiny and have seen both praise and criticism from several quarters. The Courts have noted on record its praise for the professionals\textsuperscript{17}, viz.

> The CoC has expressed its gratitude to the resolution professional for his hard work and congratulated him for his efforts to complete the CIRP within the extended period of 270 days. We also do not find any adverse remarks against the resolution professional but would like to endorse the view expressed by the CoC as this is a unique case wherein a Farm dealing with Poultry has been successfully run by him enabling him to get a resolution applicant to take over the assets above the fair market value and the financial creditors have voted the resolution plan with 100%.

and its disapproval\textsuperscript{18}, as:

> The very object of the Code is to revive a company under the CIRP and not to liquidate it. In the instant case it is clear that the resolution professional has omitted to perform his statutory duties and responsibility nor the COC seems to have shown much interest and made efforts to achieve the object of the Code for exploring the possibilities for revival of the company.... it is amply clear that the Resolution Professional has not invited prospective resolution applicants as per Section 25 of the IB Code...

**CHALLENGES AND SUGGESTIONS\textsuperscript{19}**

Challenges faced by IPs in their role as RPs start from the time, they take over the CD. The IP has no time to develop any understanding about the CDs business but is expected to make meaningful decisions to keep the business operational. Factors influencing the recommendation of an IP for a particular assignment are not clearly identifiable but experience of a professional in the specific sector/industry should be a consideration. The Board provides a panel of IPs eligible to take up assignments across 15 zones for use by the AA but does not include information regarding relevant experience\textsuperscript{20}. Information regarding specialisation/ relevant experience of the IP, if made available in public domain will enable creditors/AA to make more appropriate recommendations.

The cooperation of earlier management and employees of the CD with the IRP/RP, is required to keep the business operations smooth, ensure statutory compliances, ensure availability and accuracy of information etc., and is mandated under the Code. There have been several cases\textsuperscript{21} where the courts
have come in aid of the IPs to ensure cooperation of the promoters of the CD, erstwhile management, employees etc. It has been, ‘...clarified that IRP is acting as a Court Officer and any hindrance in the work of CIRP will amount to contempt of court. It is further directed to the promoter/director, officials and auditor of the company to fully co-operate the RP in the completion of CIRP’ and the AA also directed police assistance so that the RP can take full control of the company without any interference from ex-Director’s or his officials. However, such cooperation is often not forthcoming and enforced through an order of the AA such ‘coerced support is not as valuable and expedient as voluntarily given support’ (Iyer and Sood, 2019). Meetings of the committee of creditors (CoC) is the decision-making forum in a CIRP but also the working of which enables ‘the balancing of interests of stakeholders’.

The Code enables participation of management and representatives of employees of CD to participate without voting rights. The IP should encourage their participation and engagement in these meetings to keep them part of the process while remaining cautious about their vested interests in the CD from hampering the process. The hallowed process of the CoC meetings must be harnessed for achieving the objectives of the Code.

The IRP/RP is vested with powers and responsibility of the Board of the CD and management of its affairs immediately after appointment. The Code enables him to appoint accountants, legal or other professionals to preserve and protect the assets of the CD, including the continued business operations of the CD [Section 25 of the Code]. There is lack of clarity on who can be appointed, what should be the nature of such appointments, their fee/remuneration etc which has been a constraint for the RPs. The Board may consider providing guidelines on such appointments to enable harnessing this provision efficiently and to ensure transparency in such appointments.

As streams of insolvency and bankruptcy processes evolve there is a need for professionals to specialise. The exam and registration system would have to accommodate such specialisation in order to ensure that processes under the Code find the professional best suited for the purpose. Several countries, including the UK have partial / separate licences for personal and corporate insolvencies and evaluation systems also vary accordingly. The current examination scheme has been successful in kick-starting the profession but has scope for further improvements. Being based on objective type questions it emphasises assessment of theoretical knowledge. The limited weightage for case studies constrains evaluation of situational understanding of the candidates performing in real life conditions. An examination that is based on scenario analysis and case studies can be a better way of assessing professionals. The examination system in the UK is an open book examination involving case analysis.

Insolvency regime in India is evolving at a fast pace which brings forth opportunities and challenges. Developments include the operationalisation of individual insolvency including a fresh start process, a separate track for dealing with insolvency resolution of MSMEs, cross border insolvency and group insolvency measures under the Code. IPs have been steadfast in their role as a key pillar to the Code so far and need to be prepared to hold the mantle into a more challenging future.
NOTES

3 The Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 continue to be in force for insolvency of individuals and partnerships.
5 Annual Report 2019-20, Ministry of Corporate Affairs.
8 IPAs are registered under section 201 of the Code and are frontline regulators of IPs. There are three IPAs namely, (s) Indian Institute of Insolvency Professionals of ICAI, (b) ICSI Institute of Insolvency Professionals and (c) Insolvency Professional Agency of Institute of Cost Accountants of India. These have been established, by the professional institutes regulating the professions of accountancy, company secretaries and cost accountancy.
9 Orders of the Disciplinary Committee, IBBI.
10 M/s Alchemist Asset Reconstruction Co. Ltd. v. M/s Hotel Gaudavan Pvt. Ltd., [CP/CA. No.-(IB)-23(PB)/2017].
12 Anil Goel v. LML Ltd., [CP No. (IB)55/ALD/2007 with CA No.73/2018].
numberofassignmentsstobehandledbyIP_Final_new.pdf.
14 Open for public comments till 25th July 2020.
19 These are personal opinions of the authors and do not reflect the position of the Board.
20 The panel is provided on the website of the IBBI twice a year.
24 It is a stated objective of the Code. Preamble to the IBC.
INTRODUCTION

World over, the services industry is becoming more and more professionalised, and India is no exception to this trend. Due to the exponential increase in knowledge in several areas, specialisation in those areas (in relation to the dissemination of and access to such knowledge) has also increased dramatically. Globally, this has led to the emergence of many neo-professions, which are now as well-recognised as the traditional professions of Law and Medicine. A similar trend is seen in India, as post-independence, multiple market-linked professions have developed over the years, like the professions of Chartered Accountants, Company Secretaries, Cost Accountants, Insolvency Professionals etc.

Post liberalisation in 1991, India has been on the path to become a market-driven economy. Institutions play a very important role in market-driven economies for long-term economic development. Once the basic market economy is in place, a higher level of institutional capacity is required for ensuring its further development and sustainability. Growth will stall, if a middle-income economy proceeds to rise to a mature market economy with weak institutional structures. As the inter-relationship between various actors in the society have become more professionalised, the practitioners of traditional professions and neo-professions have become an essential intermediary between different interest groups. This has resulted in the emergence of professions as an important institution for effective functioning of our market economy. Strengthening the institutional infrastructure for regulating such professions (especially those involved in market-based relationships) is therefore important for supporting India’s economic development. Among other measures, this requires institutionalisation of minimum standards for such professions through state-sponsored regulations.

INSTITUTIONALISATION OF PROFESSIONS THROUGH STATE-SPONSORED REGULATIONS

The practitioners of several professions render services directly to the users. From this point of view, provision of services is essentially a transaction that takes place between two private persons. Therefore, a fundamental question arises about the role of the State in this. Is State intervention through state-sponsored regulations necessary for regulating such transactions? Should the users of such services be left to their own devices for taking refuge under the private law (tort law, contract law or consumer law) for protecting their interests? These issues can be evaluated from two perspectives, namely, (a) the economic perspective and (b) the legal perspective.
Economic perspective

Competition is an essential characteristic of a free market economy. State intervention can limit the abuse of economic power and ensure better quality of services at appropriate prices. Intervention through State-sponsored regulations is required when there are market imperfections which yield poor outcomes for the stakeholders. In the market of services rendered by the professionals, there exists primarily three kinds of market failures, namely, asymmetries of information, externalities and abuse of market-power. Due to the specialised nature of services rendered by the professionals, quality of such services is not easily determinable by the users. In most cases, users do not have the requisite information or specialisation to assess the quality of such services. This can lead to information asymmetries which are difficult to overcome and expose consumers to the possibility of unjust outcomes. In terms of externalities, poor quality of services is another issue that might harm the consumers and inhibit the development of the market for which those services are relevant. Substandard services rendered by professionals not only affect the consumers, but also third-parties and the entire eco-system linked to those services. Lastly, the risk of abuse of market power exists when few service providers achieve a dominant position in the market. The nature of services rendered by the professionals are highly skill-based and specialised. This can result in concentration of knowledge among few practitioners, especially if those services are largely self-regulated. This may result in creation of significantly high entry-barriers for new players.

Legal perspective

A professional service provider and his client share a legal relationship wherein both parties owe certain duties to each other. A peculiar feature of this relationship is that it operates in spheres where a specific and pre-determined outcome can never be assured for reasons beyond the control of the professional. Traditionally, common law provided a diverse set of principles to determine professional liability for different types of services. Under that system, the discussion to determine professional liability starts with the concept of reasonable care. Where a professional is able to meet this threshold, he will not incur professional liability even if the outcome of his services is not to the liking of his client. On the other hand, in a State-sponsored institutional framework for determining liability, the regulator starts from the concept of risk. It seeks fair allocation of risks between the professionals and users and prescribes rules accordingly. This process entails a realistic appreciation of the nature of the risk transferred to the professionals and the degree of risk retained by the users. There is a fundamental difference between these two approaches for determination of liability, as outlined above. The concept of reasonable care reduces the involvement of the users and applies the preconceived notion of a reasonably competent professional to the facts of each case. In contrast, the concept of risk takes into account the fair allocation of risks between the professionals and users, which leaves more room for objective evaluation. While allocating risk, the regulator focuses on requirements of the users and the nature of services rendered by the professionals, and the rules designed for this purpose are eventually tailored accordingly. This is a more holistic approach for determination of liability in comparison to reliance on the concept of reasonable care.

The above discussion highlights the importance of institutionalisation of professions through State-sponsored regulations. India has seen the institutionalisation of several market-linked professions in the past, such as Chartered Accountants, Insolvency Professionals, etc. through respective State-sponsored regulations. Just like these professionals, valuers also perform a very useful function in market-based economies. Their services are crucial for ascertaining the value of different classes of assets, as may be required under different contexts. For instance, valuation is required for several private or public
transactions under Company law, Insolvency law, and Tax law, among others. However, unlike other professions, the valuation profession is not institutionalised through State-sponsored regulations or regulated properly. This creates several arbitrage opportunities for malpractices, affects quality-control and also inhibits the development of the profession.

**STATUS OF THE VALUATION PROFESSION IN INDIA**

**Market of Valuation Services**

The market of valuation services is relevant for both public and private sectors. Primarily, there are two types of valuation services rendered by the valuation professionals in India. First, the valuation services rendered in connection with transactions under various laws like the Company law, Insolvency law, and Tax laws, among others. These type of valuation services can be further divided into two categories. The first category consists of laws that set standards for the transactions between private persons. For example, section 192 of the Companies Act, 2013 seeks to regulate the non-cash arrangement between a company and its directors. It provides that these arrangements require prior approval by a resolution in general meeting of the company. The notice of the general meeting shall include the particulars of the arrangement along with the value of the assets involved in such arrangement duly calculated by a registered valuer. By prescribing a requirement of valuation by the registered valuers, the law ensures that the shareholders take an informed decision. The second category consist of laws wherein the valuation services are required to ascertain the liabilities owed by a private person to the Government. A classic example of this can be found under tax related laws, wherein valuation services have been relevant for a very long time. Further, the second type of the valuation services are rendered by the valuation professionals on the basis of the needs of the market to enable private negotiations, for instance, during pre-contract negotiations involving tangible or intangible assets.

**Regulatory norms for valuation profession in India**

An overview of the market of valuation services underscores the reliance of the State on the services rendered by the valuation professionals. To that extent, the valuation professionals function as an extended arm of the State to regulate both private and public transactions. Without proper regulation of the services rendered by such professionals, the possibility or risk of misplaced reliance cannot be ruled out, which raises serious questions about the long-term utility of such services. Back in 2008, an unsuccessful attempt was made to provide an institutional and regulatory framework for the valuation profession, through the Valuation Professional Bill, 2008 (VP Bill, 2008). A two-tier statutory self-regulatory model was adopted. The VP Bill, 2008 provided for the constitution of a ‘Council of Valuation Professionals’ (CVP) as the tier-one level principal regulator and for Recognised Institutes as the tier-two level front-line regulators. However, this proposed reform never saw the light of the day.

**Self-Regulations of Valuation Profession in India**

Valuation services should not be understood as a by-product of services rendered by professionals in other fields, as it requires special training and background. It has developed into an independent profession over the years. Most of the valuation professionals in India are associated with multiple professional associations or self-regulatory organisations (SROs). These are primarily non-governmental organizations/associations formed by stakeholders from the private sector. The valuation professionals become members of these SROs based on the membership requirements as prescribed by such organisations. Once a valuation professional becomes a member of an SRO, they are typically required...
to follow the bye-laws and a code of conduct, if any. SROs also monitor compliance of such prescriptions and may revoke the membership of a valuation professional for non-compliances. The enforcement mechanisms of such SROs are essentially through internal adjudicatory mechanisms which can lead to suspension or expulsion of members in appropriate cases. Though there is no statutory requirement for a valuation professional to be registered with an SRO, most professionals do get affiliated with one as market practice. There is no doubt that the valuation SROs have played an important role in the development of the valuation profession in India.

**Regulation through registration process under different enactments**

Unlike the profession of Advocates, Medical Practitioners, Chartered Accountants, Company Secretaries and Cost Accountants, the valuation profession does not have a unified legal regime for its regulation. Presently, the diversity in the market for valuation services is also reflected in the mandatory norms regulating the profession. Legislation like the Wealth Tax Act, 1957 and the Companies Act, 2013, prescribe registration requirements for the valuation professionals to render valuation services for transactions envisaged thereunder. For example, the Wealth Tax Act, 1957 provides for the registration of the registered valuers under Chapter VIIIB of the Wealth Tax Act, 1957. The rules framed thereunder prescribe the qualifications of registered valuers\(^{15}\), process of registration\(^{16}\), scale of fees\(^{17}\), form of report of valuation\(^{18}\), and procedure of removal from register of names of valuers\(^{19}\). On the other hand, certain laws recognise the services of the valuation professionals registered under the Wealth Tax Act, 1957\(^{20}\) and the Companies Act, 2013\(^{21}\). Further, legislation like the Foreign Exchange Management Act, 1999 and regulations framed thereunder require rendition of valuation services by other classes of professionals, being Chartered Accountants\(^{22}\), Merchant Bankers\(^{23}\) and Cost Accountants\(^{24}\).

**The Companies (Registered Valuers and Valuation) Rules, 2017**

A positive development towards providing a comprehensive institutional and regulatory framework for valuation profession under any specific legal regime was made by the Companies (Registered Valuers & Valuation) Rules, 2017 (RV Rules, 2017) notified under the Companies Act, 2013. A review of the legislative history of this Act indicates that it took almost nine years for the Company Law regime to have a specialized framework for registered valuers from the time it was first proposed in 2008.\(^{25}\) The Companies Act, 2013 replaced a 57-year old legislation and sought to modernise the regulation and governance of companies in India. The Central Government then brought in the RV Rules, 2017, prescribed under the guiding principles of the Chapter XVII of the Companies Act, 2013 that deals with ‘Registered Valuers’. Simultaneously, the Government also issued the Companies (Removal of Difficulties) Second Order, 2017\(^{26}\) and the Companies (Amendment) Act, 2017\(^{27}\) which modified the framework in response to contemporary needs of the market for valuation services, as relevant for transactions under Company Law.

As mentioned above, the Wealth Tax Act, 1957 and the Companies Act, 2013, are two legal regimes that require valuation professionals to register under them for rendition of valuation services for the purpose of transactions relevant for those laws. Despite similarities in the general policy of registration for rendition of services, the institutional and regulatory model adopted under the Companies Act, 2013 read-with the RV Rules, 2017 is more robust and comprehensive in nature. This is attributable to five distinctive features of the RV Rules, 2017 as explained below.

(a) The RV Rules, 2017 follow a two-tier regulatory model for the valuation profession. It provides for a separate ‘authority’\(^{28}\) as the principal regulator and also recognises Registered Valuers Organisations (RVO) as the second-level front-line regulators. It is mandatory for the registered valuers to become a
member of RVOs before registering as a registered valuer.29

(b) The RV Rules, 2017 provide for the development of profession by prescribing minimum educational requirements for the persons seeking registration. They are required to undertake educational courses conducted by the RVOs.30

(c) In addition to the requirements related to qualifications and experiences of a person, this framework prescribes the requirement of ‘valuation examination’. An individual is required to pass the valuation examination conducted by the authority for one or more asset classes, to test their professional knowledge, skills in valuation, in addition to their values and ethics.31

(d) Once a person is registered as a registered valuer, he is required to abide by the mandatory norms prescribed in the RV Rules, 201732 and provide valuation33 services accordingly. It also provides for the cancellation and suspension of registration of the registered valuers for contraventions.34

(e) The RV Rules, 2017 provide for the formulation and laying down of valuation standards and policies for compliance by the companies and registered valuers.35

This new regime under Company Law thus set in motion the development of a much-needed institutional framework for at least one class of valuers, several years after the reform was first conceptualised. However, since this regime does not apply to valuation services beyond the realm of Company Law and Insolvency Law, its reach remains limited.

THE RECOMMENDATIONS OF THE COE REPORT ON VALUATION PROFESSION AND THE DRAFT VALUERS BILL, 2020

The Report of the Committee of Experts to Examine the Need for an Institutional Framework for Regulation and Development of Valuation Professionals (CoE Report) makes a compelling case for a unified legal regime and institutional framework for the regulation of the valuation profession in India. The need for such a statutory regulation and institutionalisation of the valuation profession is strongly supported by the need for accountability mechanisms empowered statutory regulators that can protect public interest through far-reaching regulatory oversight.36

Towards this end, the recommendations of the CoE Report focus on broad themes concerning the regulatory architecture, the regulation and development of the profession and finally, the regulation of the market for valuation services. The selection of these broad, high-level issues for drawing up of a regulatory framework, indicates the CoE’s inclination to only provide an ‘incomplete law’, which should be in the form of a skeletal legislation with significant delegation of powers such that it is flexible enough to adapt to the requirements of the profession, as it develops.37 The Draft Valuers Bill, 2020 (the Draft Bill), as proposed by the CoE, reflects this approach very clearly. It is pertinent to note that most regulators today, most prominently, the Insolvency and Bankruptcy Board of India (IBBI) and the Securities and Exchange Board of India (SEBI), operate through such ‘incomplete laws’ rather than overly-prescriptive legal regimes that are more rigid in trying to provide for all possible contingencies.

**Regulatory Architecture**

*Adoption of a two-tier mechanism*

A strong indicator of the formalisation of a profession is when it is brought under a statutory framework and supported by State intervention through a unified governance regime. While the valuation
profession was originally self-regulated, the CoE proposes to reorganize it under a two-tier regulatory model for its proper regulation and development – it provides for a principal regulator functioning under the aegis of the Central Government, to be called the National Institute of Valuers (NIV),\(^\text{38}\) while also providing for front-line regulators, the Valuer Professional Organisations (VPOs),\(^\text{39}\) who are entrusted with the responsibility of developing the profession. Prominently, the presence of VPOs as frontline regulators should also help further the ease of access and oversight over the numerous valuation professionals practising all over the country. Such a two-tier model has already been employed for insolvency professionals under the Insolvency and Bankruptcy Code, 2016 (IBC), and has is contributing significantly to the development of the profession.

Reliance on appropriate Governance mechanisms

The broad scheme of the CoE Report indicates that regulation of a profession should be primarily for the benefit of the general public rather than for the persons who are being regulated. In line with this approach, there is significant emphasis in the Report on developing a robust regulatory framework through the adoption of several governance mechanisms.

The CoE Report notes that a regulator acts as a ‘mini state’ in discharging quasi-legislative, executive and quasi-judicial functions.\(^\text{40}\) Hence, care is taken to ensure that there is separation of powers within the regulatory framework, (i.e., departmentalisation of the regulator), such that the departments within the regulator exercise their quasi-legislative, executive and quasi-adjudicatory functions while within ‘arm’s length from one another to act as mutual checks and balances to address public law concerns’.\(^\text{41}\) Further to this, the CoE Report and the Draft Bill provide for a structured governance mechanism with a Governing Council that is supported by an advisory committee consisting of valuers representing VPOs, the views of which the Governing Council is bound to consider. The Draft Bill goes on to provide for constitution of a ‘Committee of Valuers’ with inter alia, fifteen members nominated by VPOs, and the advice of which shall be considered by the Governing Council.\(^\text{42}\)

Additionally, the CoE Report also requires periodic review and consultation in drafting of regulations by the NIV. Consequently, the Draft Bill has extensive provisions furthering this mandate, as it provides for publication of draft regulations along with an economic analysis of the need for such regulations, which should also be accompanied by detailed provisions on the manner of implementation of such regulations along with the process and timelines for receiving and considering public comments on the same.\(^\text{43}\)

Such provisions are in line with the thinking of the Report of the Financial Sector Legislative Reforms Commission (FSLRC Report) that had proposed several reforms for regulation of the financial sector in 2013, which stressed on the need to ensure that there is no overlap in the legislative and executive functions of a regulator\(^\text{44}\) and that the regulation-making exercise includes cost-benefit analysis and public consultation of the proposals in a systematic manner.\(^\text{45}\)

Development of the Valuation Profession

The CoE Report places emphasis on the need to develop high quality valuation professionals and seeks to achieve this by laying out a detailed and structured mechanism that sets the standards for education as well as delivery of courses. The CoE Report and consequently, the provisions of the Draft Bill,\(^\text{46}\) provide for the institution of a ‘National Valuation Programme’ and a ‘Graduate Valuation Programme’, and also recognises the importance of practice-based learning by requiring mandatory internships as part of such programmes.\(^\text{47}\)
It is noteworthy that the approach to education and professional development of valuation professionals is guided by the need to serve public interest – to make available valuation professionals that provide reliable and quality services to the public. Towards this end, the CoE Report also focuses on the need to promote research and publication and seeks to ensure growth and knowledge development at all stages. This largely reflects the need to develop a highly specialised profession, the requirements of which make it desirable for valuation professionals to stay invested and grow along with it.

**Regulation of the Valuation Profession**

*Standards of Conduct an Eligibility*

As mentioned above, the CoE Report approaches the aspect of regulation from the angle of protection of users of valuation services - towards this end, it also prescribes standards of conduct that need to be maintained in order to build a high-quality cadre of valuation professionals. For instance, one of the primary considerations for development of the profession, as noted by the CoE, is the need to have well-qualified, ‘fit and proper’ persons. Once registered, a valuer will also be required to abide by multiple codes of conduct, non-compliance with which will attract penalties.

*Strict Monitoring and Compliance*

A major responsibility of any regulator involves the exercise of monitoring and compliance functions. Importantly, the CoE Report recognises that the norms of practise proposed to be enforced on the profession should be more stringent than legal controls, and this can be seen in the wide range of powers bestowed upon the NIV to act on complaints and to conduct routine inspections in addition to specific complaints and targeted inspections. Such thinking is prominently reflected in the FSLRC Report which emphasizes that the exercise of supervision and monitoring powers is fundamental for effective enforcement (albeit, those recommendations were made in a different context).

Consequently, the Draft Bill prescribes elaborate arrangements to discipline erring valuation professionals, and, keeping in priority the protection of the interests of users, prescribes provisions that also allow for disgorgement of unlawful gains and payment of compensation in appropriate cases.

The CoE Report thus recognises the need to impose clear liability and a broad range of measures, in order to address and mitigate possible market failures in the market for valuation services, while also providing for appropriate checks and balances to avoid disproportionate responses, given that actions taken by regulators can also impose significant burden on regulated entities.

**Regulating the market for valuation services**

The broad suggestions of the CoE Report favour a framework wherein only registered and qualified professionals, as recognized under the proposed framework, are allowed to provide valuation services in India. In the interests of ensuring that such valuers adopt uniform approaches that reduce the scope of divergence in their valuation methods, and boost their reliability, the CoE Report suggests the need for prescription of India-centric, uniform valuation standards. Accordingly, the Draft Bill provides for creation of a Valuation Standards Committee consisting of representatives from the Ministry of Corporate Affairs, the Ministry of Finance, the Central Board of Direct Taxes, the Reserve Bank of India, SEBI, the IBBI, and so on.

In totality, the CoE emphasises on the need for well-qualified, ‘fit and proper’ persons, who are also adequately monitored and regulated to develop a high-specialised cadre of valuation professionals for developing the market for valuation services in India.
Transitory arrangements

In India, the valuation profession has been in existence for many decades. Therefore, to ensure ‘least disruptive and seamless transition’ into the proposed institutional framework, the CoE recommended several transitory provisions to accommodate the existing valuers in the market. Towards this end, the Draft Bill provides transitory arrangements by specific to three categories of professionals rendering valuation services in India. First, the registered valuers under the RV Rules, 2017 are deemed to be valuers under the new framework. Second, a three-year window is provided for valuation professionals that possess eligibility criteria similar to the RV Rules, 2017. Third, a two-year window is given for valuation professionals that possess the required eligibility criteria under the RV Rules, 2017, but lack the required qualifications. Further, RVOs registered under the RV Rules, 2017 are deemed to be VPOs under the new framework, and until the NIV is constituted, the IBBI will exercise powers and discharge functions of the NIV. Thus, the intention is to make available such a unified framework in a phased manner that is least disruptive to the existing market and practice if valuation professionals.

CONCLUSION

As mentioned in the beginning of this paper, the valuation profession is relied upon for its services in several fields including Tax laws, Companies laws and Insolvency laws, among others. Given the important role played by valuation services in improving the credibility and certainty of several market-based transactions, it is about time there is a unified framework for the regulation of such services, and also contributes to the development of the profession. The implementation of the Draft Bill, as proposed by the CoE, will address a long-standing regulatory lacuna and also help the valuation industry to become more specialised, organised, and valuable than it already is, create more jobs and contribute to the cause of supporting India’s development.

8 Ibid at 19.

9 Jackson and Powell on Professional Liability, Sweet & Maxwell, Ed. 8, 2019 para 2-001.

10 Ibid.

11 The Banking Regulation Act, 1949; the SEBI Act, 1992; the Foreign Exchange Management Act, 1999; the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002; the Limited Liability Partnership Act, 2008; the Companies Act, 2013; IBC.


13 The VP Bill, 2008 provided that the Recognised Institutes were self-regulating organisations, and in order to render services they were required to be recognised by the CVP. ICAI, ICSI, ICoAI were deemed to be Recognised Institutes. Unlike other professions, where elected members from the profession form part of the governing body or regulatory, under the Bill, the CVP comprises predominantly members nominated by the Recognised Institutes and few members appointed by the Central Government. The Council governed the valuation professionals through Recognised Institutes, and the Recognised Institutes were responsible for inter alia registering and imparting education, conduct of examinations, maintenance, and publication of the Register, taking out disciplinary actions as specified by the CVP.

14 For example, the Institution of Valuers, the Practising Valuation Association (India), the Institution of Government Approved Valuers, Indian Institution of Valuers and the Centre for Valuation Studies, Research and Training.


18 Rule 8D of the Wealth Tax Rules, 1957.

19 Rule 8E, 8F, 8H to 8K of the Wealth Tax Rules, 1957.


21 SEBI Act, 1992 read with certain regulations framed therein and IBC.

22 Registered with the Institute of Chartered Accountants of India.

23 Registered with the SEBI.

24 Registered with the Institute of Cost Accountants in India.

25 The Chapter XVII dealing with the Registered Valuers, was first introduced in the Companies Bill, 2008 and was reintroduced in the Companies Bill, 2009. The Companies Bill, 2009 was referred to the Standing Committee of Finance, thereafter a modified version of the Chapter XVII was introduced in Companies Bill, 2011. Subsequently, no modifications were made to Chapter XVII and the Companies Act, 2013 was finally passed by the Parliament in 2013. After enactment of the Companies Act, 2013, the Chapter XVII was finally enforced with effect from 18.10.2017.

26 Ministry of Corporate Affairs, the Companies (Removal of Difficulties) Second Order, (S.O. 3400 (E)) dated October 23, 2017. Under Section 247 of the Companies Act, 2013, the Central Government provided that a registered valuer is required to be a member of a registered organisation. The Central Government sought to remove the difficulty that had arisen as there were a number of different organisations which dealt with various, distinct groups of assets and had separate sets of valuers for valuation. The recognition of these organisations was required as it would have been difficult to ensure the required level of regulation for the valuers by registering them directly with the Central Government. It was also necessary to recognise the varying standards of internal procedures and conduct practiced in these organisations to improve the standards in valuations in order to register the valuers under the section 247 of the Companies Act, 2013.
27 The Companies (Amendment) Act, 2017 which provided that registered valuer shall not undertake valuation of any asset in which he has direct or indirect interest three years before appointment as valuer or three years after valuation of assets.

28 The Central Government delegated its powers and functions under Section 247 of the Companies Act, 2013 to the Insolvency and Bankruptcy Board of India vide Notification No. S.O. 3401 (E) dated 23.10.2017 issued by the Ministry of Corporate Affairs.


30 Rule 5 of the RV Rules, 2017.

31 Second proviso to Rule 5 (1) of the RV Rules, 2017 provides that “the authority may recognise an examination conducted as part of a master’s or post graduate degree course conducted by a University which is equivalent to the valuation examination.” Till date no such examination has been recognised under this provision.

32 Rule 7 of the RV Rules, 2017.

33 Rule 8 of the RV Rules, 2017.

34 Chapter IV of the Rules, 2017.


36 Para 5.3 at pg. 86 of the CoE Report.

37 Para 5.41 at pg. 99 of the CoE Report.

38 See Clause 11 of the Draft Bill.

39 Para 5.17 at pg. 91.

40 Para 5.34 at pg. 96 of the CoE Report.

41 Paras 5.34-5.35 at pg. 96 of the CoE Report.

42 Clause 11(1)(b) and Clause 19(6) of the Draft Bill.

43 Clause 26 of the Draft Bill.

44 Para 4.2 at pg. 33 of the FSLRC Report.

45 Para 2.4.2 at pg. 16 of the FSLRC Report.

46 Clause 49 of the Draft Bill.

47 Para 4.24 at pg. 70 of the CoE Report.

48 Para 3.5 at pg. 56 of the CoE Report.

49 Para 4.26 at pg. 71 of the CoE Report.

50 Paras 4.43-4.44 at pgs. 76-77 of the CoE Report.

51 Para 4.43 at pg. 76 of the CoE Report.

52 Para 4.2 at pg. 32 of the FSLRC Report; Also see Report of the Bankruptcy Law Reforms Committee Vol. 1 at para 4.1.

53 Chapters II and III dealing with Inspection and Investigation and Adjudication, respectively, of complaints and information against service providers.

54 Clause 41 of the Draft Bill.

55 Para 4.1.10 at pg. 41 of the CoE Report.

56 Para 2.31 at pg. 26 of the CoE Report.

57 Clause 21 of the Draft Bill.

58 Clause 50(3) of the Draft Bill.

59 Clause 49(1)(d) of the Draft Bill.

60 Clause 49(1)(c) of the Draft Bill.

61 Clause 53(4) of the Draft Bill.

62 Clause 3(5) of the Draft Bill.
Part IV

Pandemic
Insolvency and Bankruptcy Code has institutionalized and professionalized corporate resolution process which is now transparent, and market led. Today when we mark the three years of IBC, with very constant real time changes which are being brought in, we have reached a stage, where we can stand up for international standards in ease of doing business.

- Smt. Nirmala Sitharaman, Hon’ble Minister of Finance and Corporate Affairs at 3rd Annual Day of the IBBI, October 1, 2019.
INTRODUCTION

The International Monetary Fund (IMF) Chief Kristalina Georgieva has described the COVID-19 pandemic as ‘A crisis like no other’. In April, 2020, the IMF had predicted a positive GDP growth for over 160 countries in the world. Three months later, the forecast has changed to a negative GDP growth in over 170 countries. The World Bank has in its assessment for the quarter ending June, 2020, described this as the deepest global recession since the World War II. The baseline assumption for the global economy is to have a contraction of 5.2 per cent in 2020 and if the spread of the disease and the lockdowns continue for longer periods, then the decline could be as severe as 8 per cent. In South Asia, the per capita growth is projected to decline by 7 per cent. Global trade has seen a sharp fall in the first half of this year. Corporates are facing decline in demand, disruption in supply chains and labour availability and huge financial stress. Services sectors are facing a greater challenge, but the pain is omnipresent across sectors of economy.

Central banks are responding with unprecedented liquidity measures and trying to keep the financial markets running. Governments are announcing measures to control the disease and to provide social protection to the vulnerable sections of society. Advanced economies have taken steps to help businesses save jobs and to resume normal functioning. Countries like India are finding it difficult to match those levels of fiscal stimuli. For an economy which was already struggling with slowdown over the last few years and where the financial system was facing rising non-performing loans, the pandemic has brought in completely unforeseen challenges. The additional stress on the corporate and financial sectors is eliciting multiple responses in India and abroad and many of these are still evolving. There are worries that a large number of companies will face situations of insolvency.

This paper tries to evaluate how the insolvency resolution process has responded to these challenges so far and also seeks to examine the nature of exemptions/modifications announced in relation to insolvency legislations in the European Union, United Kingdom, Italy, Germany, and India. The scope of the paper is not to deal with the laws of these countries exhaustively, but to provide a flavour of the various approaches that have been attempted to deal with the crisis and bring relief to the companies which face the threat of being pushed into insolvency and possible liquidation. These approaches could provide a glimpse into the future of the Insolvency and Bankruptcy Code, 2016 (Code/IBC). The paper also seeks to make certain suggestions on how the Code can adapt to deal with the crisis when the worst is over and balance the objectives of the Code while protecting companies that default on COVID-19 related debts.
INTERNATIONAL EXPERIENCE

European Union (EU)

In the wake of the pandemic, the EU had enacted several measures to enable struggling businesses to get access to credit and financial support to survive the economic crisis that has unleashed. On March 19, 2020, the EU announced a ‘Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak’ which was amended further on April 3, 2020. While the framework was focused on enabling and ensuring sufficient liquidity, a subsequent amendment of the framework on May 8, 2020 focused on the risk of insolvency faced by companies due to the pandemic (consolidated framework, as amended as of May 8, 2020, hereinafter referred to as ‘Framework for State Aid’). The Framework for State Aid recognised the need for granting limited aid in the form of direct grants, repayable advances, tax advantages, to businesses that were not in financial difficulty, as on December 31, 2019 but are facing a sudden shortage of availability of liquidity as a result of the COVID-19 outbreak, aid in form of wage subsidies for employees to avoid lay-offs to certain sectors, regions or types of undertakings, deferrals of tax and/or of social security contributions, public guarantees on loans for a limited period and loan amount, subsidised interest rates on loans, subordinated debt, which is subordinated to ordinary senior creditors in the case of insolvency proceedings. Loans are to be granted at reduced interest rates which are at least equal to the base rates applicable on January 1, 2020 in addition to the credit risk margins as set-out in the Framework for State Aid. Only loan contracts that are signed by December 31, 2020 and are limited to maximum 6 years are eligible for such reduced interest rates. Further, the maximum amount of loan that can be granted to a single beneficiary is also provided in the framework with a stipulation that if the loan has a maturity before December 31, 2020, the loan principal may be higher than if it is for a longer period. Recapitalisation measures in the form of equity and/or hybrid capital instruments to undertakings facing financial difficulties are also allowed. Member states are, however, required to publish relevant information on each individual aid granted. Member states can also decide to support companies in the travel and tourism industry to help them meet reimbursement claims due to the pandemic. The aid provided under the framework however is not meant to preserve or restore the viability, liquidity or solvency of financial or credit institutions even though the measures undertaken might indirectly benefit them. The overall aid amount for each undertaking is capped at EUR 800 000 even if the undertaking is active in several sectors and subject to applicable sectoral caps under the framework. However, the aid for each undertaking in the fishery and aquaculture sector is capped at EUR 120 000 and for those in the primary production of agricultural products, at EUR 100 000 per undertaking. These measures are cleared for being compatible with section 107 (3)(b) of the Treaty on the Functioning of European Union (TFEU) under which the European Commission can allow member states to grant aid for remedying a serious disturbance in its economy. A number of measures were enacted under the Framework for State Aid to support and aid research and response to the COVID-19 outbreak.

United Kingdom (UK)

The UK Government on March 20, 2020, published its Corporate Insolvency and Governance Bill which was enacted on June 25, 2020. The Corporate Insolvency and Governance Act, 2020 (Governance
Act) includes both permanent as well as temporary measures to bring relief to companies which are facing a financial crisis due to the COVID-19 pandemic.

Among the measures proposed is the suspension of the offence of ‘wrongful trading’ to protect directors of companies who could otherwise become liable under this provision as companies face the risk of going into insolvency.24 Under the wrongful trading provision, a director of a company can be made liable if he allows the company to trade after he ‘knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or administration’.25 This exemption will bring huge and much needed relief to the directors as a successful wrongful trading claim can make the director liable to contribute to a company's assets at the time of insolvency. In assessing such a claim, courts also closely scrutinise the director's actions to minimise the potential loss to creditors after he becomes aware of the impending insolvency of the company. In a context such as that of the current pandemic, this essentially creates a paradox where on the one hand, the company may face the threat of going into insolvency because of not being able to run its business due to the lockdown measures imposed, and on the other, directors may risk charges for wrongful trading for commencing trading when the company can resume business operations, which may very well be in the best interests of the company as well as its stakeholders. Another measure to protect companies is the restriction on winding up petitions and statutory demands being filed against companies which are unable to pay their debts due to COVID-19 related reasons unless the creditor has reasonable reasons for believing that COVID-19 has not had a financial effect on the company, or that the facts which cause the relevant ground to apply are without any effect of the pandemic.26

The Governance Act has introduced a provision providing a moratorium for companies to shield them from claims by creditors while they try to restructure and rescue their companies in a difficult time. This provision allows directors to retain control of a company for twenty days after the moratorium comes into force, though a licensed insolvency practitioner has to be appointed who will act as a ‘monitor’ to undertake ongoing assessment of whether the company can be rescued as a going concern.27 Generally, the monitor is required to submit a statement prior to the commencement of the moratorium stating that in his view, it is likely that a moratorium would result in the rescue of the company as a going concern. However, since several companies that were already struggling may have been severely affected due to the pandemic, it may not be possible to meet this requirement in relation to many such companies. In order to ensure that such companies are not adversely affected due to this provision, a temporary provision in the act (valid until September 30, 2020) allows the monitor to make a statement that a moratorium would have rescued the company if it were not for any worsening of the financial position of the company for reasons relating to COVID-19.28

In order to secure supply chains and the continuity in business operations, the Governance Act also amended the Insolvency Act, 1986 to change the nature of termination clauses in supply contracts.29 The UK insolvency legislation prohibits suppliers from invoking termination clauses where the contract is for supply of essential goods when the company has entered into insolvency or restructuring process or is under a moratorium. Termination clauses or any other provision in supply contracts cease to have effect if they allow the contractor to terminate the contract or do anything because the company entered into relevant insolvency procedure.30 However, a companies that become subject to insolvency procedure from the date of enactment of the provision until September 30, 2020 and suppliers that are small entities as defined under the act, are exempt from this requirement.31
Italy

Several emergency measures have been introduced in Italy to ease the burden on companies due to the effects of the pandemic through Legislative Decree no. 18 of March 17, 2020, and Legislative Decree no. 23 of April 8, 2020. The measures have been introduced to protect companies that were already struggling and whose situation has been exacerbated due to the pandemic as well as companies that were financially healthy before the pandemic but are now facing difficulties.

As an instance of one such measure, Italy has postponed the enactment of its Business Crisis and Insolvency Code (Insolvency Code) which was expected to overhaul Italy’s existing insolvency framework set out in Royal Decree no. 267 of March 16, 1942, and which was to come into force on August 14, 2020. The implementation has been deferred by one year to September 1, 2021. The Insolvency Code, inter alia, provides for an alert mechanism to detect when a company is in financial distress and lays a responsibility on the directors of companies to identify signs that indicate that a company is heading towards insolvency and take steps to prevent it from going into insolvency. It was felt that the same would add immense burden in the context of the pandemic where many companies are suffering exorbitant losses due to prolonged shutdown of operations and drop in turnovers.

As part of the emergency measures enacted, companies that face a reduction in equity or share capital below what is legally mandated until December 31, 2020 will not face liquidation. This measure would also prevent the directors of such companies from being held liable for not filing for insolvency or liquidation. Measures taken also include extension of terms for fulfilling restructuring agreements or composition of debt with creditors that were entered into before February 23, 2020 (the date on which the pandemic is seen to have begun affecting companies for the purpose of implementation of these measures) and expire before December 31, 2020, for a period of six months; allowing fresh filing of application before the court seeking extension of up to ninety days for submission of a new restructuring plan or a new composition of debt with creditors that would consider the economic impact of the pandemic, where a restructuring plan or composition of debt has not been approved by court until February 23, 2020; making all petitions filed for bankruptcy between March 9, 2020 and June 30, 2020 inadmissible; extension of period of maturity of loans and mortgages that are expiring before September 30, 2020 and allowing suspension of payment of instalments towards loans or mortgages until September 30, 2020.

Italian law also allows for shareholders to give loan to companies subject to such loans being subordinate to other debts of a company if the loan is granted when the indebtedness of the company was excessively higher than the shareholder’s equity and if the company’s financial situation was such that it needed a shareholder’s contribution. In order to encourage and incentivise such shareholder loans to companies, provisions pertaining to loan subordination have been suspended between April 8, 2020 and December 31, 2020. This is an important measure that is aimed at increasing liquidity in companies and enabling shareholders to rescue companies struggling due to the effects of the pandemic.

Germany

The legislative response to the COVID-19 pandemic in Germany has been very swift. The Act to Temporarily Suspend the Obligation to File for Insolvency And To Limit Directors’ Liability in the Case of Insolvency Caused by the COVID-19 pandemic was published as part of the Act on Mitigating the Effects of the COVID-19 pandemic in Civil, Insolvency and Criminal Procedure Law of March 27, 2020 in less than two weeks after it was proposed by the Federal Government and was given retrospective effect from March 1, 2020 (Insolvency Suspension Act).
Under the German Insolvency Statute of 1994, companies that become illiquid or are over-indebted are required to file an application for insolvency immediately after they recognise that they are unable to pay their debts but in any case, not later than three weeks from when such reasons become known. In case there is a delay in filing such a petition for insolvency, the members of the board can be held responsible to the creditors for the damages caused due to such delay. They can also be held liable for imprisonment up to three years or a fine. The filing obligations with regard to opening of proceedings after a company goes into insolvency has been suspended until September 30, 2020 subject to certain conditions and can be further extended until March 31, 2021. However, to be exempted from this requirement, it is necessary that the reason for insolvency is the pandemic and not any other, and further, prospects must exist for remedying this inability to pay debts. In what can be seen as a reassuring design of this policy though, these requirements are presumed in favour of the insolvent company and the burden of proof for showing that these conditions are not met lies on the third party claiming so. If the company was not insolvent as on December 31, 2019, it is presumed that the reasons for the insolvency of the company are related to the pandemic. In fact, the window to challenge such a presumption has been made very small by stating that any rebuttals should only be considered where there is ‘no doubt’ that the pandemic was not the cause for the insolvency of the company.

In addition to this, a slew of measures, including exemptions under the company law have been implemented to enhance liquidity in companies by incentivising loans from banks as well as shareholders. The possibility of contesting transactions such as with other contracting partners is reduced so as to allay the fears of such contracting partners with respect to repayment obligations of the payments made to them should the restructuring efforts not fructify and the company go into insolvency etc. These measures and steps are expected to help companies come up with effective restructuring options and help protect businesses as a going concern.

**INDIAN CONTEXT**

The Government of India announced several measures aimed at reformation and providing relief to distressed businesses. Some of the measures announced are discussed below:

(a) The Insolvency and Bankruptcy Board of India (IBBI) inserted a new regulation in the Insolvency and Bankruptcy Board of India (Insolvency Resolution for Corporate Persons) Regulations, 2016 (CIRP Regulations) which provides that despite the timelines under the CIRP Regulations, the period of lockdown enforced by the Government of India in response to the pandemic will be excluded from the timelines that are required to be followed in a CIRP, but will remain subject to the IBC.
(b) Similar to the amendment to CIRP Regulations, an amendment has been made to the IBBI (Liquidation Process) Regulations, 2016 exempting the period of the lockdown from being counted for any liquidation process under the regulations.
(c) Under section 4 of the IBC, CIRP can be initiated upon a default of Rs. 1 lakh. However, section 4 empowers the Central Government to notify ‘the minimum amount of default of higher value which shall not be more than one crore rupees.’ The Ministry of Corporate Affairs (MCA) in exercise of its powers under section 4 of the IBC on March 28, 2020 increased the threshold for default to initiate insolvency proceedings against companies from Rs. 1 lakh to Rs. 1 crore. This increase in threshold is aimed at protecting small companies and Micro, Small and Medium Enterprises (MSMEs) from stumbling in the context of the shutdown of economic activities due to the pandemic.
In February, 2020, the Report of the Insolvency Law Committee (ILC)\textsuperscript{47} had suggested revising the threshold of calculating default from Rs. 1 lakh to Rs. 50 lakhs. It had noted that the low limit of Rs. 1 lakh had led to a large number of CIRP applications being filed under the IBC and consequently, enormous pressure on the Adjudicating Authority. This necessitated a review of the threshold limit prescribed. However, the committee had also noted that a distinction must be made between different classes of creditors. A large number of MSMEs are also operational creditors and while their credit exposure is not as high as financial creditors, the enforcement of debt obligations under the IBC has instilled a lot of confidence in these MSMEs. Accordingly, the committee suggested that a different threshold of Rs. 5 lakh only may be prescribed for operational creditors to initiate CIRP. In this context, the decision to increase the threshold of debt default to Rs. 1 crore without distinguishing between classes of creditors may lead to putting MSME creditors at a disadvantage since in many cases, their exposure may be much lesser. While the intent of the government to protect MSMEs must be lauded, it must be borne in mind that MSMEs need to be shielded not just as debtors but also as creditors.

(d) In May, 2020, as part of Rs. 20 lakh crore stimulus package for companies, especially MSMEs, which are threatened with the possibility of liquidation, the Finance Minister announced a slew of reforms.\textsuperscript{48} This includes exclusion of debts incurred by companies due to the COVID-19 pandemic from the ‘default’ calculated under IBC. This is a welcome relief for companies, specially MSMEs and companies in sectors like hospitality, civil aviation and tourism which have been particularly affected by the pandemic.

(e) The operation of sections 7, 9 and 10 has been suspended ‘for any default arising on or after March 25, 2020 for a period of six months or further period, not exceeding one year from such date, as may be notified in this behalf’.\textsuperscript{49} No CIRP can be initiated in respect of any default during such period. This measure is intended to insulate companies from the financial effects of the pandemic and allow them time to restructure their debts and stand up on their feet instead of being pushed into insolvency. It is also a step to prevent tribunals, which are already dealing with a lot of caseload, from getting overburdened. Instead of examining the cause of distress on a case to case basis, a blanket suspension has removed uncertainties and reduced cost of litigation for the struggling companies.

(f) The operation of section 66(2) dealing with ‘fraudulent and wrongful trading’ has also been suspended in respect of defaults undertaken during the period for which CIRP process has been suspended under section 10A of the IBC.\textsuperscript{50} Section 66(2) allows a resolution professional to file an application to make a director or partner of the corporate debtor (CD) liable to make such contribution to the assets of the CD if ‘before the insolvency commencement date, such director or partner knew or ought to have known that there was no reasonable prospect of avoiding the commencement of a corporate insolvency resolution process in respect of such corporate debtor’ and if ‘such director or partner did not exercise due diligence in minimising the potential loss to the creditors of the corporate debtor’. This is an important exemption to protect directors and partners of companies from incurring liability during the pandemic.

Rethinking IBC in the post-pandemic world

As the pandemic situation in the country has emerged during the last six months, there are several districts and municipal areas still under lockdown. Normal economic activities have not yet resumed in many parts of the country. It may be fair to assume that companies will likely deal with the effects of the pandemic beyond March 25, 2021, the maximum period in respect of which insolvency proceedings cannot be initiated. In such a case, it may be necessary that in addition to the measures already announced some more changes are taken up. Some of these could be as follows:
(a) Change in threshold for initiating CIRP against personal guarantors (PGs): While the limit for default on debt to initiate CIRP against CDs has been increased from Rs. 1 lakh to Rs. 1 crore, the threshold for default to initiate CIRP against PGs remains unchanged so far. The Central Government notified Part III of the IBC which deals with the insolvency and bankruptcy of individuals and partnership firms in so far as it applies to PGs of a CD with effect from December 1, 2020. Insolvency against PGs can be initiated for an amount as small as Rs. 1,000.\textsuperscript{51} As companies default on their debt obligations, it is only logical that so will the PGs. The threshold for initiating insolvency proceedings against PGs must also be revised upwards of the current threshold.

(b) Pre-packaged Insolvency Resolution Process (PPIRP): The IBC was introduced to preserve the maximum value of the distressed assets of the CD and enforce the rights of the creditors against the CD in a time-bound and efficient manner through well-defined statutory processes. While the IBC has proven to be an effective step in boosting creditor confidence and enabling India to become more creditor-friendly, it has also led to significant change in corporate behaviour and more cases are being settled between the parties.\textsuperscript{52} However, out-of-court agreements for restructuring the CD’s debts are not recognised or governed by statute. A PPIRP allows a hybrid process whereby restructuring of the CD is negotiated between the creditors and the CD and finally, approved by a formal insolvency resolution process. PPIRP is statutorily recognised in many jurisdictions including the United States and the UK. On April 16, 2020, the MCA invited comments on PPIRP.\textsuperscript{53} A Non-paper on Pre-packs has been drawn up and is being deliberated upon. This matter needs to be carefully thought through. One important factor for the success of IBC is that the debtor loses control of the company and its management with the initiation of CIRP. Another deterrent for errant behaviour has been the prohibition imposed under section 29A on who can be a resolution applicant. Under the proposed PPIRP, if waiver from these two stipulations has to be considered then sufficient safeguards need to be provided so that the provisions are not misused to thwart the whole process. One way out could be to proceed in a calibrated fashion and to start with only MSMEs in the first phase. Since the provisions of the IBC dealing with MSMEs have not yet been notified, an experiment can be done with MSMEs to begin with. It is also a fact that smaller businesses have suffered the most during the pandemic and a resolution process for these entities is badly needed. Besides, using powers given to it under section 240A, the Central Government can notify these provisions for MSMEs without having to go through the process of amending the IBC. Such procedures offer many advantages over the traditional and often, long drawn insolvency resolution process. PPIRP would likely be resorted to only when it is in the creditor’s best interests to do so. This would mean that significant value of the CD may be preserved by avoiding long court procedures with the risk of the liquidation of the CD. Saving costs of insolvency proceedings may also be weighed as an advantage to opt for PPIRP. These benefits to the creditors also offer the chance to preserve business continuity of the CD while ensuring a transparent and cost-effective procedure that also benefits the CD. Further, during a PPIRP, directors of the CD continue to exercise a degree of control over the company. They may use this opportunity to buy the company or use their commercial wisdom and experience of running the company to cut the best possible deal with potential buyers of the company in its interests.

While the broad advantages of PPIRP are many, the finer details of the process will have to be laid down specifically and be suited to the Indian context as well as be in tune with the provisions of the IBC. Concerns regarding the eligibility criteria under section 29A of the IBC being extended to pre-packs, the degree of control to be retained by the directors, protection of interests of unsecured creditors of the company in PPIRP need to be worked out.
The non-paper has broadly distinguished MSMEs from non-MSMEs in that, *inter alia*, PPIRP has proposed to be made compulsory for MSMEs, while voluntary and optional in case of non-MSMEs. The non-paper also suggests that the existing promoter or management of the CD retains control during the PPIRP, though an independent insolvency professional must be appointed by the committee of creditors (CoC). It is, however, felt that PPRIP should be made available as an alternate option over and above the CIRP.

(c) **More flexibility to withdraw cases under IBC post admission:** Currently under the IBC, the Adjudicating Authority may allow the withdrawal of the CIRP on an application made with the approval of 90 per cent voting share of the CoC.54 Section 12A of the IBC was inserted after the Supreme Court’s judgment in the case of *Lokhandwala Kataria Construction Private Limited v. Nisus Finance and Investment Managers LLP* 55, where the court ruled on the question whether the ‘National Company Law Appellate Tribunal could utilise the inherent power under Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 to allow a compromise before it by the parties after admission of the matter.’56 The Supreme Court agreed with the order of the National Company Law Appellate Tribunal that such a power could not be utilised. Understandably, such a refusal was against the tenets of the IBC which was enacted with the aim to enhance the business continuity of the CD while guaranteeing the rights of creditors. A settlement between them, therefore, should be viewed favourably as it is at any stage of the CIRP. However, the Report of the ILC, published in March, 2018, dealing with the issue of ‘Withdrawal of CIRP Proceedings Pursuant to Settlement’ also noted that the objective of the IBC is to ensure participation and protection of interests of all stakeholders as against only the applicant creditor.57 Accordingly, the provision was drafted allowing for withdrawal of CIRP while providing a very high threshold of 90 per cent voting share of the CoC in favour of withdrawal. The provision successfully balances conflicting objectives of the IBC - encouraging settlement between creditors and CD but also ensuring that all creditors participate collectively. Up till December 2019, 135 withdrawals have taken place under Section 12A of the IBC.58 However, in light of the COVID-19 pandemic, there is a need to push more cases of settlement and encourage withdrawal of CIRP under section 12A. In such a case, prescribing a lower threshold to approve withdrawal post admission of CIRP under section 12A may be considered for a limited period of time - time till which companies are expected to deal with the economic effects of the pandemic.

(d) It is extremely important that in these difficult times companies which are viable, and which have not violated any law are assisted in their survival and growth. This requires that an active mechanism be put in place to resolve cases through timely restructuring and rehabilitation of stressed accounts much before these companies reach the insolvency stage. The banking industry, the Reserve Bank of India and the Government have to create such a non-discriminatory regime which is in the best interests of the enterprises as well as the banking sector.

**CONCLUSION**

The COVID-19 pandemic has presented an unprecedented crisis for economies all over the world and India is no exception. Central banks have opened up the liquidity taps. But these measures have their limitations, especially for a country like India. Banking regulators have announced moratorium on loan repayments and forbearance on strict implementation of capital adequacy for financial firms. Governments have come out with fiscal stimuli of the size unheard of in the past. In the initial months, the focus has been on augmenting healthcare facilities and on providing social protection to the vulnerable sections of the population. However, as the economic pain of prolonged or recurring lockdown becomes
unbearable, measures to revive and restore productive activities will now have to take centre-stage. The support must include saving viable companies unable to bear the pandemic-induced shocks. The interventions must be in place for dealing with cases which show early signs of stress and also the cases beyond early stages. The insolvency resolution process can play an important role by being flexible and sensitive to the needs of borrowers and lenders at the same time in a fast-developing situation. MSMEs need a special consideration, so do certain sectors specifically hit by the pandemic. Steps taken by other countries discussed above such as preventing suppliers from invoking termination clauses in supplier contracts where the company is going through insolvency or pre-packs (if enacted) as in UK, allowing relief to contractual partners of the CD during its restructuring efforts by restricting the scope of contesting transactions in case the CD goes into insolvency, as in Germany could provide guidance regarding other measures that can ease the burden of companies under financial distress due to the pandemic.

NOTES

3 Ibid.
4 Ibid.
6 Framework for State Aid, Section 3.1.
7 Framework for State Aid, Section 3.10, Point 42.
8 Framework for State Aid, Section 3.9, Point 40.
9 Framework for State Aid, Section 3.2, Point 25.
10 Framework for State Aid, Section 3.3.
12 Framework for State Aid, Section 3.3, Point 27(a).
13 Framework for State Aid, Section 3.3, Point 27(c).
14 Framework for State Aid, Section 3.3, Point 27(e).
15 Framework for State Aid, Section 3.11.
18 Framework for State Aid, Section 1.1, Point 9.
19 Framework for State Aid, Point 20bis.
20 Framework for State Aid, Point 23bis.
Framework for State Aid, Point 23 (a).


UK Insolvency Act, 1986, Section 214.

Corporate and Insolvency Act, 2020, Schedule 10, Part 2, Section 2.

Corporate and Insolvency Act, 2020, Chapter 3 A9 (2), Chapter A6(1).

Corporate and Insolvency Act, 2020, Chapter 2 A6(1)(e) read with Schedule 4, Part 2, Section 6(1) (b).

Insolvency Act, 1986, Section 233B as inserted by Corporate and Insolvency Act, 2020, Section 14.

Insolvency Act, 1986, Section 233B as inserted by Corporate and Insolvency Act, 2020, Section 14.

Corporate and Insolvency Act, 2020, Section 15(1) and (2).

Legislative Decree No. 14 of January 12, 2019.


Insolvency Statute of October 5, 1994 (German Insolvency Statute), Section 15a para 1 sentence 1 read with Section 19.

German Civil Code, Section 823 para 2 read with German Insolvency Statute, Section15a.

Section 15a para 4, German Insolvency Statute.

Section 1, Insolvency Suspension Act.

Section 4, Insolvency Suspension Act.

Section 1, Insolvency Suspension Act.

Insolvency Suspension Act, Statement of Reasons.


Section 4, IBC.


Section 10A, IBC, inserted by Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, Section 2.

Section 66(3), IBC inserted by Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, Section 3.

Section 78, IBC.


Section 12A, IBC.


ibid.


Supra Note 52.
Global Crisis
Setting the Agenda for Next Generation Insolvency Reforms

Sumant Batra

The Coronavirus pandemic (COVID-19) is the defining global crisis of our time and the greatest global humanitarian challenge that the world has faced since World War II. Along with an unprecedented human toll, the COVID-19 pandemic has triggered a deep economic crisis. Given the magnitude of potential unemployment, business failure and financial-system risk, the global economic impact could be broader than any that we have seen since the Great Depression of the 1930s (Great Depression). The recession will hurt low-income economies disproportionately. India is also facing a significant economic shock. There could be solvency risk within the Indian financial system as a large number of micro, small and medium enterprise (MSME) loans face risk of slipping into default, along with significant per cent in the corporate sector and the retail segment. The pace of recovery will be determined by the policy choices taken to contain the job losses, reduced income levels, corporate defaults and rising non-performing loans.

Amongst the priority policy decisions called for in this time, insolvency law reform assumes great importance. Being a key component in the financial architecture of the country, insolvency law plays a central role in underpinning investment while advancing important social objectives of maintaining public confidence in the corporate and financial sectors and preserving employment through an effective rehabilitation of distressed but viable enterprises. In 2016, India introduced a robust insolvency law in the Insolvency and Bankruptcy Code (Code). Due to its effective implementation, green shoots were already starting to show. The Code is largely a sound piece of legislation. But the rapid developments of the last six months demand that the Code be reviewed urgently, and necessary amendments made to adjust with the change in circumstances. In the past, global events and recessions have triggered major shifts in insolvency policy. The spectre of these events hovers amid the economic turbulence caused by COVID-19. The Government of India (GoI) has announced some measures but they do not offer a complete solution. Surely more steps are under consideration. This paper makes an argument for some bold measures that the GoI might want to consider.

CRISIS AND INSOLVENCY LAWS – A PEEK INTO THE HISTORY

A brief mention of insolvency policy developments in times of crisis may be useful to provide a context to the suggestions made in this paper. The insolvency systems were not always the way we see them today. For centuries, the insolvency laws were draconian and debtors were subjected to severe treatment in the event of a bankruptcy. The law and society viewed the bankrupts as anti-social and immoral characters, and penalised them by forfeiture of property or relinquishment of spousal consortium, surrendering children as slaves, imprisonment and in extreme cases relegated them to “suffer as a felon, without the benefit of clergy,” a polite phrase for the death penalty. Aside from severe
punishments, the bankrupts were routinely degraded and humiliated in public.\(^1\)

Initial change in attitude and outlook towards bankruptcy occurred during the course of the nineteenth century mainly as a result of the economic transformation, rise of industrialisation, separation between company ownership and control, and increase in entrepreneurial activity. Over the next century, bankruptcy legislations in countries across the world passed through a process of change because of many compelling events. The process continues till date.

**The Great Depression**

It was the miseries of the Great Depression of the 1930s which led to the first wave of major insolvency reforms. It all started with an unprecedented stock market crash in the United States (US) on October 24, 1929 which quickly turned into an intense international economic crisis, the worst the world has ever seen. At this time, Munroe Railroad and Banking Co. defaulted on its obligations to its lenders. There was no mechanism in place to address this failure, other than the lender’s right to foreclose and the court’s right to appoint a receiver to take over the debtor’s assets. Because piecemeal sale of the debtor’s assets could result in great financial loss to all, the court, hearing the matter, merged these two legal concepts and ordered that the lender sell the assets all at once as a going concern sale, rather than piecemeal. Amazingly, this tiny innovation in foreclosure practice led to a new way of looking at reorganisation and value. Lenders continued to threaten foreclosure but did not always follow through. Courts began appointing a receiver in each case, who would watch over and protect the debtor’s property and request an injunction against creditor collection efforts.\(^2\) This developed in the Chandler Act of 1938 which allowed for reorganisations in a new chapter XI.\(^3\) In a way, the economic upheaval of the Great Depression prompted the US to innovate to save enterprises and introduce the concept of ‘fresh start’. Soon, Germany introduced Vergleichsordnung in 1935.\(^4\) In 1952, Japan, a trade partner of the US, changed the character of its bankruptcy system in accordance with the American ideals.

**The 1970s Recession**

The first major recession in the post-World War- II era, in the 70s, ushered in the second major wave of reforms setting an era of modernisation of insolvency laws. Again, it was the US which led the way by inserting a dynamic ‘debtor in possession’ based business reorganisation mechanism, that is chapter 11 in their bankruptcy law. The oil crisis compelled the United Kingdom (UK) to take a re-look at the insolvency law. A committee headed by Kenneth Cork was commissioned to propose improvements.\(^5\) The Cork report led to the Insolvency Act, 1986 introducing the ‘credit in control’ system. The insolvency reform process became increasingly global in character. The countries around the world now had the option to select any one of the two defining insolvency systems. India introduced the Sick Industrial Companies (Special Provisions) Act in 1985 (repealed in 2016), inspired from Chapter 11 of the US Bankruptcy Code. The law, borrowed from a free market economy, proved to be a misfit in India’s protected economy.

**The Asian Financial Crisis**

The Asian Financial Crisis of 1997 (AFC) was a major stimulus for insolvency law reform in Asia. Fearing that the AFC might plunge the world economy into systemic breakdown, the G-7 and G-22 put emergency measures into action. Led by the US, leaders of advanced economies pressed international financial institutions to adopt measures to halt the downward slide of national economies teetering on the edge of bankruptcy. The creation of robust bankruptcy systems featured prominently in the reform architecture. In the decade that followed the International Monetary Fund (IMF), the World Bank, the
Organisation for Economic Cooperation and Development (OECD), the Asian Development Bank and UNCITRAL started major initiatives to foster insolvency law reforms. The UNCITRAL Legislative Guide on Insolvency and the World Bank Principles for Effective Insolvency and Creditor/Debtor Regime were amongst key outcomes of this effort.

Indonesia, Thailand, Malaysia, Philippines and Korea were affected the most by the financial crisis. All the four amended their insolvency laws. Each established a publicly owned asset management company (IBRA in Indonesia, KAMCO in Korea, Danaharta in Malaysia and Thai Asset Management Company in Thailand). China and India were not directly affected by the AFC but were nevertheless, struggling with their own domestic non-performing loans (NPAs). China took its own time in fashioning its new Enterprise Bankruptcy Law, which was finally enacted in August, 2006. India set up Eradi Committee, and later, J.J. Irani Committee to review existing insolvency laws and suggest reforms. A separate bankruptcy tribunal and an independent cadre of insolvency procession were among the many reforms recommended by these committees which were reiterated by the Bankruptcy Law Reforms Committee (BLRC) in its report in 2016 and implemented in the Code. Another major outcome of the AFC was the development of out-of-court restructuring processes built mainly on the London Approach. The Reserve Bank of India too framed the Corporate Debt Restructuring mechanism (CDR) in 2001.

**Lehman Brothers - 2008**

Then came the global crisis of 2008 triggered by the insolvency filing of Lehman Brothers. The economies around the world went into a spin. Bankruptcy filings in developed countries, both business and personal, rose at accelerating rates post the filing. For veterans of the AFC, the unravelling of the world economy in late 2008 post the failure of Lehman Brothers had a familiar but chilling resonance. The failure of Lehman defied the ‘too big to fail’ principle. It also underlined the need for a comprehensive resolution system that sets forth in advance the rules under which the government will act following the appointment of a receiver to prevent a ‘run on the bank’ and the resulting financial instability. The focus of policymakers shifted to insolvency system of banks. In US, two areas of reform resulted from Lehman’s bankruptcy and the effect the failure had on the financial crisis: the new Dodd-Frank orderly resolution authority that replaced bankruptcy for ‘too big to fail’ banks, and the elimination by accounting standard setters of the loophole that enabled the use of Repo 105, an accounting technique of Lehman that also allowed balance sheet ‘window dressing’.

**COVID-19 AND GLOBAL RESPONSE**

It is evident from the above discussion that in times of crisis, insolvency laws shifted gears and innovative reforms were introduced. The crisis triggered by COVID-19 is unique as the countries face an extraordinary humanitarian issue due to the spread of virus and deaths caused, and impact on economies. Most countries have announced major financial packages to salvage their fast depleting economies. Many have announced reliefs to debtors against defaults and protection to directors from wrongful trading except in cases of fraud. As of now the reaction of policy makers has been to contain further damage by introducing short term temporary measurers. Surely, international bodies and countries are giving deep consideration to formidable steps needed.

Singapore enacted the Insolvency Considerations for the Singapore (Temporary Measures) Act, 2020 (Act) to provide a party to a contract relief if it is unable to perform an obligation due to be performed on or after February 1, 2020 materially caused by COVID-19. The Act provides temporary relief for businesses, firms and individuals by making modifications to Singapore’s Bankruptcy and Insolvency
laws by raising the monetary debt threshold for personal bankruptcy from $15,000 to $60,000. For businesses, the monetary debt threshold was raised from $10,000 to $100,000. The statutory period to respond to demands from creditors before a presumption of insolvency arises was extended from 21 days to 6 months. Directors have been temporarily relieved from their obligations to prevent their companies trading while insolvent if the debts are incurred in the company’s ordinary course of business. They will nevertheless remain criminally liable if the debts are incurred fraudulently.

The UK announced measures to help companies undergoing financial rescue to keep trading and avoid insolvency, and to continue to get hold of essential supplies. A temporary suspension of the wrongful trading provisions was announced, backdated to March 1, 2020. Expediting of introduction of the new legislation announced in August, 2018 was also announced to introduce a number of new restructuring tools, including the new moratorium to give companies and a new restructuring plan including a “cross-class cram-down” provision, under which a company can bind dissenting classes of creditors amongst other features.

The US enacted the Coronavirus Aid, Relief and Economic Security Act (CARES) to provide an economic stimulus package to support US businesses and individuals. The CARES include revisions to certain provisions of the US Bankruptcy Code in an effort to provide better and more effective bankruptcy relief to small businesses and individuals. The Small Business Reorganization Act of 2019 (SBRA), which was enacted in August, 2019 was made effective from February, 2020 to qualify more small businesses for filing for relief under the new Subchapter V of Chapter 11 by temporarily increasing the debt threshold from $2,725,625 of debt to $7,500,000 for one year. The SBRA is designed to enable small business debtors to reorganise their financial affairs in a more efficient and cost-effective manner while also maintaining more control over their businesses. The bankruptcy process will be quicker with the deadline for filing a plan being just 90 days (versus 120 days in a Chapter 11 case). Debtors are not obligated to pay quarterly US Trustee’s fees, which in a traditional Chapter 11 case can be significant. Creditors’ committees will generally not be appointed minimising the chances of disputes and distractions that a debtor might face in a Chapter 11 case. A standing trustee will be appointed in every SBRA case. Only the debtor is permitted to file a plan of reorganisation, eliminating the risk of competing plans. A Subchapter V plan may be confirmed even if all impaired classes vote to reject the plan.

**INDIAN RESPONSE TO COVID-19**

India promulgated the Insolvency and Bankruptcy Code (Amendment), 2020 on June 5, 2020 to protect the borrowers from default arising on or after March 25, 2020 (the date on which lockdown came into effect) by suspending access to the Code for such defaults for a period of six months which may be extended upto one year. Earlier, the government raised the threshold amount of default for filing insolvency from Rs. 1,00,000/- (one lakh rupees only) to Rs. 1,00,00,000/- (one crore rupees only). It was announced that special restructuring provisions for MSMEs would be framed under the Code. A distressed asset fund for MSMEs was also announced.

The measures announced thus far do not offer a comprehensive response to the circumstances created and likely to develop going forward due to COVID-19 and its aftermath. It is important to recognise that the post-COVID-19 world will not be the same as before. We are already on the cusp of a new world order in which the forces of uninterrupted globalisation process will likely give way to the forces of protective nationalism and self-dependence. The emerging world order will evince more intense geo-
political competitions and tension among great powers – most notably between the US and China. This poses a grave risk to the global supply chains which will produce negative economic outcomes in many countries. This will lead to a realignment of international groups and alliances. In this changing world order, there will be greater scrutiny of foreign investment. These dynamics will compel India to take many quick decisions to adjust its foreign affairs and trade policies with changing times resulting in a churn in the corporate and trading world. The Indian companies will be compelled to rapidly remodel to the shifting goal posts. This could leave many companies unable to change to the new economic order and face the risk of insolvency. Those already going through resolution will likely take longer to come out of the red.

There is however a bright side to this. The World War II devastated large parts of Europe and Asia. However, post-war reconstruction reversed the economic tide bringing three decades of growth in jobs, trade and stock markets. The Indian US$ 150 Billion stressed asset market offers an opportunity to India in this challenge. But to take advantage of this opportunity, some bold and out-of-box decisions are needed. Some are discussed here.

**Stabilise the insolvency industry**

The Code had just about taken off in the middle of the year 2019. In a way, its wheels had just about left earth. Lockdown took the wind out from under its wings forcing the Code to an emergency landing. The Code and its regulations should be serviced quickly and let out on the runway again at the earliest. Keeping it grounded for long or letting it off on the runway without a deep assessment and technical overhaul, will make it a challenging task for a second take-off with same vigour as in the past. The top priority in this exercise should, however, be to steady the insolvency system. Attention should be on stabilising or restabilising, as the case may be, the businesses undergoing resolution, to their pre-lockdown status, if not better. The cashflows would have been severely affected in most cases. The lenders should step forward to make cash available to salvage fast depleting value. Recommencing businesses will be a challenge with restrictions and new rules for operating business in the COVID-19 affected areas, shrunk labour and above all, fear of pandemic. The Insolvency Professionals (IPs) will have to work overtime to keep things under control. Drop in valuation of assets of the corporate debtor (CD) is the biggest of all concerns. There will be demand for fresh valuations by potential resolution applicants (RAs) and in many cases, even the lenders as they use it as a benchmark for approving resolution plans. Many RAs, successful and prospective may show withdrawal symptoms. Managing stressed suppliers seeking advance cash payments will be another nightmare. The purchasers will likely cut down orders owing to lack of demand and may not be able to pay promptly for supplies. There will be pressure to manage costs. The long suspense over the future of the Code during the lockdown has created uncertainty in the insolvency industry in general and amongst the insolvency profession in particular. Confidence building measures are required by the Insolvency and Bankruptcy Board of India (IBBI). The IBBI should consider relieving the insolvency profession of time-consuming and burdensome procedural compliances so that they can focus on managing crisis on hand. With National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT) shut for hearings during the lockdown, backlog would have piled up on their rosters. There will be a mad rush by parties seeking urgent relief in pending cases. The priority of all stakeholders should be to normalise the cases already in resolution. Alongside, the GoI should commence ideating on reforms, changes and other steps needed. Following are some suggestions for consideration.

**Introduce ‘debtor in possession’ features in the Code**

As discussed above, COVID-19 has caused a geo-political churn and escalated tension between the US
and China. Many US corporations have announced that they intend to pull out of China and set up shop in India. Relocating these global manufacturing units to India would require some economic reforms including the Code. The US corporations are accustomed to a ‘debtor in possession’ law. They would find it hard to reconcile to a ‘credit in control’ regime where they will have to surrender management to an IP in the event of a single default to any creditor and be forbidden to bid due to restrictions under section 29A of the Code. Insolvency systems profoundly reflect the legal, historical, political, and cultural context of the countries that have developed them. Given the vast cultural differences around the world, and the history of each country’s economy and attitudes about money and debt, there is no one-kind-fit-all bankruptcy system. Traditionally, the insolvency world has been divided in ‘credit in control’ and ‘debtor in possession’ regime. The US companies are not accustomed to ‘credit in control regimes’ and the Code in its present form could be deterrent to attracting investment from US and its ally countries seeking to shift to India. The Code should be amended to introduce ‘debtor in possession’ provisions, alongside the existing ‘credit in control’ provisions. Otherwise, the US based companies would end up forum shopping and file insolvency proceedings in jurisdictions with familiar insolvency laws. Also, after cross border insolvency law is enacted by India and a foreign court is called upon to decide where ‘main proceedings’ should be held, the choice between ‘debtor in possession’ and ‘creditor in control’ regime could weigh in as a determining factor. In cases, where there is no trust deficit between the creditors and the debtor, a ‘debtor in possession’ law would work better as it would avoid disruption caused by transition of management to IP. Singapore adopted this approach in their recent forms. Other countries too are examining if both options should be available. If India wants to emerge as restructuring hub in which global investors community has confidence, it is important that the Code reflects policy choices that are of universal appeal and are not representative of one form and style of restructuring, that is, ‘credit in control’.

Relaxation in section 29A of the Code

As a follow up from the above point, section 29A of the Code, which disqualifies the persons mentioned therein, including the promoters and management from putting in a resolution plan for the CD, will likely serve as a big deterrent to foreign investors. Foreign companies are more investor-driven than family controlled. Nowhere in the world does such a restriction in the nature of section 29A exist. They will find it hard to swallow this bitter pill. Further, India does not have a developed stressed asset investor market. The GoI has been making efforts to attract these investors and has also seen some success. But, in a post-lockdown world, things will be different. While some distressed asset investors will step back to wait for the right time, others will become overly aggressive and want to buy assets at marked down prices. Due to section 29A, with the pool of bidders shrunk and with liquidity thinning globally, finding investors is going to be more challenging than ever. Section 29A will become a major obstacle in resolution. The section is aimed at protecting the creditors against unscrupulous promoters. There are many honest Indian promoters who are unfortunate defaulters and deserve a second chance, and in particular where no trust deficit exists with the lenders. The government should consider reviewing section 29A. As an alternate to the current restriction, a middle ground could be adopted that permits the promoters to bid for the CD but leaving it to the creditors to decide if they want to play ball with the promoter. Discretion should be with the committee of creditors (CoC) to waive section 29A disqualification by requisite vote if their confidence in the promoter is not lost or where the promoters’ plan is the best among competing plans.

Introduce mediation and arbitration

It is not in the creditors’ interests for their IP to engage in long-winded and expensive litigation particularly where resources available to IPs are limited. Litigation can be time-consuming, expensive and uncertain.
Alternate dispute resolution (ADR) mechanism can facilitate an early and commercially successful outcome for all parties. Mediation in particular has become a very valuable tool for resolving disputes of all kinds in many jurisdictions, including those in the insolvency sphere. A successful mediation can help in minimising risk for the parties, whether that risk be financial, business, reputational, cultural or risk of any other sort. In many countries mediation has become a standard part of most litigation processes, and it has been reported that as many as 60% of all disputes referred to mediation in the Australian superior court system settle. The US and Singapore courts also encourage mediation in insolvency proceedings. India should consider introducing provisions in the Code to make room for ADR.

Small and medium enterprises

MSMEs are the main engines driving employment, economic growth, and entrepreneurship in India. They face the most challenging task in weathering the financial shocks caused by COVID-19. It is MSMEs that need most the support of a sound insolvency system. The Code is designed with the complexity and sophistication of large companies in mind, not to address issues relevant to micro and small businesses. The complexity of the Code is a disincentive for small business owners facing financial distress to seek timely access to the insolvency system. The GoI has already announced that a new framework will be introduced for MSMEs under section 240A of the Code.

Finding a solution for MSMEs within the existing policy framework of insolvency is going to be challenging notwithstanding the flexibility offered by section 240A. Most micro and small enterprises are partnership firms or proprietorships. They would fall under Part-III of the Code, which has been operationalised only for personal guarantors as of now and rules and regulations framed keeping their economic status in mind. When approaching financial distress, small business owners face challenges such as limited information, few financing options, and overlaps between business and personal debt. Their business is heavily dependent on the capabilities, competence, and intellectual property of owners who are often also the managers of business. The ‘debtor in possession’ framework is best suited for them as any disruption or displacement can swiftly destroy value and make resolution a futile exercise. It might be useful to give a closer look to SBRA and borrow some features from it.

Strengthen Out of Court Restructuring

India has amongst the most dynamic out of court restructuring in the world. It was fairly effective but for the few flaws: (a) lack of binding effect due to its voluntary character; (b) inadequate transparency in the process; (c) non-engagement of insolvency experts (it was a very closed door process); and (d) non-participation of non-bank creditors and lenders not signatory to the inter-creditor agreement and other key stakeholders. The GoI is expected to introduce a framework for pre-packaged insolvency (pre-packs) soon. It may already be in operation by the time this short paper is published.

Pre-packs allow a plan for restructuring the debtor company to be solicited in advance of commencement of formal insolvency. The debtor and creditors negotiate and conclude a plan to restructure the debtor company. Eventually, the agreed plan is approved and implemented through the formal process under the insolvency law. Since 2002, pre-packs have been in common use in the global turnaround and insolvency marketplace. But, pre-packs are not free of criticism as they are perceived to be favourable to secured creditors. Operational creditors (OCs) and statutory dues holders may feel left out of the negotiations and advisors may also be conflicted if these problems are not addressed. The Code will need amendments to make way for pre-packs to provide that a pre-negotiated plan operating in the shadow of the Code is agreed by financial creditors (FCs) holding a prescribed percentage of debt, conforms to the laws presently in force in India and satisfies the provisions of the Code in relation to
the contents of the resolution plan. It is important that pre-pack policy is framed by the GoI in deep consultation and coordination with the RBI as it significantly falls in the domain of the central bank.

**Priorities ‘Economy’ and ‘Society’ as two key stakeholders**

The COVID-19 has impacted lives of humans at all layers of the pyramid. Those at the bottom are hit the hardest. The various judgments of the Supreme Court of India in months preceding the lockdown, established the supremacy of the FCs, through the CoC, on approval of the commercial and other terms of the resolution plan. The other stakeholders, be it OCs (including government and its agencies), workmen and other stakeholders were left to swallow the plan with a spoonful of salt. Most OCs run small businesses. Non-payment of their dues has a direct bearing on their sustenance and survival. The GoI is duty bound to protect these businesses in the aftermath of COVID-19. Announcements to this effect have been made. With this shift in the general sentiment, the NCLT, NCLAT and the Supreme Court are expected to and likely will, look at OCs, particularly small non-bank creditors and workmen, more compassionately than in the past. There would be a greater expectation from the FCs to treat other creditors and stakeholders equitably and fairly. Decisions of CoC will invite greater scrutiny in particular when they resolve to liquidate the CD, to salvage jobs and in other cases to satisfy that those creditors who are not on the creditors’ committee are not short changed in the approved plan. Objections to the plans will be heard more patiently by the NCLT than in the past. The jurisprudence will see a tilt in favour of larger economic interest of the country and society. Consequently, the ‘Economy’ and ‘Society’ will emerge as two key stakeholders for some time to come.

**Mitigating the risk of intervention by courts**

The NCLT becomes *functus officio* after the resolution plan is approved by it under the Code. In the aftermath of the lockdown, many RAs whose resolution plans have been approved by the NCLT may seek its modifications. Some may even seek its withdrawal. They will likely rely on force majeure clause or the doctrine of frustration. The NCLT may express helplessness to grant any relief owing to lack of jurisdiction. This could prompt the RA to seek remedy in the writ jurisdiction of the High Court. The GoI should consider amending the Code to provide room for adjudication by NCLT of *bonafide* requests where the lenders are agreeable to such modification. The creditors should adopt a pragmatic approach to requests for review of resolution plans approved by it or under implementation. All the RAs seeking modification should not be viewed from the prism of suspicion. *Bonafide* requests should be offered an ear and consideration. RAs seeking to abuse the situation should be dealt with firmly.

**Bad bank**

India created a Stressed Asset Stabilization Fund (‘SASF’) in 2004 when IDBI was converting to a bank. The SASF helped IDBI swap funds of about Rs. 9,000 crore. SASF experience was not anything to write home about. The main impediment in the success of a Bad bank could be the absence of a turnaround industry in the country. A turnaround professional has the expertise to spot problems and create new solutions, and in the process turnaround the business, operations and cashflows. The turnaround is important so that the Bad bank can offload the asset and recover its investment if not make profit. Bad bank is not a great idea for India as past experience shows. It might not rescue Indian banks from their NPAs altogether but surely can provide some respite in this hard time when the whole economy is under pressure due to the pandemic.
Implementation of Cross Border Insolvency law

Climbing up the World Bank’s Ease of Doing Business ranking has been a key engine driving insolvency reform. No doubt the introduction of a cross border insolvency law based on UNCITRAL Model Law on Cross Border Insolvency (Model Law) will give India another jump. This author has been a staunch advocate of the need to introduce Model Law at the earliest and reiterates that India should enact it soon. But it will be prudent to defer its implementation till measures taken to stabilise the Code are in place. The focus should be on reviving the energy of Code by introducing various amendments many of which are mentioned here. The enactment of Model Law should be linked with the introduction of other amendments to the Code to accommodate the necessary changes needed in the new economic order emerging in post COVID-19 world. It will also be optically unreasonable at this juncture to distract attention from small businesses in need of urgent restructuring and allocate resources elsewhere. The gap between enactment of cross border insolvency law and its implementation can be used to educate people, create awareness and build capacity among stakeholders.

Revive Financial Resolution and Deposit Insurance Bill

The Financial Resolution and Deposit Insurance Bill (FRDI Bill) was introduced in the Parliament in August, 2017 to provide for the resolution of certain categories of financial service providers in distress; the deposit insurance to consumers of certain categories of financial services; designation of systemically important financial institutions; and establishment of a resolution corporation for protection of consumers of specified service providers and of public funds for ensuring the stability and resilience of the financial system and for matters connected therewith or incidental thereto. The statement of objects and reasons for the FRDI Bill provided for establishment of a resolution corporation, designation of certain financial service providers and constitution of certain funds for the purposes of the proposed legislation. The proposed legislation together with the Code was expected to provide a comprehensive resolution mechanism for the economy. The Bill was later withdrawn.

The GoI should revive the FRDI Bill to introduce the mechanism for insolvency resolution of financial institutions after ironing out the controversial issues in the FRDI Bill. Establishing a single regulatory authority for insolvency resolution of financial institutions, CDs and individuals should be considered.

CONCLUSION

In 1991, the balance of payment crisis provided a political opportunity to the then government in office to execute reforms citing pressure from the IMF. The situation in the current crisis is different. There is no international agency at the other end of the negotiating table. India is free to introduce reforms to push its own aspirations and agenda. This is not the time to pluck the low hanging fruit but to mount the tree and grab the seemingly unreachable fruits. Climbing up will also provide a clearer view of the horizon and help make long term policies. India should neither seek status quo ante to pre-lockdown stage nor seek continuity from the past. India should catch the bull by the horns and use this large-scale disruption to launch the next generation insolvency reforms which will propel the country to amongst the top thinkers on the global insolvency table and establish our leadership in the subject. A leap of faith (read, bold reforms) will also induce fresh energy in the insolvency system and galvanise the stakeholders into action.
NOTES


4 Supra Note 3.


Evaluating Policy Options for Economic Recovery

Shubhashis Gangopadhyay

The ‘lockdown’ due to the COVID-19 pandemic meant that almost all economic activities were shut down, especially those that required labour to assemble at a place of work. The ones exempted from the lockdown were activities where labour could work from home or, were in essential services. But, the latter two were also affected adversely in as far as they had business engagements, either as suppliers or as demanders, with the activities that were shut down. In effect, the lock down wound down the economy and many economic transactions ground to a halt. Not surprisingly, the financial markets were also impacted including the market for credit.

The first impact on the credit market has been the looming spectre of (short-term) future defaults and decline (for a longer duration) in the demand for new loans. Given banking norms, this would mean an increase in non-performing assets (NPAs) in the hands of banks. Given the Insolvency and Bankruptcy Code, 2016 (IBC), this would lead to an increase in bankruptcy cases, especially among the cash-poor small and medium enterprises. This translates into a loss of employment and growth not only during the lockdown, but also after the lockdown has been relaxed as defaulting companies and the IBC will have to be scrambling for some time to get the economy back on track.

The problem with stress in financial markets is that it affects all real sectors in the economy. What makes matters worse is that the declining real sector, affected by stress in financial markets, creates a feedback that exacerbates the original stress in financial markets. This compounding effect delays the pick-up in economic activity even after the lockdown is removed. Policymakers, therefore, will have to make the financial markets functional as quickly as possible.

POLICY OPTIONS

There are three distinct policy options to consider, all of which will involve the IBC in different ways. First, do nothing (option ‘N’) to change either the credit contract or the IBC procedure. Given the lockdown, firms will be unable to make repayments of loans that have become due. Creditors will apply to IBC and the bankruptcy/insolvency procedures will kick in. This will create stress in existing assets but that can be handled through direct subsidies to stressed assets. Second, suspend the IBC proceedings (option ‘S’) and ask banks to restructure loans or, advance fresh loans, or roll over loans that have become due. A third option (‘M’) is to suspend the payment of all dues from the borrower to the bank for some time i.e., announce a period of moratorium on loan repayments.

It is important to understand the difference between options ‘S’ and ‘M’. In ‘S’, banks are being forced to deal with non-payment of dues by a restructuring that keeps the current management in place. In option ‘M’, current management continues as in ‘S’, but the restructuring plan is the same for all - no payment of dues from borrowers for some time. Option ‘M’ constrains banks more than option ‘S’. Of course, both prevent bankruptcy, unlike option ‘N’.
Even though all the three options are attempts to kick-start the economy, both the nature and the pace at which recovery happens will be determined by the particular policy followed, and for how long it is followed.

**Diagnosing the nature of the problem**

Almost all transactions in financial markets relate fundamentally to asset values and, by definition, the value of an asset is the present value of all its future returns. This, obviously, makes its value uncertain as the future is uncertain. Uncertainty, by itself, is not a problem. What creates the problem is that the players on the two sides of the credit market have different subjective and objective evaluations of the nature of uncertainty. They not only have different objective knowledge about the uncertainty, they also differ in the way uncertainty affects them. The problem is compounded by the fact that an agent can successfully hide her information as well as her idiosyncratic preference for the risk she faces. This leads to market imperfections and, sometimes, to a complete breakdown of the market mechanisms. The options have to be evaluated based on these, for each lead to different types of incentives for different types of players.

In the simplest example possible, consider three distinct stages of how the information unfolds and who takes what decisions based on their information. This sequence is given in Figure 1. At Stage 1, borrower has specific information about her own characteristics and forms her expectations regarding Stage 3 outcomes based on this information set. The creditor has information on the actions undertaken by the borrower and tries to infer the characteristics of the borrower.

**Figure 1**

<table>
<thead>
<tr>
<th>Stage 1</th>
<th>Stage 2</th>
<th>Stage 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan amount and repayment schedule is determined</td>
<td>Asset operated by borrower</td>
<td>Uncertainty is resolved and contractual obligations are met</td>
</tr>
</tbody>
</table>

In particular, he does not have any knowledge regarding the unobservable characteristics of the borrower, e.g., her preferences towards risk, inherent abilities or precise reasons for undertaking the project - all information known to the borrower but not to the creditor. In Stage 2, based on disclosure norms and verifiable contractual obligations, the creditor has more information than in Stage 1 but this is still not as much information as the borrower has. In Stage 3 project outcomes are realized and all creditor claims are met according to the contract terms agreed upon in Stage 1. This is the simplest standard model of asymmetric information under which the borrower and creditor operates, with the borrower possessing better information compared to the creditor.

What the COVID-19 pandemic has done is to shock the system between Stages 2 and 3 (see Figure 2). While the shock (lockdown) is observed by both, its implications for Stage 3 outcomes are better known by the borrower than the creditor. First, without undertaking a monitoring cost, it is not possible for the creditor to gauge the loss in the project due to the lockdown as the extent of the loss is a function of the interaction between the specific (unobservable) characteristics of the borrower (which are unknown to the creditor) and the lockdown. For example, the borrower may have receivables from essential services that have not been shut down and, hence, this part of the cash inflow into the project is, if at all, affected positively by the lockdown.
The fundamental point being made here is that the expectations under which the debt contract was signed between the borrower and the lender changed once the lockdown was announced. There are two things that were not part of the calculations of either party during the signing of the contract. First is, of course, the pandemic. Second is the loss the banks have to bear. In normal times, the inherent uncertainties in projects, adverse selection and moral hazard arising from asymmetric information and, foreseeable external market shocks, are analysed to generate probabilities of default on loans. Stage 1 contract terms are calibrated to ensure that the probability and the extent of default are covered by payments from successful projects. However, after the lockdown, this probability of loss has simply exploded. The banks are, therefore, more focussed on minimizing losses rather than maximizing returns. This calls for a renegotiation of the contract terms.

One major aspect, not being covered by the policy discussions is the transaction costs that will be faced by banks. In normal circumstances, the creditor does not need to check on project returns as long as its debt is fully serviced. So-called verification costs by the bank kicks in to prevent strategic default and the IBC is an efficient mechanism that keeps such transaction costs low. Costly 'state' verification by the creditor also acts as a deterrent against opportunistic behaviour by borrowers. To credibly commit to this threat, creditors are required to verify only when their claims are not met and not otherwise. In other words, these transaction costs appear only when the borrower defaults. When signing the contract in Stage 1, this probability of default-led verification was part of the calculation of the interest on loans. In the current scenario, however, this probability is close, if not exactly equal to 1!

It is in the interest of the borrower to delay debt repayments and if she can make sufficient noise and petition lawmakers, repayment claims can be delayed longer than is optimal. Since much of our banking assets are with public sector banks, losses made in these banks can be recapitalised by tax revenues. Given that there are only a few private sector banks, this makes policy favouring borrowers more likely.

**EVALUATING THE POLICY OPTIONS**

**Option 'N'**

To evaluate the policy options, we have to consider two different types of defaulting borrowers - one who would have missed payment even without the lockdown and the other who would have made the payment if the pandemic and subsequent lockdown did not happen. There is a third type of borrower (on-line retail companies or essential service providing companies or very cash-rich companies) who can repay in spite of the lockdown. Let $D_1$ be the debt claim on the borrower of the first type, $D_2$ on the second type and $D_3$ on the third type. If $R_i, i=1,2,3$ are the post lockdown values in the project then, by hypothesis, we have $R_1 < D_1, R_2 < D_2$ and $R_3 \geq D_3$. If the lockdown does not bring about any changes in the credit market or the operation of the IBC (i.e., policy option 'N' is implemented), then the bank will verify $R_1$ and $R_2$ but not $R_3$. This verification will happen most efficiently through the IBC procedures.
But what will be the outcome of this process? Let $d_1 < D_1$ (and $d_2 < D_2$) be the amounts that the creditor(s) can collect from the defaulting firm(s). The reduction in the value of the realized part of the claim will be a function of (at least) two (sets of) things: (a) the sector in which the borrower operates and how specifically this sector has been affected by the pandemic and the consequent lockdown and (b) idiosyncratic characteristics and managerial capability of the borrower (both largely unobservable by the creditor). If both these types of borrowers come under the IBC, there are more chances of the two being distinguished as both the potential bidders and professional evaluators will be investigating these assets. This would mean that borrower type 1 is more likely to be shut down while borrower type 2 is more likely to continue operation.

Prior to the pandemic and in more normal circumstances, there have been significantly fewer instances of liquidation of assets through IBC and more instances of insolvent companies changing hands, or being restructured, as going concerns. In other words, the new bankruptcy procedures seem to be avoiding the deadweight losses brought about by liquidation. There is no reason to believe that this would not continue even after the pandemic. Of course, bids for continuing as a going concern may be generally deflated, given the overall drop in economic activity but so will there be a simultaneous reduction in the liquidation value for the exact same reasons. Indeed, it is, and has always been, in the interest of the banks to replace inefficient managers and continue with the asset rather than shutting down the projects entirely.

The point being made here is that the market and third party resolution professionals have a better chance of distinguishing economic distress (a failed asset) from financial distress (default due to cash flow issues in projects of positive net present value).

Why is such an option not being considered? It is largely because of the observation made in the last paragraph of the immediately preceding section. It is politically easier to intervene in the credit market compared to letting market forces work out a new equilibrium in an environment that was not envisaged in Stage 1.

**Option ‘M’**

In this option, creditors are being asked to delay the repayment due to them on the credit they had extended. Let us see what this means for each of the three types of borrowers described above. First, any delay in loan repayment helps all three types. Financial credit has a time cost and delayed payment reduces this cost of the loan to borrowers. Also, in as far as there is some cash with the borrower, and funds are fungible, it enables them to divert these to activities that have a higher recovery rate than the one they are involved in. This harms the creditors of the asset on which the payment has been delayed. And, it certainly helps the type 1 borrower who would have been out even if the pandemic had not struck.

An argument often given for this option is that a type 2 borrower is insolvent now because of the adverse shock caused by the pandemic and will be able to repay as the economy starts recovering. But, if this is true, the financial market experts will be better adept at identifying such possibilities than a policymaker. Indeed, this is exactly what creditors and the market players try to achieve during bankruptcy proceedings and the IBC was designed to accomplish this faster and better. When the going gets tough, the tough get going, is an adage holding for both companies and the regulators!
Option 'S'

Option 'S', or suspending IBC procedures is actually worse than option 'M'. While the moratorium may not increase the exposure to type 1 borrowers, their forced restructuring under 'S' will put good money down inefficient projects. If the policymaker has any political compulsions to help all the three types of businesses, there can be no dispute since economic efficiency may not be the only objective of a society. However, such objectives should be attempted in a more direct manner e.g., by giving direct subsidies to businesses. Since 1991, the reform process has been trying to dismantle all hidden subsidies and make them more transparent. Option 'S' runs counter to that and, more importantly, creates a distortion in the working of a regulatory institution and sets a bad precedent of interference in the functioning of a regulatory institution.

CONCLUSION

One of the main purposes of the IBC was to weed out strategic default by borrowers. Strategic default is possible because of asymmetric information between creditors and borrowers. When a company is brought under IBC, a defaulting company is investigated precisely to establish whether the default is strategic or due to the stochastic nature of project returns or, due to incorrect cash-flow management. These considerations are as relevant under normal circumstances as they are during the pandemic.

An efficient bankruptcy institution enables the system to identify the best possible course for a distressed asset. Suspending this institution’s activities during a recession will not only prolong the slump - as bad companies will persist along with the good - it will also reduce the rate at which the economy recovers when it does. The politics of ‘helping’ distressed firms is going against its economics of weeding out the inefficient. Since the IBC is the best institution in the system to do the latter, it makes little sense to remove it from the implementation of the path to economic recovery.

NOTES

...Now because of Insolvency and Bankruptcy Code, the return of nearly Rs. 3 lakh crore into the system has been assured.

- Shri Narendra Modi, Hon'ble Prime Minister of India in his address at the Republic Summit, 2019, November 26, 2019.
Debt Default, Recovery, and Resolution in a Pandemic
What to expect in the New Normal

Bhargavi Zaveri

That the year 2020 has presented a unique challenge to legal regimes governing debt recovery and resolution around the world, is an understatement. Conventional wisdom on robust contract enforcement, legal certainty, strong creditor protection and speedy resolution can no longer be applied with the same conviction. Policymakers around the world have taken steps to allow households and businesses some ‘breathing space’ from the recovery of dues. Standstills have become the norm, debt recovery the exception.

Policymakers and central banks have primarily used five tools from their arsenal to effectuate this approach: fiscal stimulus to households and businesses, monetary policy measures (including liquidity injection through banking channels), statutory moratoria on debt repayment and suspension of parts of bankruptcy laws. States have also used soft nudges to pre-empt a deluge of litigation and bankruptcies.¹

This article critically analyses three sets of developments in India in connection with standstills and forbearance during the pandemic. First, the moratorium imposed by the Reserve Bank of India (RBI), as the banking regulator, on the recovery of debt by lenders regulated by it. Second, the temporary suspension of the Insolvency and Bankruptcy Code, 2016 (IBC) in its entirety, and third, forbearance offered through court judgements.

How will these forbearance measures affect the state of debt recovery in India? Will they impact all kinds of borrowers and credit segments equally? What will their impact be on credit discipline and overall contract enforcement in India? This article attempts to unravel the seen and unseen effects of these developments for the credit market in India.

RBI MORATORIUM ON DEBT RECOVERY: SOME HITS AND MISSES

On March 27, 2020, the RBI announced a ‘COVID Regulatory package’ comprising several measures to help the financial sector and borrowers deal with the impact of the global pandemic.² A key measure was allowing all lending institutions (banks, NBFCs, etc.) to grant a ‘moratorium’ on installments and interest on term loans falling due until end of May, 2020.³ The RBI, in exercise of its powers as a banking regulator, declared that the deferment of such installments and interest will not be classified as ‘defaults’, and will not be subjected to a classification downgrade in the lenders’ books.

The measure, taken within two days of the announcement of a nationwide lockdown, was well-timed and underpinned by a largely sound design. It offered immediate payment relief to a large segment of the borrowers of banks and RBI-regulated lending institutions. It covered term loans, credit cards and borrowings through cash credits and overdraft facilities, which accounts for over 96 per cent of the
Debt Default, Recovery, and Resolution in a Pandemic: What to expect in the New Normal

outstanding loan portfolio of banks (Table 1). Most importantly, refraining from a regulatory diktat, RBI left it to the lenders to design the moratorium as per their own policies as long as they transparently disseminated the offer and consistently applied it, to their borrowers. The presumption was that in a competitive lending sector, each lender is incentivised to offer the best deal to its borrowers.

<table>
<thead>
<tr>
<th>Type of loan/ advance</th>
<th>Rs. (in lakh crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term loans</td>
<td>57.43</td>
</tr>
<tr>
<td>Cash Credit/ Overdraft</td>
<td>36.07</td>
</tr>
<tr>
<td>Bills payable/ discounted</td>
<td>3.6</td>
</tr>
<tr>
<td>Total</td>
<td>97.1</td>
</tr>
</tbody>
</table>

Source: RBI (as on March 31, 2019)

The measure was challenged in the Supreme Court (SC) on the ground that it was ineffective as it was designed to merely ‘defer’ payment obligations that became due during the six-month period beginning March 1, 2020 and ending August 31, 2020 (RBI Moratorium Period). The interest on these loans continued to accrue and compounded and would be payable by the borrowers after the moratorium period. While the SC adjourned the case to early August after holding a couple of hearings, it questioned the regulator’s wisdom in allowing the interest to be compounded. The court’s intervention in this matter is problematic for several reasons. Two are explained below.

First, the basis for the court’s intervention remains unclear. The question before the court is essentially a policy related question, namely, whether the banking regulator is empowered to relax its norms on asset classification if borrowers failed to repay their loans during the RBI Moratorium Period. Note that the RBI circular merely ‘permits’ lenders to grant the moratorium and assures them that the loan will not be downgraded in the lender’s books if the borrower defaults during the RBI Moratorium Period. Questioning the wisdom of the banking regulator, on grounds other than the constitutionality of the measures, is tantamount to questioning the regulator’s policy. This is a slippery slope which the court must resist even in the most tempting of times.

Second, postponement of the matter to early August - nearly towards the end of the RBI Moratorium Period - created tremendous uncertainty for all the stakeholders involved. Borrowers are likely to decide whether or not to avail of the moratorium depending on the pay-out that they will have to make once the moratorium is lifted. It hindered the ability of lenders to accurately assess the extent of the waiver that the court will ask of them, and consequently make appropriate provision for the defaults. Even if the government were to absorb the loss, estimation of this loss would have to wait until the court’s decision. This left every decision maker in the dark on the size of the moratorium at a macro-economic level and at the level of a household.

Apart from the SC challenge, two other issues may limit the impact of the RBI measure. First, the non-applicability of the moratorium on the interest and principal repayments on bonds issued by lenders, such as non-banking financial companies (NBFCs) and housing finance companies (HFCs). Most of these lenders raise capital through bond issuances, which were subscribed by banks and other financial institutions such as mutual funds and pension funds. While the moratorium applied to the loans advanced by NBFCs and HFCs to their borrowers and resultantly starved them of cash flows, it did not simultaneously defer the NBFCs’ and HFCs’ obligations to service the interest and principal repayments
falling due during the RBI Moratorium Period. At a time when the NBFC sector was already struggling with financial distress, the RBI measure tightened the noose further.

Second, the moratorium spanned at least six months comprising more than one earnings and disclosure season. In the absence of any obligation to disclose the extent to which the moratorium has been availed of, the disclosures of the lending entities have largely varied in quality and detail. Resultantly, the volume, kind and value of borrowers who have actually availed of the moratorium, continues to remain unclear. Data on these aspects is extremely valuable not only to depositors and shareholders of these lending entities, but can serve as high frequency indicators of the manner in which the economy is coping with the lockdown, the number and kinds of defaults and bankruptcies to expect at the end of the moratorium.

TEMPORARY SUSPENSION OF THE IBC: RECOVERY Vs. RESOLUTION

On June 5, 2020, the Central Government promulgated an ordinance suspending the IBC, in its entirety, for a period of six months, which could be extended upto a year. Effectively, if a default is committed between March 25, 2020 and September 24, 2020 (IBC Suspension Period), such default could not be used to trigger the IBC at any point in time in the future.

Several countries, such as the UK, Germany and France have suspended parts of their bankruptcy laws dealing with the obligation of the debtor to file for bankruptcy or creditor filings. Some others, such as Australia, have made other adjustments, such as increasing the duration of the statutory notice preceding the invocation of the bankruptcy law. However, India is one of the few countries to have suspended its entire bankruptcy law. This has two critical implications for debt recovery and resolution in India.

First, it leaves two options open for the reorganisation of the corporate debtor, namely, the regulations for the resolution of stressed assets specified by the RBI in June, 2019 (hereafter, RBI Resolution Framework), and the provisions of the Companies Act, 2013, dealing with schemes of arrangement and compromises. These are not optimal. The RBI Resolution Framework binds only RBI-regulated entities and no other creditors such as foreign lenders, mutual funds, bond holders, vendors, employees, etc. The latter is largely untested in India in the context of financial distress.

This leaves debtor firms – the very firms that the suspension of the IBC intended to protect - in a rather low-equilibrium. To take an example, if the IBC were not suspended, a rational debtor could consider opting for the RBI moratorium at the cost of allowing the compound interest to accrue. If the debtor were unable to repay it at the end of the RBI Moratorium Period, the debtor could have sought reorganisation of the debt under the IBC. However, with the IBC now suspended, it is unclear if this choice would be open to debtors.

Second, large parts of the RBI moratorium period and the IBC Suspension Period overlap with each other, effectively suspending both debt recovery and debt resolution for some time in India. Consequently, the mechanism available to a creditor entirely depends on when the default was committed and by whom.

Tables 2 and 3 illustrate this proposition. Under the current legal architecture, two options are available to creditors for the recovery of their debt, namely, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), pursuing the claim before a Debt Recovery Tribunal (DRT) or in a civil suit or arbitration. SARFAESI allows some types of creditors, namely banks, financial institutions and NBFCs to enforce the underlying security to recover their debt.
The Recovery of Debts and Bankruptcy Act, 1993 sets up specialised tribunals, called DRTs to allow banks and financial institutions to pursue their claims. For the sake of simplicity, Tables 2 and 3 classify the recovery mechanism before a DRT as a suit as the process for recovery under this mechanism is largely similar to that of a civil suit.

For the purpose of reorganisation, creditors have the choice of pursuing a petition under the IBC, a scheme of arrangement or compromise under the Companies Act, 2013 and the RBI Resolution Framework as discussed above.

Table 2 envisages a scenario where a corporate debtor defaults on a term loan due to a bank or NBFC. It is clear that if the default is committed anytime between March 1, 2020 up to August 31, 2020, the only relief available to the creditor is reorganisation under a scheme of compromise or arrangement as it does not require a default to have been committed. This is because during this time, the RBI Moratorium Period runs concurrently with the IBC Suspension Period. Therefore, for example, even if the default is committed prior to the date of the ordinance suspending the IBC, that default cannot be used to invoke the IBC due to the ongoing RBI Moratorium Period.

Table 2: Scenario: Borrower defaults on term loan from bank or NBFC

<table>
<thead>
<tr>
<th>Date of default (2020)</th>
<th>Recovery mechanisms</th>
<th>Resolution/ reorganisation mechanisms</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SARFAESI&lt;sup&gt;a&lt;/sup&gt;</td>
<td>Suits/ arbitration</td>
</tr>
<tr>
<td>March 1 - 24</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>March 25 - August 31</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>September 1 - 24</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Table 3 envisages a scenario where a bond issuer defaults to a bond holder, such as a mutual fund or a pension fund.

Table 3: Scenario: Bond issuer defaults to a bond holder

<table>
<thead>
<tr>
<th>Date of default (2020)</th>
<th>Recovery mechanisms</th>
<th>Resolution/ reorganisation mechanisms</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SARFAESI&lt;sup&gt;a&lt;/sup&gt;</td>
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<tr>
<td>March 1 - 24</td>
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</tr>
<tr>
<td>March 25 - August 31</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>September 1 - 24</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

A combined reading of Tables 2 and 3 shows that for defaults committed anytime between March 1, 2020 to September 24, 2020 (which could be extended to March 24, 2021), recovery and reorganisation mechanisms for creditors in India will differ substantially for different kinds of borrowers and creditors, depending on the timing of the default and the kind of creditor.

One of the objectives of the IBC and several subsequent reforms implemented by the Government and the RBI was to equalise all credit relationships in so far as concerns the recovery and reorganisation options available to them. These policy developments have substantially, even if temporarily, disrupted this agenda.
COURTS: FORBEARANCE Vs. CONTRACT SANCTITY AND PRUDENTIAL NORMS

Even before the policy announcements described above, several debtors and creditors had begun approaching courts seeking relief from debt or a waiver from the enforcement of covenants by creditors, especially covenants that allowed the lender to invoke a pledge of shares underlying the credit. The field is now occupied by court orders granting debt forbearance waiving regulatory prudential norms on a case-by-case basis and inconsistent judgements.

For example, in one of the early cases in the lockdown before the Bombay High Court, the court passed an order injuncting IDBI Trusteeship Company from selling the shares of Future Retail Ltd., which were pledged as a security for the debentures issued by a Future group company.\(^\text{10}\) The reason underlying this relief was a sharp decline of over 60 per cent in the value of the equity stock of Future Retail since the beginning of March, due to the nationwide shutdown. Thereafter, the Bombay and Delhi High Courts have passed similar orders restraining creditors from invoking pledges\(^\text{11}\), and restraining lenders from classifying loans that had defaulted prior to the lockdown, as non-performing assets.\(^\text{12}\) In a more recent case, however, the Delhi High Court allowed IDBI Trusteeship to sell the pledged shares of Zee Entertainment Enterprises Ltd. ignoring the impact of the pandemic on the business or the price of the shares.

These orders are deeply problematic because they are likely to have a long-lasting impact on the sanctity of debt contracts. Similarly, judicial intervention on the manner in which a bank must classify the asset in its books, erodes prudential norms and can potentially adversely affect the financial health of the bank, which in turn, jeopardises depositors and savers. Finally, these orders create deep rule of law issues as none of the orders mentioned above seek to rely on the law or terms of the debt contract, but are driven by the court’s notion of what is just and equitable depending on the exigencies of the situation and the gravity of the pandemic.

These orders will have two tangible effects. First, it will increase the implicit cost of credit in the country. Given the liberal attitude of courts in granting forbearance (even for defaults committed before even the first COVID-19 positive case was detected in India), lenders will seek to build in other forms of security, such as personal guarantees and escrow mechanisms to secure repayment. Second, from the debtors’ perspective, boiler plate clauses in debt contracts, including in particular, clauses relating to material adverse changes and effects, will be negotiated more vigorously. The objective will be to widen the scope of these contractual terms to allow scope for forbearance.

CONCLUSION

A 40,000 feet view of the legislative, regulatory and jurisprudential developments in the credit space in 2020, indicates that while they might work in the short run to shield debtors from the immediate shock of the pandemic, the long-term impact will be hard to quantify. Policymakers and regulators must do everything in their power to elicit better and timely disclosures from lenders on the impact of the RBI moratorium and the suspension of the law.

Given that all debt recovery and resolution mechanisms are nearly entirely suspended, a sensitisation initiative for both lenders and borrowers on the manner in which they could deal with financial distress as economic activity resumes, would also be in order. While lenders would have to be sensitised against the disproportionate use of the bankruptcy threat, borrowers, especially small and micro enterprises, sole proprietors, etc. would need to be familiarised with the concept of bankruptcy and the need to de-
stigmatize the idea of bankruptcy. They would also need support on dealing with financial distress, the legal remedies available to them and the need for transparency and fairness in their dealings.

Could this have been done differently? The answer seems to be mixed. While policymakers got many things, such as the timing of the RBI moratorium and the suspension of the IBC largely right, there was scope for more nuanced interventions. For example, there is near consensus on the view that the IBC should not have been suspended in its entirety and debtors should have been given the option to use the legal framework to voluntarily reorganise themselves. Similarly, this time can be gainfully used to build the ecosystem necessary to support individual insolvency so that as economic activity resumes, individuals, micro and small sized unincorporated entities can use the law for the purpose which all bankruptcy regimes are meant to serve – give a new lease of life to debtors. After all, the essence of capitalism is to reward success and accept failure with equanimity.

NOTES

1 For example, the UK government issued an advisory nudging people to refrain from exercising their contractual rights, in particular with respect to asking for or making payment. Similarly, the state of New York imposed a moratorium on COVID-related commercial or residential evictions from tenanted properties.

2 Notification dated March 27, 2020 bearing number RBI/2019-20/186 DOR.No.BP. BC.47/21.04.048/2019-20 issued by the RBI.

3 This was subsequently extended to August 31, 2020.

4 Since the provisions of the IBC governing individual insolvency have not been notified, this effectively means suspension of the IBC with respect to corporate debtors only.

5 These regulations, titled Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019, were notified by the RBI on June 7, 2019.


7 It might be argued that the circular declaring the RBI moratorium period does not pre-empt lenders from approaching the court for default, especially if the lender’s policy does not grant the moratorium to a specific borrower. However, it would be difficult for a court to accept this proposition, given that the banking regulator has directed all lenders to allow forbearance for certain kinds of loans.

8 If the bank or NBFC is a secured creditor.

9 If the bond holders are secured and the bonds are held by a bank or a NBFC that is eligible for relief under SARFAESI.


11 For example, in Idea Toll & Infrastructure Pvt. Ltd. and Anr. v. ICICI Home Finance Company Ltd. and Anr., the Bombay High Court restricted ICICI Home Finance, from invoking the pledge of collateral and selling the shares of MEP Infrastructure Developers, in respect of defaults committed by MEP prior to the lockdown.

12 Transcon Skycity Pvt Ltd & Ors v. ICICI Bank Ltd. And Ors. (April 11, 2020); Anant Raj Ltd. v. Yes Bank Ltd. (April 6, 2020).
Addressing Distressed Micro and Small Business Debt during COVID-19 Pandemic

Mahesh Uttamchandani, Antonia Menezes and Sagar S. Shankar

The COVID-19 pandemic is expected to unleash a wave of bankruptcies across the globe. According to the Bank for International Settlements, 50 per cent of firms do not have enough cash to pay debt servicing costs over the coming year. Absent government support, the IMF predicts that small and medium enterprise (SME) bankruptcies could triple in 2020. One study forecasts that the estimated median survival time of 7,000 firms in 12 countries ranges from 8 to 19 weeks under a scenario of extreme economic distress and a recent joint study between the World Bank, OECD and Facebook found that, of 30,000 micro, small and medium enterprises (MSMEs) surveyed, 26 per cent had already closed down in 2020 by the end of May.

It is perhaps no surprise that micro and small enterprises (MSEs) are particularly vulnerable to financial shocks. These enterprises are increasingly recognized as being the backbone of many economies but face specific hurdles in using the insolvency system. For instance, many MSEs are unincorporated entities, such as sole proprietorships, and in common law jurisdictions (such as India) these enterprises would be subject to the personal bankruptcy or consumer bankruptcy regime. Moreover, the natural person’s business debts and personal debts are often cominled or include personal guarantees, which can have severe consequences for the entrepreneur and their family, including social stigma and an ongoing debt burden. Unfortunately, in many countries, personal bankruptcy regimes are less developed and offer fewer liquidation alternatives than corporate insolvency frameworks. Secondly, MSEs typically have fewer resources and the ability to resort to formal procedures to tackle financial distress. Thirdly, creditors have few incentives to deal with MSE debtors, the ‘creditor apathy’ problem, and secured creditors are more likely to enforce their debts at the first sign of financial distress. Additional concerns are discussed in detail in a World Bank Group Report.

WORLD BANK GROUP’S INITIATIVE TO ADDRESS MSE INSOLVENCY

The World Bank Group is designated as a global standard setter in the field of insolvency by the Financial Stability Board, alongside the United Nations Commission for International Trade Law (UNCITRAL). In this context, the global World Bank Group Task Force for Effective Insolvency and Creditor/Debtor Regimes (ICR Task Force) has developed extensive reports and new principles (Principles) for addressing the insolvency of MSEs. These Principles are expected to be released shortly, and set out key objectives and policies that countries should consider in the design and implementation of effective MSE insolvency systems. For instance, the Principles recognise that the term ‘MSE’ may have different definitions depending on the socio-economic context and jurisdiction in which it is used, and therefore the core criteria of which enterprises are considered MSEs should be a policy decision.
Overall, the Principles aim to facilitate the rescue and restructuring of all viable MSEs in order to preserve entrepreneurial initiative, whilst aiming to effectively liquidate non-viable MSEs with minimal associated stigma and sanctions. In this context, the Principles promote out-of-court informal restructuring, ideally at an early stage of distress, and a debtor-in-possession model, whilst recognising that qualified and independent insolvency representatives should be appointed to handle liquidations. Following a liquidation process, automatic discharge of good faith entrepreneurs is a primary feature of an effective MSE insolvency regime. One of the objectives of the Principles is to minimise the complexity and costs of ordinary insolvency regimes and promote the use of technology to facilitate procedures.

INDIA’S EFFORTS TO STRENGTHEN THE INSOLVENCY REGIME

The Government of India has made great strides to strengthen its insolvency regime, since enactment of the Insolvency and Bankruptcy Code (IBC) in May, 2016 and the setting up of the Insolvency and Bankruptcy Board of India (IBBI) in October, 2016. Their proactiveness and responsiveness to feedback from stakeholders can be seen in the fact that the IBC has undergone five amendments since enactment, including the most recent in June, 2020, which was a direct response to the COVID-19 pandemic. The IBC has also resulted in the creation of new infrastructure; from creating a cadre of over 3000 Insolvency Professionals to market infrastructures such as Information Utilities and Insolvency Professional Agencies. Put together, these elements have contributed to the success of the IBC in improving corporate insolvency resolution in the country, as is borne out by India’s rapid increase in rankings on the World Bank’s Doing Business ‘Resolving Insolvency’ indicator, where it has gone from a ranking of 137 in 2015 to 52 in 2020.

INDIA’S PERSONAL INSOLVENCY PROVISIONS

Although India’s IBC has been in operation since December 2016, its implementation has been limited to corporate insolvencies and the proposed provisions of the IBC for dealing with personal insolvency and bankruptcy are for the most part still pending notification.

In terms of treatment of insolvent individuals under the proposed IBC framework, there are two primary means of dealing with their insolvency - (a) a fresh start process; and (b) the insolvency resolution process. These procedures, as currently designed in the Code, appear to incorporate several features that the World Bank Principles promote, such as a discharge regime for natural persons.

Regarding implementation of these procedures, the IBBI constituted a Working Group. In its report released in March 2019, the Working Group identified various categories of individuals (such as personal guarantors to corporate debtors, partners/proprietors of partnership/proprietorship firms and other individual debtors) and called for a diversified approach in dealing with their respective insolvencies. As a first step, in November, 2019, the Ministry of Corporate Affairs and IBBI notified specific rules and regulations providing a legal framework for dealing with the insolvency of personal guarantors of corporate debtors. It also notified relevant IBC provisions for such personal guarantors in its notification dated November 2019. This framework is already seeing challenges before the Delhi High Court and it remains to be seen how this will affect implementation of the personal insolvency regime.

SOME PROPOSALS FOR MOVING AHEAD

The Government of India should be commended for its efforts to date in strengthening India’s insolvency regime. However, implementing an effective regime for MSEs will be critical in light of the pandemic
and the expected economic impacts around the globe and in India. An important first step will be for the Government of India to notify the existing personal bankruptcy provisions in the IBC. While doing so, there are additional developments that the Government might consider.

As enumerated earlier, the fresh start process will form a key channel for the resolution of personal bankruptcies of micro-enterprises. There is an opportunity to explore new approaches to the fresh start process by the IBBI, including by integrating information from other credit infrastructure in the country such as credit bureaus and the CERSAI collateral registry, in order to design a quick, non-adjudicatory process. IBBI and the Government might also consider exploring the use of Online Dispute Resolution platforms, which can be used both within a strong pre-insolvency framework to encourage debtors to file for relief before they are in a state of insolvency, as well as in an insolvency proceeding for a MSME, where it can play a role to support negotiations on restructuring or resolution of MSME debts. Complementing such initiatives would be the use of platforms such as Early Warning Tools, which are emerging in the European Union12. Given its track record of fostering innovative public-private goods such as the Unified Payments Interface, Aadhar and others, India has the potential to become an innovator in the development and application of new IT infrastructures for insolvency and bankruptcy and serve as a global best practice for other jurisdictions.

NOTES

1 The findings, interpretations and conclusions expressed in this article do not necessarily reflect the views of The World Bank, its Board of Executive Directors or the governments they represent.
8 https://www.ibbi.gov.in/uploads/resources/e6153215c43ebfcd00b29f946d8005bc.pdf.
With the reorganisation procedure available (through the Insolvency and Bankruptcy Code, 2016), companies have effective tools to restore financial viability, and creditors have access to better tools to successfully negotiate and have greater chances to revert the money loaned at the end of insolvency proceedings.

Proceedings in the Supreme Court of India through the current post-COVID era repeatedly point to the societal and judicial perception that something more concrete needs to be done for businesses that are unable to service loans during this pandemic emergency.

At the time of writing this piece, the Union Government was reportedly asked by the Court to come up with its own position on the subject, without regard to the Reserve Bank of India’s (RBI) policy empowering banks to provide borrowers a breather on servicing of debt.

Indeed, the breathless streaming of threads of tweets from online Court reporters, at times with a spin, disseminating every judicial remark, does not represent final judicial findings. One must remember that the only means for a bench to think aloud and convey a passing thought is to ask a question. To treat this as an expression of judicial opinion would not only be hasty but could be foolhardy. Until the final view is handed down in a judgement, a good open judicial mind may swing, until eventually persuaded by reason and logic.

Yet, the persistent surfacing of queries about the wisdom of policy formulation in the COVID era, underlines the need to actively think about what measures must to be taken next, particularly, with insolvency and bankruptcy law. It was in early June that an Ordinance was promulgated to suspend the ability to invoke the Insolvency and Bankruptcy Code, 2016 (IBC) for defaults occurring after March 25, 2020 for a period of six months or such further period as may be notified. In doing so, not only was the power of creditors to initiate insolvency proceedings suspended, even a voluntary submission to insolvency by the debtor stood suspended.

In parallel, the RBI formulated a policy to give banks discretion to postpone payment obligations of borrowers. This is a framework that enables the banks to delay taking a hit in their own books by providing for non-performing assets (NPAs). But other regulators, who regulate other lenders in the same money market, cannot replicate the approach due to the sheer difference in the objectives and regulatory considerations that would be at play. For example, a mutual fund that has to compute and set out daily Net Asset Values for its schemes for pricing entry and exit of unitholders into the fund’s corpus on a daily basis, stands on a totally different footing. They do not enjoy the luxury of not recognising a NPA, without consequences as serious as shutting the gate for issue and redemption of units. That would be akin to a bank having to prevent cash withdrawals while it adjusts life for its borrowers – utterly chaotic. Therefore, neither the Securities and Exchange Board of India nor the Insurance Regulatory and Developmental Authority have emulated the RBI. A debenture issuance by a borrower may lead to some debentures resting in the hands of banks, who may provide a moratorium, and other portions of the same debenture issue in the hands of insurers and mutual funds.

It is in this backdrop that the blanket suspension of the ability to invoke the IBC, through every route, needs to be reconsidered. The Ordinance promulgated on June 5, 2020 inserts a new section 10A that
takes away the ability to initiate corporate insolvency resolution under section 7 (initiation by financial creditors); section 9 (initiation by operational creditors) and section 10 (initiation by the corporate debtor) ‘for any default arising on or after’ March 25, 2020. Such suspension would operate for a period of six months or such further notified period.

The blanket suspension of all three entry points to the resolution process would mean that even if a corporate borrower were desirous of voluntarily seeking a moratorium permitted by law, it would have no recourse to the IBC, which is the only statutory and legal framework in which, in the best interests of all parties, a package deal can be made enforceable to resolve the debtor and bind all constituents and stakeholders.

Therefore, a legitimate and now-well-tried-and-tested framework to make creditors sit around a table and attempt working out a compromise to save the enterprise now stands suspended. The moratorium under the IBC is mandatory and statutory, overseen by a quasi-judicial tribunal, with two rounds of appellate review. Moth-balling such a framework entailing a statutory moratorium, would naturally lead to a greater clamour for a moratorium framed by regulatory agencies outside the IBC, as is being seen in various writ petitions in courts.

By necessity, any framework outside the IBC would be patchy, with conflicting objectives of different regulators, leading to an asymmetrical approach to issues facing the creditors and debtors. This is not to say that the moth-balling was baseless. When the decision to suspend the IBC was taken, nothing was known about how deep and how bad things would turn out. With the lockdown having run two months, we were on the learning curve. Now, having meditated on the developments since early June, it is time to revisit the lockdown of the Ordinance with an ‘Unlock IBC v.1’ mission.

For starters, section 10 must be released from its lockdown, and debtors who desire to attempt a resolution must be permitted to avail of the IBC framework. Debtors who made ends meet before March 25, 2020, but now unable to do so, would get a reprieve by getting a statutory moratorium to protect them, and a platform to engage with creditors to take a realistic view of matters.

One must remember that the IBC protects the debtor with a statutory moratorium. We already have provisions for statutory protection of the debtor’s ability to transact with society with essentials being supplied to the debtor during resolution. Therefore, opening up the avenue for a debtor who is voluntarily desirous of restructuring, is a vital step. A framework for fiduciary duties to borrowers and other stakeholders rather than to shareholders alone is embedded in the IBC, and there is no scope for a moral hazard.

Other jurisdictions have set some precedents with their handling of the bankruptcy laws. Their policy precedents are of value to study and adapt. The United Kingdom (UK), where the law gives every class of creditors a say, the law has been amended to introduce a cross-class-cram-down concept whereby a class of creditors that does not buy into the resolution plan are prevented from frustrating a resolution, subject to conditions. In other words, the UK has enabled ‘cramming down’ a resolution on dissenting classes of creditors. For India, where the financial creditors hold the key, a cram-down may be considered by introducing a lower voting threshold for approving a resolution plan. The inability of institutions to take a stance on a haircut in these difficult times would also be mitigated if the law enables a nudge recognising the current need to address the extraordinary situation at hand.

The power of financial creditors to approach the IBC ecosystem may be queued up next and the power of operational creditors to approach the IBC may start thereafter. For now, it is time to roll out Unlock IBC v.1.
Small Business and the Insolvency Law

Ajit Ranade

INTRODUCTION

It is four years since the passage of India’s historic insolvency and bankruptcy law. There is now enough data and evidence to take stock of its performance. The performance assessment would be based on observed and unobserved consequences and outcomes. The more lasting and deeper impact of the law might be a behavioral change and instilling of credit discipline which is not readily visible to a researcher. This is a matter for further enquiry. The unobserved changes are directly a consequence of the strength of the enforcement of the code. If enforcement slackens, or if the law itself is diluted, to that extent its potency for change, also suffers.

It is worth noting that the insolvency law is an instrument of economic reforms, to ensure better functioning of debt and credit markets, speedier resolution of distress, lowering the burden of bad loans on the banking system, and a general improvement in the ease of opening, doing and closing of businesses. It is also aimed at maximizing the value of assets under stress of insolvency and unlocking them for productive use. So, the law is not an end in itself, but an instrument to achieve better economic outcomes for the people.

In this article we focus on the specific issue of challenges faced by small business enterprises and what remedy or relevance, if any, is provided by the present insolvency and bankruptcy law.

SUCCESS OF IBC

The objective of the law as framed, was to have a robust framework and mechanism for resolution of insolvency and bankruptcy. The main criteria was that it was meant to work with market principles, its working was to be incentive compatible to all the stakeholders, and most importantly, it was to be accomplished within a stipulated time limit. The time element, and the hard deadline within which resolution or restructuring is to be achieved, is the kingpin of this law and framework. Failure to achieve resolution within the deadline automatically leads to liquidation. The objective of the law is not to lead all cases to liquidation, but rather an efficient and quick resolution, which in turn leads to unlocking of idle capital, revival of economic activity and productive use of all resources. This may or may not involve change in ownership and management of the enterprise. To enhance the chances of success in the working of this law, all those involved in its preparation and drafting went the extra mile. As Dr. M. S. Sahoo, founder Chairperson of the IBBI has pointed out, various arms of the government, as well as different regulators, agreed to special provisions and relaxation in their respective domains to ensure the success in the working of this new law. The company, banking and revenue laws made adjustments, the Reserve Bank of India (RBI), Securities and Exchanges Board of India (SEBI), the
Competition Commission of India (CCI), all readily agreed to amendments in respective statutes and regulations, to remove foreseeable hurdles in the working of the Insolvency and Bankruptcy Code, 2016 (IBC).

Four years later, as the economy struggles to combat a pandemic and deep recession, it can be said that the IBC has worked well, but not lived up to its promise. This may be due to factors beyond its design and derived from the political economy. The various amendments to the law including the relaxation of key features, such as the time limit, might be seen in two ways. Either the changes imply a proactive, pragmatic, and responsive legislature, or it means needless capitulation to vested interests.

The prominent example of the judiciary striking down the RBI’s February, 2018 circular, is a case in point. That circular was meant to mandatorily send all cases of stressed loans to the IBC process, if attempts at restructuring between the borrower and lender failed within a reasonable time. It was a transparent rule and no discretion was to be used by the RBI in enforcing the IBC process. But it was shot down. As former Governor Urjit Patel expressing his dismay, says in his book ‘Overdraft: Saving the Indian Saver’, ‘it is difficult to understand ... that a transparent rule is untenable, but discretion on a case-by-case approach is kosher.’ The record also shows that 4 of the ‘big 12’ cases of willful defaulters referred to by the RBI to IBC are yet to be resolved and even the others could not be resolved in a time bound manner.

There is no doubt that matters have improved after the IBC law came into force. There is now an ecosystem in place, with a proactive, transparent, and communicative regulator, and a new class of resolution professionals whose accreditation is based on principles of integrity and impartiality, among other things. And of course, the formation of new Information Utilities, an innovation of the IBC.

As mentioned in the beginning, the performance assessment of IBC is based on outcomes. If we see the recovery rate of claims made under the cases in IBC, it is about 43 per cent, which is much higher than in pre-IBC days. The average time taken for resolution is substantially lower than 4.5 years that was the average norm during pre-IBC days. More than 4500 cases have been settled even before being admitted to IBC process by the National Company Law Tribunal (NCLT), and the amount recovered in these settlements is quite substantial. This is the deterrent effect of IBC and is testimony to its success. On the flip side, a matter of disquiet is that one fourth of the cases in IBC are ending up in liquidation, where the salvage value is barely 10 per cent. The purpose of IBC is not to lead all matters to liquidation, the strict time deadline notwithstanding.

CHALLENGE OF MICRO, SMALL AND MEDIUM ENTERPRISES

The rollout of IBC marks an era in India’s economic history, wherein the pendulum has shifted toward the creditors. It has enhanced creditor rights, and reduced the relative bargaining power of debtors, whether they be distressed by business downturns, or are willful defaulters. The IBC law recognises two kinds of creditors, namely financial and operational. The former take precedence in terms of seniority of claim, but the interests of the latter are equally important. In this section we examine the challenges faced by small business enterprises, and to what extent does the IBC framework ease those challenges. The IBC becomes relevant to MSME’s mostly when they are operational creditors to large debtors. There are cases when MSME can be financial creditors too.

Worldwide, the problems of micro small and medium enterprises (MSME) are similar. While actual definitions of an MSME may vary from country to country, the following are stylized facts about them:
• They typically find it difficult to raise funding from formal sources, such as banks and capital markets. Hence even their working capital is financed by own funds, informal sources such as friends and family, or buyers’ credit on in rare cases advances from their customers.

• They tend to have over-dependence on a few customers. This concentration of exposure can be a source of secure business in good times, but severe distress in bad times.

• They are usually suppliers or vendors to large corporations.

• Due to smaller scale, they cannot afford overheads and fixed costs.

• Compliance of tax laws and other regulations is a significant burden. Lack of sophistication or financial literacy can be a big disadvantage. Their ability to invest in resources to overcome these burdens is limited.

• In a downturn they usually face acute cash management problems, since receivable payments get delayed, whereas they do not get commensurate credit on the input side. In such cases illiquidity can easily transform into insolvency.

• Their ability to leverage technology or invest in R & D is constrained by lack of investable funds. This affects their ability to innovate.

But despite these characteristics, the MSMEs are critically important to the economy. They also have certain advantages, such as being nimble and agile due to their small size. They are also quicker in decision making since they are run by owner managers, and often they are not bogged down by too many legal, tax or regulatory compliance requirements. They often have extra support in terms of mandated lending quota from banks, or subsidised interest rates, or some protection from bankruptcy.

MSME in India

In India, the small business sector also has legislative support of the MSME Act of 2006. This law has measures for promotion, development, and enhancement of competitiveness of MSME’s. These could be in the form of availability of subsidized credit funds, preferential treatment in government procurement, assistance in training and skills, and capital subsidies. Most importantly Chapter 5 of the Act imposes penalty on any buyer who fails to make payment within 45 days. The Act also specifies how payment delay and related disputes are to be settled. This part of the Act has relevance in the context of IBC. In case of default the MSME could approach the Facilitation Council which can help with payment, or impose a penalty or pass a decree. But in practice this mechanism has met with limited success. The Act also mentions the setting up of the Trade Related Entrepreneurship and Development Scheme (TREAD Scheme) which developed several lacunae and was discontinued in 2017.

The importance of MSMEs for the Indian economy cannot be overemphasised. There are an estimated 63 million units, employing nearly 120 million people, comprising of nearly half of all non-agricultural employment. Together they contribute to nearly half of industrial output and exports. The fact that they contribute so substantially to exports means that they are globally competitive. Perhaps some of the competitiveness derives from being below the radar of certain regulation, or due to low overheads. During the post GST period, since exports were not zero-rated, the delay in getting GST refunds adversely affected the MSME export performance. Access to formal credit via banks or non-bank finance companies is barely 15 per cent of all credit. This is despite a strong push from the Reserve Bank of India for financial inclusion, and also the priority sector tag afforded to the MSME sector by RBI. Clearly the challenge of funding MSMEs is formidable.
**IBC, PANDEMIC AND MSMEs**

The launch of IBC, and inclusion of MSME as operational creditors provided much promise. Would the pending payments problem be effectively addressed? The IBC of 2016 provides for a low threshold of just Rs 1 lakh for any claimant debtor to trigger the company insolvency resolution process (CIRP). This was to empower small suppliers and vendors to also have access to this powerful tool for enforcing timely payments.

Alas, it is not so in practice. Two examples suffice to illustrate. The multi-billion-dollar company Flipkart was dragged to NCLT on the ground that it had defaulted on a payment of Rs 26.95 crore. The case was admitted by NCLT but later stayed by a High Court in Bengaluru. Later in February, 2020, the National Company Law Appellate Tribunal (NCLAT) set aside the insolvency proceedings against the e-commerce giant, on grounds that the (small) vendor had failed to prove existence of operational debt. The second example is of another giant, Aviva Life Insurance which was dragged into insolvency proceedings for non-payment of license fees for use of office premises, i.e. rent for office space. The non-payment was for Rs 27 lakhs. Aviva said it was surprised that a small commercial dispute led to an insolvency order, as if to wind up a giant insurance business. The case was settled before any further development. But it was admitted by the NCLT for sure.

These two and other related cases raised the question whether a small default could be presumption of insolvency of a large company. The NCLT is not supposed to ascertain for itself with an independent test for insolvency. The trigger is simply the default, which is above the threshold amount specified in the law. This low threshold has empowered small suppliers, and even employees in ensuring timely payments without delay. But if a delay or default may not be due to malafide intent, and simply due to other genuine reasons, then pushing the company into an insolvency resolution process may be inappropriate.

In the context of MSMEs, the question has arisen whether the IBC is in danger of becoming a recovery tool, which it was not meant to be. How then do we address the genuine problem of delayed payments?

During the pandemic and subsequent lockdown, the economy went into a nosedive, as three fourth of the aggregate activity was shutdown. The GDP shrunk by 24 per cent during the April to June quarter of 2020. One of the big casualties were the MSME. Due to the downturn, payments have been elongated from both the private and public sectors. The MSME Minister said on record, that the government and public sector companies owe Rs 5 trillion in delayed payments to MSMEs. These are bills not in dispute, and invoices are accepted. Clearing these payments is a high priority and can work as a fiscal stimulus.

Could the IBC have alleviated this problem of delayed payment? Of course not. In fact, during the COVID-19 pandemic, the IBC has been amended (via an Ordinance) to raise the threshold trigger from Rs. 1 lakh to Rs 10 million. This itself means a lot of MSME cannot now take a defaulting customer to NCLT. Another amendment is that IBC itself is at standstill for six months for any default occurring on or after March 25, 2020. The Ordinance says that no initiation of CIRP of a corporate debtor is to be filed during these six months. It is like an IBC suspension. The rationale behind this amendment is that the downturn in the wake of COVID-19 will cause many defaults and possibly bankruptcies, which should be protected from the CIRP. It was also felt that during the pandemic and lockdown period not enough resolution professionals may be available to tackle the expected spate of defaults and bankruptcies. Further, in May, 2020 the Government announced a more liberal definition of MSMEs making it easier for a much wider class of enterprises to be qualified for benefits under various MSME schemes. The government also announced a fiscal package of guaranteed loans worth Rs. 3 trillion for the MSME sector.
It may be noted that the earlier amendment of 2017, of insertion of section 29A was to prevent defaulting debtors to regain control by applying as resolution applicants. This was to bar rogue promoters, who due to their conduct had contributed to the default. The prohibition was also extended to the liquidation phase, so that promoters do not simply end up re-purchasing their company and assets at lower prices during liquidation. But all these restrictions have been waived off for the MSME, with the assumption that for small companies, the promoter is probably best suited to revive the company. Besides there would be very limited interest from third party buyers for such defaulting MSMEs.

**Dealing with Payment Delays to MSME**

Which brings us to the original problem plaguing MSMEs, made worse during business downturns. This is the problem of recoveries and of delayed payments. The IBC is not meant to be a recovery instrument. Nor have the penalty provisions in the MSME Act 2006 helped to reduce the delays. Are there any other options?

In general, the MSMEs do not have the legal or financial muscle to proceed against their (typically large) customer for non-payment. This inability was sought to be overcome by provision in the MSME Act 2006. The threat of penalty imposed on the buyer, if the delay is more than 45 days was supposed to decrease the problem of delayed payments. That does not seem to have had a significant success. In a recent interaction with industry, the MSME minister spoke about exploring the passage of new laws to ensure that major industries, government, public sector units, all pay their MSME vendors within 45 days. The government of India already has an online monitoring system to track delayed payments to MSMEs. As of May 20, 2020, the online system listed unpaid claims of Rs. 413.44 billion. Contrast this with the number quoted by the MSME minister himself and corroborated by industry estimates, which is close to Rs 5 trillion. Hence not even ten percent seems to be the success rate. Of course, this could be due to the deeply distressed situation and liquidity shock caused by the pandemic, lockdown and consequent recession. But it is precisely these situations that the law was designed to address. In boom times the payment delay problems are less acute.

The data shows that more than 4500 cases of insolvency were resolved even before being admitted to the NCLT. This shows that the IBC was somewhat effective, because the buyer paid up, not wanting to get entangled in burdensome insolvency process. But the magnitude of this deterrence of IBC is not clear. Besides, most MSMEs will not have the wherewithal to proceed with the IBC filing. Of course, this proposition needs to be tested. In the meantime, during COVID-19 pandemic, the threshold trigger has been raised from Rs. 1 lakh to Rs. 10 million. There is talk and debate of raising it further, to prevent frivolous usage. Surely a big company should not fear messy insolvency process for defaulting on a minor payment. The larger point is that although IBC is not meant to be a recovery tool, the potential threat of dragging a company to NCLT can and does have some material impact on payments to MSME.

The other mechanism first proposed by the Financial Sectors Reforms Committee of 2008 is the electronic bill factoring exchange. In 2014 the RBI issued guidelines for a trade receivable e-discounting system, and eventually in 2015 the Receivable Exchange of India Limited (RXIL) was setup, and its platform is called TREDs. Two other entities have also been licensed by the RBI, and those platforms are called A.TREDs and M1xchange.

As of about a year and half ago, the total number of bills discounted via these platforms was less than 70,000. The total number of MSME’s brought onto the platforms were probably less than 3000 as per press reports⁴. And the total amount settled was less than Rs. 20 billion. This shows very limited success.
In November, 2018, the government mandated that all companies whose turnover is larger than Rs. 5 billion be brought on the platform, and their bills ought to be discounted. But buyers of these discounted bills, such as banks, need to be convinced of the risk return payoff. The discount works out to be 8.5 to 12.5 per cent, which is a very attractive price. But even then, a much bigger nudge is needed for TREDS to become an effective tool to tackle delayed payments.

Two suggestions are as follows. These have been well articulated in an article by Ananth Nageswaran and Madhuri Saripalle. Firstly, have an automatic linkage between GST and TREDS. Remove the requirement to specifically endorse in the TREDS platform. The principle is that if you accept the invoice for input credit in GST, then it must be deemed accepted for TREDS purposes too.

Secondly, the Government-Procurement Portal (GEM) should also be linked to TREDS since the Government is the biggest buyer from MSMEs. The receivables from the government surely contains very low risk (or zero risk), so that the discount factor would also be correspondingly low. These two suggestions if implemented could substantially improve the situation of delayed payments to MSME’s.

Beyond these, some states have a 'name and shame' approach to putting moral pressure on large companies to pay their small vendors on time. An online portal lists all pending payments, and the matter is sought to be escalated. But this measure, despite its noble intent, is thwarted by the fact that most MSMEs cannot afford to displease or embarrass their customer publicly. This is even more pronounced since quite often MSMEs have only one or two customers, with whom the relationship is lifelong, whereas the matter of delayed payment may be temporary and not chronic.

CONCLUSION

The IBC envisages resolution of a failing yet economically viable firm. This has been upheld by the Supreme Court in the matter of Swiss Ribbons Pvt. Ltd & Anr. v. Union of India & Ors., in which it was held that the Code is a beneficial legislation which seeks to revive the corporate debtor, not being a mere recovery legislation for creditors. In the matter of Binani Industries Limited v. Bank of Baroda & Anr., the NCLAT has stated that the first order objective is resolution. The second order objective is maximisation of value of assets of the firm and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests. This order of objectives is sacrosanct.

In this article we have examined the issue of whether IBC has played any role in alleviating the situation of delayed or defaulted payment to MSME vendors, by their big and small buyers. There is some indication that it has helped, although the scope of the problem is much larger and beyond the domain of IBC. The IBC was not meant to be a recovery tool.
NOTES


6 Writ Petition (Civil) No. 99 of 2018.

7 CA (AT) No. 82, 123, 188, 216 & 234 -2018.
Part V

Path Ahead
Due to the Insolvency and Bankruptcy Code, nearly 3.5 lakh crore have also been recovered by the banks and other institutions.

- Shri Ram Nath Kovind, Hon'ble President of India during his address to the Joint Session of Parliament, January 31, 2020.
New Thinking on Resolution of Small Firms

K. P. Krishnan, Ajay Shah and Susan Thomas

The budget speech of 2015 included a series of measures for supporting micro, small and medium enterprises (MSMEs). One of these was an announcement for a reform of the bankruptcy system to create a new comprehensive bill to replace existing laws. When the Insolvency and Bankruptcy Code, 2016 (IBC) was passed by Parliament in 2016, it became a single resolution framework for the distress of all persons in India, covering both corporate default resolution and individual default resolution. The question that arises is whether the law, as it stands today, serves well to resolve the corporate insolvency of MSMEs efficiently. The reason to differentiate between MSME and the larger firms in corporate insolvency resolution is often that the MSME have features closer to an individual than a firm in terms of a smaller degree of existing organisational capital to be preserved and lower complexity in credit relationships. This suggests that it should be easy to wind up these entities and for the entrepreneurs to start afresh. On the other hand, small businesses assets are more tightly interlinked with personal assets of the entrepreneur. While a single creditor, who has the dominant power in negotiations during an insolvency, can put a possibly viable enterprise into premature closure, the lack of clear separation between business and personal assets can make this a long-drawn-out process.

The international discussion about insolvency resolution for MSMEs tend towards having a more explicit role of the debtor in triggering insolvency resolution and allowing for a debtor-in-possession model during the resolution process. In order to manage the moral hazard problems in a debtor-in-possession approach, there is a greater onus placed on disclosure by the debtor. Information is to be disclosed in pre-defined, standardised formats at regular frequency and strict monitoring by third parties. Further, information captured and monitored about the business assets of the business during the entire life of the business, as opposed to just during the time of distress, helps with clarity of asset partitioning during insolvency and bankruptcy resolution. In this spirit, the United Nations Commission on International Trade Law (UNCITRAL) draft legislation on MSMEs recommends a business registry framework where MSMEs can be registered and information available about them to improve their access to finance as well as to enhance the availability of their business opportunities.

Thus, a central element in facilitating the development of the MSMEs, while maintaining their objectives, comes at the cost of higher information disclosure and monitoring. In this paper, we conclude with the suggestion that the IBC was designed with features that are strengths in the operations of an MSME as a going concern as well as for an MSME which entered into financial distress. Of these, a key feature is the institutional infrastructure of regulated information utilities, which can enable filing and storage of information by debtors. This was originally visualised to allow secure yet easy access of credit and asset security information to all parties in the IBC ecosystem including creditors, insolvency professionals as well as the judiciary. What is useful to note is that such a system can also enable a platform for mandatory reporting and disclosures by the debtor during the insolvency and bankruptcy proceedings in a low cost manner. From the perspective of the IBC, these are functions that can readily be satisfied.
by the information utilities which was visualised as a repository of information about credit contracts as well as the assets and operations of the debtor.

FACTS ABOUT SMALL ENTERPRISES IN INDIA

MSMEs are widely seen as a source of employment in the economy and, because of this, are perceived as important for economic growth. This makes them a target of policy interest. The starting point in designing public policy is to know and understand who the MSMEs are, including what the objectives of the enterprises are, what their assets and liabilities are, and the details of the operations of their business models. Unfortunately, there is little information that is readily available about the MSMEs, either in terms of organised data-sets or in terms of existing research. Most studies about the choices and behaviour of firms tend to be restricted to the large sized, long lived, and listed firms because there is ready information available about them and whose behaviour is explained using profit maximising objective functions. However, Hurst and Pugsley (2011) argue that the small business entrepreneur does not necessarily go into business to target larger scale of operations or to achieve large profits, but instead for non-pecuniary benefits. This suggests that the choices of MSMEs may not necessarily be consistent with the choices made by larger firms whose objective is to optimise. While a low debt to equity ratio for a large firm may indicate a low access to finance, this may not necessarily be true for MSMEs with similar levels of leverage which may settle on a low leverage by choice rather than constraints. Thus, policy to facilitate the development of large firms may not be suitable as policy for the development of MSMEs.

Part of the problem of a single framework for MSMEs is the wide variation in the forms of MSMEs across countries. The most widely used classification of firms as MSME is by the number of their employees. For instance, USA classifies MSMEs on this basis. Most other countries employ a combination of number of employees as well as some measure of size by way of net-worth or turnover, from the countries of the EU to those in the Far-East Asian regions. The thresholds based on which an enterprise is micro, small and medium can vary across countries, but the underlying features remain the same.

India is an exception to this rule in that MSMEs are identified and classified based on the quantum of a firm's investment in plant and machinery. Thresholds of the quantum of investment is specified to classify firms as micro, small or medium. These thresholds differentiate between manufacturing and services firms as well. Thus, until the first quarter of 2020, a manufacturing firm that invested anything less than Rs. 2.5 million in plant and machinery was a micro manufacturing enterprise. A manufacturing firm that invested between Rs. 50 million and Rs. 100 million was classified as a medium manufacturing enterprise. In between these two were small enterprises. These thresholds were lower by 2.5 times for defining MSME services firms. These firms are registered by the Ministry of Micro, Small and Medium Enterprises set up under the Micro, Small and Medium Enterprises Act 2006 (MSME Act). The ministry designs and implements policy to help the development and growth of MSMEs, including implementing credit support schemes specifically for these enterprises.

In 2018-2019, there were 63.3 million firms that were classified as MSME with 63 million classified as micro enterprises, 30 thousand as small and 5 thousand as medium enterprises. These firms were estimated to account for 29 per cent of the GDP in the country that year. Further, they account for around 110 million employees with 108 million estimated to be employed in the micro enterprises.

In addition to firms registered under the MSME Act, firms that are registered as limited liability companies with the Ministry of Corporate Affairs (MCA) under Companies Act, 2013 may also
meet the criteria for the MSME enterprises. As of 2019, there were a total of 1.1 million firms registered with the MCA. There were 110,000 new firms that were registered in 2018-2019 alone, many of which are likely to meet the MSME requirement. Sharma and Sinha (2020)\(^5\) analysed the firms available in the CMIE Prowess database for 2018-2019 to examine if any of these firms satisfied the MSME classification criteria. The data-set had 7689 manufacturing and services firms which were not subsidiaries or firms involved in wholesale or retail trading, or firms that had missing financial observations. Of this subset of firms, 2488 firms could be classified as MSME. This is around 33 per cent of the data. This subset can be used as a benchmark for what we can expect is the number of firms registered by the Registrar of Companies at the MCA as MSMEs. In the first quarter of 2020, the MSME classification was changed to include turnover as part of the MSME definition, along with higher thresholds for the investment in plant and machinery for the three categories of firms. This reduced the number of MSMEs from 2488 to 1444, or to 19 per cent of the MCA firm data.

Lastly, as elsewhere in the world, MSMEs in India proliferate in the form of proprietorship. These are typically registered under the Shops and Establishments Act at the level of each State.

Across all these different entities, there is great variation in the availability of systematically organised data-sets that are available or have been systematically studied other than the firms registered with the MCA. The Ministry of MSME publishes estimates of the number and turnover of their registered MSMEs, along with the number employed as well as the industry sectors where the MSMEs operate\(^6\). As far as we are able to tell, there is no access to the underlying information about the balance sheet or the annual operations of these entities. Information about proprietorships are collected at the level of each State, and there is no reliable access point in the public domain to obtain or analyse this data. We find that, unlike in jurisdictions such as USA and the UK where there are efforts to collect information on small businesses through regular surveys of these small businesses that are administered in a timely manner (Hurst and Pugsley, 2011; Davis et al., 2016\(^7\)), there are no reliable data sources that are yet available about small business in India. There is some information in an All India Census conducted about the MSMEs at some frequency, but these tend to be outdated and the information collected is limited.\(^8\)

Two relatively recent sources that can potentially help in providing some information about these firms are (a) the MCA-21 database of the MCA and (b) private institutions such as credit rating agencies of the MSMEs and MSME information aggregators like Dun & Bradstreet India or CMIE, and FinTech credit platforms. There is well established research that shows that credit information collected for MSMEs through such platforms improve the access to credit for MSMEs substantially (Kallberg and Udell, 2003\(^9\)). However, this information is not made readily available to the public. In the following section, we present some preliminary work from a project\(^10\) about the financing patterns of MSMEs.

**Financing sources**

Firms finance their operations and project development from a variety of sources, that can either be thought of as being equity or debt. Debt can be in the form of borrowings and current liabilities, with the distinction that borrowings are funds raised from various financiers with a promise to repay with interest, while current liabilities are payments that the firm owes to their trading partners or to cover expected losses in the form of provisions, and other liabilities such as unpaid dividends or pre-paid income. All firms start with equity as the first source of finance. Through their years of operations, they tend to also have debt in the form of current liabilities and borrowings.
Table: Sources of funds for Large firms and MSMEs, 2014-2017

This table shows source of funding for two sets of firms: Large firms is a set of 17,350 firms from the CMIE Prowess database, while the other columns use data for a sample of 4600 firms from the MCA-21 database. The data is for a two-year period 2015-2016 and 2016-2017. Each value reported is calculated as a ratio of the sum of funding from a source across all the firm observations in the sample over the sum of the total liabilities for the same set of firm observations.

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</table>

Source: CMIE Prowess for the Large firms and the MCA-21 database for the rest

Table above shows the fraction of funding that the average firm in the CMIE Prowess database has across Borrowing (which is collected as loans from formal financial sources, short-term and long-term), Current liabilities (which is largely supplier’s credit, advances and deposits and has a short-term nature) and Equity (which includes both externally raised funds as well as retained earnings). This is a conservative picture of financing for small Indian business, since it uses data for a small sample. But this does provide a few interesting features of how MSME finance differs from the larger sample of registered firms. The first is that MSMEs depend more on equity financing compared to the large firms, and the large firms tend to have more Current liabilities funding than the MSME firms. Finally, borrowings from formal financial sources appear to be a higher fraction of funding for Construction and Manufacturing MSMEs which supports the notion that borrowing is more readily available in industries which have physical collateral to offer than those without (such as services and trade).

The MCA-21 sample dataset does not have information about the number of employees. However, we do observe the age of the firms in this sample. A surprising observation that emerges is that the funding patterns described above are agnostic to the age of the firm. We observe that older firms (above 10 years) tend to have more financing through equity than younger firms. This suggests that as firms age while still remaining small, they tend to finance themselves more through retained earnings rather than through formal financial borrowings.

Given the size of the sample, we reiterate that this must be treated as indicative only. Nevertheless, this snapshot does add to the perception that access to credit is a feature of small business in India. But, the presence of a significant fraction of old firms among the firms of the MCA-21 data-set suggests that, like the observation in the study on the small US business, the lower leverage might indicate a deliberate choice to stay small instead.
RETHINKING THE INSOLVENCY OF SMALL ENTERPRISES

Traditionally, there has been no separate legal framework for resolving MSME distress. They are treated as firms in insolvency or bankruptcy, which is resolved under the provisions of companies law. But over the last two decades, there has been an increasing recognition that MSME cannot be treated under the same legal assumptions as larger firms.

One feature is that MSMEs do not have the complexity of credit relationships that large firms have, with loans from multiple financial firms. The decision making is likely to be simpler because the resolution decision is likely to rest with a single financial firm rather than a consensus decision across multiple firms. On the other hand, the concentration of decision making means that the single financial firm is likely to have the balance on power in the negotiation leading to closure of viable enterprises.

Another feature of the MSME that differs from the typical large firm is the lack of clear separation between personal and business assets of the promoter/entrepreneur. Very often, the assets in small firms will be jointly owned by various family members of the entrepreneur. In an environment where lending is dominantly against secured credit, this introduces the challenge of how to protect the small business entrepreneur’s property rights against the need to ensure that the secured creditors can protect their interests so that they continue to be incentivised to lend to small businesses.

In these features, resolving MSME insolvency is closer to individual insolvency than to corporate insolvency. However, it is simultaneously clear that there is organisational capital in an MSME which deserves to be preserved if the MSME is a viable, going concern. The challenge is to combine the features of preserving enterprise value for viable enterprises while allowing a fresh start to entrepreneurs who are not viable so that their property rights are protected in bankruptcy.

More broadly, when designing the insolvency and bankruptcy resolution framework for an enterprise, it raises the need to keep in mind the objectives with which the enterprise is created. Insolvency and bankruptcy resolution laws must not be so onerous that these become the dominant consideration in the decision to create and operate the enterprise.

A rich source of work which takes the holistic approach to identify the optimal framework to deal with development of MSMEs as distinct from larger firms is the UNCITRAL Working Group on MSMEs. The development of MSMEs is part of Goal 8 of the United Nations Sustainable Development Goals (SDG) charter and the UNCITRAL Working Group on MSMEs has proposed a new form of enterprise called the UNCITRAL Limited Liability Organisation (UNLLO) that represents a general form of MSMEs which is distinct from companies and individuals. They identify the requirements common to MSMEs, regardless of their form, as follows:

- **Autonomy and flexibility** in the forms under which the enterprise can be setup and operationalised.
- **Simplicity of rules and terms of operations** of the business, so that neither the legal establishment nor the operations is a costly nor a lengthy or time-consuming process.
- **Legally recognisable identity** that can help the entity get visibility and credibility when dealing with other entities, companies and persons. This becomes particularly important in improving access to financial markets or in international trade.
- **Certainty of property rights** which will allow entrepreneurs to control assets in order to access finance but will also allow them to use asset partitioning to protect personal assets from business claims.
Control over their business which will allow them to exercise management control in decisions related to administration and business strategy. In return for these features, these entities would have to adhere to the discipline of visibility and transparency of operations. The framework therefore makes registration with a business registry a requirement (UNCITRAL, 2019). This enables MSMEs in a jurisdiction to be registered in a manner that information is visible more broadly to the formal economy, both domestic and international. In addition, certain records of information have to be maintained on a regular basis by the entity including: the registration information, rules of the organisation, names of all shareholders, past and present, financial statements, tax returns and records about their activities and operations. This information allows visibility on the MSME with the type of details that facilitates both financing as well as business transactions. It also has the added benefit that, in insolvency, access to such information allows for lower asymmetry of information for all parties which has the potential to reduce both costs of, and time to, insolvency resolution.

The above list of requirements suggests a larger role and participation by the MSME entrepreneur to lead insolvency and bankruptcy resolution processes. Thus, the insolvency process must allow the debtor entrepreneur to trigger insolvency resolution, and if the insolvency application is accepted, it must allow for a debtor-in-possession model during the resolution and for the entrepreneur to propose a resolution plan for the distressed enterprise. In return, the process must have in place elements to ensure that the creditor does not lose trust that their interests will also be taken into account in the resolution. There are stringent requirements of disclosure on the debtor that enterprise assets will not be stripped during the process. It is important to have a third party like a insolvency professional to monitor and verify the disclosure to ensure that the systemic integrity is maintained.

CONCLUSION

The prime focus in the IBC was upon the bankruptcy process of large firms. The trade-offs in institutional design for large firms differ from those of small firms. In order to think about the bankruptcy process of small firms, it is important to carefully look at the stylised facts about small firms and envision how their bankruptcy process could best be organised. In this article, we have shown some principles that can guide such thinking. It is likely that the ‘information utilities’, that were originally envisaged by the Bankruptcy Legislative Reforms Committee (BLRC), will prove to be an important part of the answer. In the design of the IBC, this industry was visualised and designed in order to capture essential information about both financial and operational credit contracts and the repayment performance of all the persons that can use the IBC as the forum to resolve their insolvency. In order to service the wide range of entities that form the domain of MSMEs in India, there are several advantages to the design adopted for this industry - a private competitive market of information utilities that have to be interoperable to ensure both access as well as economic efficiency.
NOTES


3 Hurst and Pugsley (2011) include flexible working hours or not working for a boss as examples of non-pecuniary benefits of starting an enterprise.


8 For example, the results of the Fourth All India Census on MSME was conducted in 2006-2007, http://www.dcmsme.gov.in/publications/census10.pdf.


10 This project was undertaken at the Indira Gandhi Institute of Development Research titled “A cross-sectional study of firm financing patterns using the MCA-21 data-set” using a grant from the MCA under the “Guidelines for Funding Research and Studies, Workshops and Conferences etc. under the Plan Scheme Corporate Data Management (CDM) of the MCA”.

11 Supra Note 1.

12 SDG 8 is to “Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all”, with particular attention to the growth of the MSME particularly through a higher access to finance.


मुक्ति का ये अभियान कारपोरेट वर्ल्ड में भी चला। IBC बनाकर हमने status quo बदला और हजारों करोड़ रुपया की वापसी सुनिश्चित करने के साथ ही मुसीबत में फंसी कंपनियों को एक मार्ग भी दिखाया। वरना हमारे वहां one way था... आ तो सकते थे लेकिन लिकल नहीं सकते थे हमने लिकलने के लिए भी अवसर पैदा किए हैं।

- Shri Narendra Modi, Hon’ble Prime Minister of India in his address at Global Business Summit by Economic Times, March 6, 2020
Building a Personal Insolvency Framework
Fresh Start and Beyond

Shashank Saksena

The policy frameworks for personal insolvency have evolved in an interconnected world, and that is why we see an explosion of reforms of the personal insolvency frameworks, on the one hand, and also the emergence of some general principles and rationales behind this development, on the other hand. Many legal frameworks emphasise the social insurance aspect of consumer insolvency laws. According to this view, debt forgiveness provides relief to the financially stressed households existing outside the social safety net and therefore functions as an ‘insurer of last resort’. There are two perspectives underlying this framework, namely, an economic perspective and the social perspective. The former maintains that debt-discharge fulfils the fundamental economic definition of insurance. It reallocates risk from a debtor (the insured) to its creditor (the insurer), for which the creditor may require recompense in the form of a higher interest rate. The debt-discharge in bankruptcy is social insurance as compared to private insurance because it is an essential aspect of the relationship between debtors and most unsecured creditors where the debt-discharge right of the former cannot be renounced. The alternative social perspective is that bankruptcy is a kind of social insurance that has more functional significance than a matter of economic theory. Hence bankruptcy framework is effectually an ‘insurer of last resort’, providing a kind of protection to individuals who are inadequately protected by the legal and institutional regimes designed to promote economic security. These scholars have relied less on the risk-transfer function of bankruptcy and have appraised bankruptcy more as a reflection of wider socio-economic difficulties. If we consider the bankruptcy framework in the broader social insurance framework, then its optimal role in achieving the intended outcome could be examined. We may evaluate the relative costs of bankruptcy protection and those of other schemes of social safety net to conceptualise the least-cost strategy under the personal bankruptcy framework, especially the ‘fresh start’. Such costs include administrative costs, costs related to self-insurance, moral hazard, and macroeconomic costs to credit and labour markets. I will argue that contemporary economic conditions present a strong case for reorienting the law towards the fresh start policy and its social insurance function.

The Global Financial Crisis and subsequent Great Recession have prompted experts to identify the negative economic consequences of the excessive level of debt in generating the crisis and in extending consequent recession. More and more economists advocate the virtues of household debt forgiveness policies. Personal insolvency is an instrument to avoid the crisis. This paper emphasises the convincing case for using personal insolvency as a social insurance instrument to deal with ‘debt overhang’ problems and reallocate more efficiently the risks intrinsic to a debt based economy. Economists have claimed that financial crises are not the only risk caused by high levels of debt. Such debt also constrains economic growth because borrowers who pay the interest and the lenders who collect it use their financial resources differently.
While the deleveraging policies were being considered by Governments in the form of targeting of social protection programmes including personal bankruptcy reforms, the COVID-19 pandemic has further complicated the peacetime reform efforts. Unprecedented fiscal policies to offset the economic impact of the COVID-19 have driven the level of global debt close to the peaks observed in the second world war. Although the IMF global database on household debt, which provides data upto 2018 only, shows that there was relative global stability of household debt, there were significant inter and intra-country variations across countries. The household debt globally was estimated to be around USD 40 trillion at end-2019\(^9\). The ratio of household debt to GDP ('debt ratio') was highest around the time of the Global Financial Crisis (GFC) and, after decreasing in the first half of the 2010s, has stayed more or less unchanged since 2015. While there are special and temporal variations in the debt ratio, the composition of aggregate household debt is generally alike, with mortgages accounting for a predominant proportion of total debt. The resilience of the household sector is important for both macroeconomic and financial stability in the wake of the COVID-19, as its level would affect both consumption expenditure (reduction in consumption) and debt repayments (defaults). The Governments and financial sector regulators have provided relief to indebted households by expanding the scope of social protection programmes and providing temporary moratoriums on debt payments and insolvency proceedings related to the COVID-19 induced economic shocks. The household debt to GDP ratio in India ranged between 8.68 per cent and 11.04 per cent in the last decade or so till 2018. However, the household debt levels would increase on account of the COVID-19 related employment and income shocks, and to that extent, the financial resilience would be adversely affected. It is in this context that the creation of a debt forgiveness policy becomes very important in the overall social protection framework.

Sometimes the insolvency filings are analysed through the perspectives of diverse images of the debtor, namely: the strategic, structural, and behavioural actor models\(^6\). These perspectives have a very profound impact on the creation of the insolvency framework. The applicability of the model would determine the policy choices for structuring the framework, and therefore, its selection is a strategic choice in building the insolvency framework\(^7\).

The strategic model is founded on the utility-maximiser rational individuals in the neo-classical tradition. Therefore, their behaviour can be predicted as a systematic reaction to regulatory inducement. The inference is that debt forgiveness policies may give rise to ‘perverse’ incentives for unprincipled manipulation\(^8\). Sometimes, traces of this approach are found in the contractualist requirement of a quid pro quo in mandating sanction for the behaviour conditionality, like mandatory time gap between two insolvency applications. It is another matter if these conditionalities are effective in sustaining the required behavioural change. Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, in their seminal study (1989), came to the conclusion that the cases of bankruptcy abuse are rare and that bankruptcy law is not an efficient instrument to bring about the desired behavioural change in people as they do not respond to incremental changes. They also do not find any evidence of bankruptcy recidivism (Sullivan et.al., 1989, pp.192-95). Only about 8 per cent of their debtors were previously adjudged bankrupt. Moreover, the authors state that only about a third of that 8 per cent are ‘true repeaters’\(^-\) which they define as persons who received a discharge, acquired additional debt, and then again applied for bankruptcy. They contrast this category with a larger group that managed to repay debts between Chapter 7 discharges\(^9\). They contend that bankrupts are not obsessive wealth maximisers (Sullivan et.al., 1989, pp. 243)\(^10\).

The structural model is consistent with the idea of a rational individual, but it posits that the individuals may not have flexibility to act strategically due to their situational limitations as they do not have too
many options between different opportunities. The behavioural model employs social psychology to adapt the assumptions of the rational individual model. Individuals are characteristically disposed to over-optimism, and their preferences are circumscribed by present-biases, restricting their reaction to regulatory incentives. This trait encompasses incentives for strategic welfare abuse, as well as those targeting to counter such abuse. The proponents and opponents of liberal personal insolvency law are influenced by these contrasting approaches, and several concepts such as means test and anti-abuse provisions are routinely advanced in the effective framework for personal insolvency. If the structural or behavioural debtor models were valid, the legal framework would have been structured on the concept of social insurance, whereby the legal framework for debt forgiveness should assign risk between the debtor and her creditors with a view to easing the ex-post effects of financial failure. Per contra, if the strategic actor model was valid, the law would also create ex-ante motivations, including those for avoiding the strategic abuse.

Considering the Indian situation, it would be fair to assume that the image of the average potential applicant does not match with the concept of a strategic individual, but rather he is part of the most vulnerable groups in society. As structural debtors, they enter into insolvency situation because they are the sufferers of financial shocks, or, as behavioural debtors, they are the victims of their own behavioural biases as they overly estimate their repayment capacity. The Situation Assessment Survey of Agricultural Households in NSS 70th Round (January, 2013 - December, 2013) looked at the level of living of farm households as measured by household consumer expenditure, income, productive assets, their indebtedness, farming practices, farming preferences, resource availability, their awareness of technological developments and access to modern technology in the field of agriculture. Nearly 70 per cent of India's 90 million agricultural households spend more than their income on average each month, pushing them towards debt. These households, who spend more than their earnings, own less than 1 hectare of land. The economic stress of such farm households is exacerbated by additional loans that such households take to address the health issues, leaving them with a reduced capacity to invest in the farm business. While the outstanding loans for health related issues doubled over a decade to 2012, the loans for the farm business decreased by about half during the same period. The expenditure incurred on the productive assets used in the farm and non-farm business by the agricultural households belonging to the bottom 80 per cent in terms of monthly per capita consumption expenditure was reported to be lesser than that of the all India average. The reported expenditure on the productive assets for these households during July, 2012 - June, 2013 ranged from about one-fourth to two-third of the all India average of Rs. 1087. The survey revealed that about 52 per cent of the agricultural households in rural India were estimated to be indebted. The average amount of outstanding loan per agricultural household was estimated to be about Rs. 47,000. These facts emphasise the importance of undertaking complementary policy reforms to supplement the social insurance policy of ‘fresh start’.

The above description of the situational analysis of the indebtedness points towards the existence of the market failure rationale, which justifies the ‘fresh start’ to the debtors freeing them from the sub-optimal bargains formed by the imperfect credit markets. It is argued that information asymmetries between lenders and borrowers and behavioural biases of consumers will systematically produce inefficient credit contracts. Consequently, the costs of over-indebtedness are not just shared by parties to credit transactions but also by third parties, implying that rather than implement market allocations, personal insolvency could lead to internalisation of negative externalities. These social costs are diverse, including the cost to the public social welfare systems in providing for the basic requirements of the financially stressed households. The established relationship between debt and health problems implies that ubiquitous over-indebtedness may also strain healthcare systems.
The preponderant concerns of policymakers are broader systemic macro-economic costs of over-indebtedness. Chronic indebtedness may reduce employees' economic productivity, forcing debtors out of the workforce, either by making work uneconomical or through problems caused by ill-health, which may make employees unfit for work. By allowing debt relief, the law reallocates costs of over-indebtedness from debtors to creditors, who have greater capacity to avert default from occurring (through the efficient credit appraisal of borrowers) and bear costs of the default. This enables efficient redistribution and internalisation of social costs of credit markets and induces creditors to reduce incidence of default and over-indebtedness.

While the overarching logic of social insurance aspects of personal insolvency law has been generally accepted, there are two major objections that may come in the way of full adoption of debt relief. These are moral hazard and credit market impact. The mitigating policies to address the first objection include imposing reasonable restrictions on debtor access, investigation and probable sanction of guilty debtors, and the debtor's sacrifice to creditors of non-essential income and assets. A second perpetual objection to introducing debt relief reforms is the claim that they will increase the cost of and reduce access to credit. The counter argument is more nuanced. It asks, considering the experience of great recession and 'debt overhang', whether a reduction in less costly household credit would adversely affect economic activity more than the fall in demand caused by overly leveraged households' declining consumption. Viewed from these perspectives, personal insolvency law may reduce debt flows and ensure that credit markets’ costs are internalised through truer pricing, rather than implement market bargains indiscriminately.

A major policy issue unearthed in the global proliferation of personal insolvency law reforms during the last 30 years relates to the debtor with little income and meagre assets who may be unable to afford bankruptcy in those jurisdictions where access to the individual bankruptcy system is not costless. These 'Low Income-Low Asset' debtors (LILAs) or 'No-Income-No Asset' debtors (NINAs) may represent a multitude of debtors globally, and the World Bank identifies this group as a policy challenge. The NINA phenomenon raises questions of structure and financing of debt relief. While bright-line rules and criteria exist, such as individuals with no significant realisable assets and no disposable income to repay debts, or with income below a certain level, there is an apprehension that they may be over or under inclusive. The 'fresh start' process under the Insolvency and Bankruptcy Code, 2016 (IBC) provides a composite criteria of income, assets, and the outstanding debt, and these need to be flexibly fixed. There may be a question if a sole proprietorship should be distinguished from individual debtor as there may often be a mixture of business and household debt in sole proprietorships. It is felt that there may not be a solid reason in principle to eliminate sole proprietors from access to the NINA Procedure. The World Bank identifies five approaches to the financing of personal insolvency systems: (a) state funding of the process (including both creditor and debtor costs); (b) cross subsidisation of low value insolvencies by higher values estates; (c) state subsidies to professionals involved in the process and writing off court costs where there is an inability to repay; (d) levies on creditors, such as taxation of distressed debt to fund these cases where individuals have no ability to pay; and (e) no state support beyond any general public good funding of the court system. Considering the need to have an efficient and timely discharge of indebted individual debtors, an administrative adjudication framework, funded with state financing, is more desirable compared to the tribunal based adjudication system under IBC. This would also enable equality of access to small but highly indebted individuals compared to other resource-rich debtors who have greater access to the insolvency system.
may be greatly facilitated from the support of a professional intermediary to prepare applications and pilot through the system. The adjudication process for the fresh start may be greatly facilitated by online technology and may also reduce costs, but vulnerable debtors may still require face-to-face help in completing the simplified fresh start process. Therefore, going beyond the mediation and judicial adjudication of personal insolvency, as recommended by the Working Group on Personal Insolvency, constituted by Insolvency and Bankruptcy Board of India, a completely administrative adjudication process with a cadre of adjudicators would be more efficient. These administrative officials would not only improve access but also acts as conscientious gatekeepers to allow entry of only eligible applicants. The administrative adjudication mechanism should be supplemented with debt counselling of individuals applying for the ‘fresh start’. A longitudinal study in the UK by Gaby Atfield, Robert Lindley, and Michael Orton (2016) found that although debt counselling may not in itself have enabled people to become debt-free, it helped them to manage their finances until their personal circumstances changed. The participants who thought that they were ‘managing’ their debt, generally through payment plans and cautious money management, found debt advice principally valuable in helping them live with the experience of being in debt, often over a long period of time. For many of those who were still in debt at the end of the project, debt advice tried to focus on avoiding crises and helping them to manage the experience of living in debt.

However, it is argued by some experts that the fresh start is an incomplete tool to alleviate financial distress. Using primary longitudinal data, Katherine Porter and Deborah Thorne (2006) examine the fresh start concept against the realities of life after bankruptcy. They found that just one year after bankruptcy, one in four debtors was finding it difficult to pay routine bills, and one in three debtors was reportedly in the financial situation similar to or worse than when that debtor applied for bankruptcy. Their analysis established that regular and sufficient income is important to improved post-bankruptcy financial health. Factors that caused decline in household income, such as unemployment and underemployment, illness or injury, and old age, weaken the chances of financial recovery. They conclude that bankruptcy is an incomplete instrument to rehabilitate those in financial distress and propose adjustments to bankruptcy law and social programs that will improve the fresh start outcomes for individuals after financial failure.

In another study, Katherine Porter (2010) found that even after the debt discharge, the consequences of bankruptcy continue. The bankruptcy transforms the borrowing behaviour. After bankruptcy, the overall credit use by such bankrupt households is restrained compared both with other Americans generally and with pre-bankruptcy borrowing of such households. While the modest use of credit could signify a difficulty in accessing credit markets, it is an indication of self-inflicted restraint on bankruptcy debtors, even in the face of enticement by lenders and the continued financial stress of such debtors. This indicates that people who have suffered financial failure may curb their future economic activity.

The longitudinal studies indicate the centrality of income augmentation policies to supplement the fresh start in India. The behavioural self-imposed restraint on accessing fresh credit even when such access is provided by lenders, further continuance of bankruptcy details on the credit registry system over a long period, say, beyond five years, would all reduce credit access of bankrupt individuals. NSSO Situational Assessment Survey brought out the income-expenditure gap and the decline of productive investment of small farm households owing to an increase in health related expenditure. Hopefully, the Ayushman Bharat and Jan Suraksha life-insurance schemes of the Government would alleviate the health expenditure related expenditure, encouraging productive expenditure by fresh start beneficiaries. In this context, it is important that the public policies should also augment investment in rural economy. Chand, Kumar, and Kumar (2012) estimated the total factor productivity (TFP) for major crops in India.
for the period of 1975 to 2005 and its critical importance in increasing agricultural production. They had precisely analysed how investment in agricultural research encouraged TFP across crops. They found that with an increase in investment in agricultural research, the real agricultural production costs declined in the range of 1.0 - 2.3 per cent. The Internal Rate of Return of investment in agricultural research was assessed at 42 per cent., and this gave a fair possibility for a positive investment scenario in Indian agriculture. If the targeted growth rate of production in agriculture is to be achieved, a substantial proportion of that would come from TFP Growth. Contribution of agricultural research to the realisation of self-sufficiency in food and growth in TFP as well as high payoff to investment in agricultural research and extension are solid justifications for adequate funding for research and extension in agriculture. Therefore, a much higher allocation of public resources to agricultural research system of the country would be necessary to achieve higher TFP growth in agriculture and augmenting incomes of farm households.

The above analysis demonstrated the usefulness of the fresh start process to alleviate the individual indebtedness in India. It would be appropriate that the process is simple and cost-effective with some element of debt counselling. However, in view of the evidence collected in the longitudinal studies, the fresh start as a social insurance instrument needs to be supplemented by other social insurance policies. Such studies may be conducted in India also on a regular basis to make the course correction in framing and modifying the social protection policies. However, any debt-free life after the fresh start cannot be imagined without focussing on income augmentation policies for such financially distressed individuals. This holistic approach would not only be welfare-enhancing for financially distressed people but would also alleviate the debt overhang problem and would be growth-promoting.

NOTES
2 See Feibelman, op. cit., Supra Note 1.
4 Mian, Atif and Sufi, Amir (2014), *House of debt*
– How they (and you) caused the great recession, and how we can prevent it from happening again. University of Chicago Press.


9 Sullivan, et.al., op. cit., n 1.

10 Sullivan, et. al., op. cit., n 1.


16 Mian and Sufi, op. cit., n 4.

17 World Bank, op. cit., Para. 182.


The life of a company is as precious as that of a human. The IBC provides a new lifeline to rescue a company when it experiences a serious threat to life.

- Dr. M. S. Sahoo, Chairperson, IBBI, Financial Express, March 5, 2020
In December 2019, the Insolvency and Bankruptcy Board of India (IBBI) notified provisions for personal insolvencies under the Insolvency and Bankruptcy Code, 2016 (Code) for personal guarantors (PGs) to corporate debtors (CDs). The IBBI has released regulations for cases involving guarantors and has indicated that it is moving toward notification of the provisions for other personal debtors. As of now, it appears that a small number of applications have been filed under these provisions but none have yet been admitted. It is not clear if the financial and economic effects of the COVID-19 pandemic will accelerate or decelerate progress toward notifying the IBC for other personal debtors. It is certainly possible, however, that the current crisis will hasten notification, and therefore it is particularly important for scholars and policymakers to address some critical questions of policy and design that the Code and the current regulations leave open. This essay identifies one of the most critical questions about the personal insolvency regime that still needs to be fully specified – the design of debtors’ repayment plans – and argues for some baseline standardisation.

The Code includes three general chapters or pathways for personal debtors: fresh start, insolvency, and bankruptcy. The Code’s fresh start process is available for debtors with very modest financial profiles who are ‘unable to pay [their] debt;’ who do not have more than Rs. 60,000 in annual income, Rs. 20,000 in assets, Rs. 35,000 in qualifying debts; and who do not own a dwelling unit. It does not provide for any distribution to creditors. The Code’s insolvency regime requires debtors to propose and complete a repayment plan. Eligibility for insolvency extends to debtors who have defaulted on debt of at least Rs. 1,000 and who are not otherwise eligible for the fresh start process. Bankruptcy, which provides a discharge of many unsecured debts in exchange for any non-exempt assets the debtor has, is only available if a debtor’s insolvency case fails or when a debtor’s repayment plan ends before completion. This article only addresses the insolvency pathway, which is presumably the first-order chapter for most debtors who are likely to utilise the system.

While the Code sets out the broad framework of the personal insolvency regime, it is still unclear whether there will be limits, requirements, or guidance, for various aspects of repayment plans. The Code itself only requires that the plan must provide a justification for the plan and state any fee given under the plan to a resolution professional (RP). The regulations for personal guarantors mandate that repayment plans set forth a budget that provides for a debtor’s ‘reasonable expenses’ and give at least 10 percent of the debtor’s income to creditors. The Code appears to envision that other unspecified aspects of plans will be subject to debtors’ proposals and negotiations with creditors.

In this article, we proposed that repayment plans and other aspects of the insolvency process should be standardised enough to ensure a baseline treatment of both debtors and creditors, subject to
some flexibility for unique or exceptional circumstances. While a generally negotiated process may be appropriate for commercial debtors under the Code, we believe that the process for personal debtors should be significantly more rule bound. This is consistent with global trends in insolvency and bankruptcy law and is driven by our recognition of some structural differences between personal and commercial debtors and our concerns about institutional capacity, predictability, and fairness.

Unlike regimes for commercial debtors, personal insolvency and bankruptcy regimes serve a crucial social insurance function and directly impact the well-being of individuals and their households. And often the amount of money at stake for creditors in any particular case is not enough to motivate attentive engagement. Both of these structural differences between personal and commercial debtors provide good reasons to specify basic aspects of the personal insolvency process. In terms of institutional capacity, as we explain in more detail below, we seriously doubt that the system of Debt Recovery Tribunals (DRTs) and RPs can effectively tailor outcomes for the number of cases that will likely be admitted if even a small percentage of eligible debtors end up in the system. We are also concerned about the ability of the Board to effectively monitor the performance of RPs throughout a system that relies heavily on their coordination of a negotiated process. Furthermore, even if the system could feasibly tailor outcomes, the ad hoc nature of that approach would not likely ensure fair or equal treatment of similarly situated debtors and creditors. Any of these factors could threaten the effectiveness, predictability, and perceived legitimacy of the system and prove unsettling to developing credit markets.

This article focuses on five aspects of repayment plans that we believe are the most important to regulate or standardise: the amount of income that debtors are expected to repay during the plan period; the amount and types of assets that debtors are expected to relinquish; the duration of repayment plans; the treatment of secured claims under the plans; and the amount of debt that is to be discharged under plans. Specifying a baseline approach to each of these aspects of repayment plans can be done through formal regulation by the Board or through the promulgation of a model plan or protocol by the IBBI.2

We further propose that, if an approach to those aspects of plans can be adopted, the system might also dispense with the need for creditors to vote to approve plans, except perhaps to approve plans with more generous relief to debtors. This would presumably require an amendment of the Code. Finally, we propose that the Board or the Tribunals adopt an approach to ‘fast-track’ debtors to bankruptcy who cannot repay any significant amount in insolvency.

This article describes basic global trends in personal insolvency and bankruptcy law, which reflect the various aims of these systems, and situates the fundamental design choices of the Code in relation to these trends. It then analyses some of the critical features of repayment plans under the Code, explains and justifies the proposal for standardisation of each, and explains the rationales for reducing creditors' role in the process and for adopting a fast track to bankruptcy for some debtors. It is important to acknowledge that many personal insolvencies in India will inevitably be related to failures of medium and small businesses owned by the insolvent debtors. It is entirely possible that the personal or corporate insolvency provisions of the Code might be reformed to deal with the hybrid nature of small business failures. This thorny set of policy questions is beyond the scope of this article. Rather, it evaluates design options for purely personal insolvencies, recognising that these might be adjusted to account for the role of the personal insolvency system for MSME's in the future.
THE CODE’S PERSONAL INSOLVENCY REGIME IN GLOBAL CONTEXT

Global Trends

A personal insolvency or bankruptcy regime can serve different and, ideally, related functions. Most generally, such a regime provides for the repayment and/or discharge of debt owed by an individual or household to their various creditors. In some circumstances, it can help creditors recover a greater portion of debts owed by individuals and households than they would absent the regime, or, more commonly, make any recoveries more predictable and timelier. It can also provide debtors with temporary protection from debt collection and some degree of debt relief. In many jurisdictions, this protection and relief for debtors predominates, with the policy aim of reducing the social costs of financial distress and to restore debtors to economic productivity. By allocating losses ex post, an insolvency or bankruptcy regime may influence private decisions about lending and borrowing ex ante.

In describing global trends in personal insolvency and bankruptcy law, this article draws heavily on the World Bank’s 2014 Report on the Treatment of the Insolvency of Natural Persons. As the World Bank Report describes in great detail, most jurisdictions with personal insolvency or bankruptcy regimes have adopted some combination of two different approaches: repayment from future income over time or liquidation of the debtor’s non-exempt assets, often described as straight bankruptcy. Unsecured obligations are paid from available income and/or assets; and, generally, at least some of the remaining unpaid debts are discharged. While most countries have court- or tribunal-based systems, ‘public agencies play a significant role in several countries.’

Most insolvency and bankruptcy systems have basic threshold eligibility requirements that generally aim to limit access to the system to those debtors who are in acute or protracted financial distress. Such eligibility requirements include “a minimum level of debt; a future oriented test of ‘permanent insolvency’; ‘good faith’; or a requirement that debts are caused by events beyond a debtor’s control such as illness or unemployment.” Some systems also require that debtors seek financial counseling or attempt to negotiate with creditors to be eligible for insolvency or bankruptcy relief. As a practical matter, access to personal insolvency or bankruptcy is often also affected by threshold costs of the process itself, including administrative fees, fees to professionals, and direct costs of gathering necessary information and documents.

Some insolvency and bankruptcy systems allow both creditors and debtors to initiate cases for debtors, while other systems only allow debtors to initiate cases. This is a potentially significant difference. As the World Bank Report notes, [A]lmost all countries that have introduced distinct systems of insolvency of natural persons in recent decades only accept filings by debtors for admission into these proceedings. [C]reditors’ insolvency petitions against individual debtors are uncommon even in most of the countries where such petitions are possible. There are some systems, however, where personal bankruptcy is used as a threat in the collection efforts of creditors, and the threat is more intense where the stigma attached to bankruptcy is greater.

Debates over the scope of eligibility and relief available to debtors in insolvency or bankruptcy often revolve around concerns about moral hazard or outright abuse. It turns out that there is little evidence of such moral hazard, even in regimes with generous relief and relatively easy eligibility. Potential moral hazard is offset by a combination of social factors, the direct costs of obtaining relief, and limits on subsequent access to the system. Debtor abuse is addressed in some regimes by investigations of
information provided by debtors, substantive limits on relief based on debtor behavior before or after seeking relief, auditing and sanctions during the pendency of cases, or some combination of these approaches.

Some jurisdictions allow or require debtors to select among different types of legal pathways or substantive frameworks. In such systems, professional intermediaries generally play a crucial role in helping debtors make this choice, and this role can create potential conflicts for those professionals if they stand to earn more under one option than another. Some of these intermediaries are official actors, while others are independent and selected by private parties. Many regimes, however, do not let debtors choose among options but pre-determine what process, or sequence of processes, is available to debtors. The most common approach among jurisdictions is some combination of repayment and liquidation regimes that requires debtors to give creditors a portion of their future income as well as some portion of their existing non-exempt assets.

**Basic Design of the Code**

Personal insolvency and bankruptcy were not a primary focus of policymakers who drafted and enacted the Code, and they have received significantly less public attention than the provisions for commercial debtors. Regarding personal insolvency and bankruptcy, the Code opts for an approach that combines a repayment plan regime with a straight bankruptcy one, but debtors do not choose between them. Rather, they must try the repayment option first. As noted above, eligibility for insolvency extends to debtors who have defaulted on debt of at least Rs. 1,000 and who are not otherwise eligible for the fresh start process.

Contrary to global trends noted above, the Code allows both debtors and creditors to initiate a personal insolvency. Whoever files can select an RP, who serves various important functions in any case. For example, the RP is charged with assisting debtors in preparing and submitting their repayment plans. Their creditors then vote to approve or reject the plan or modify it with the debtor's consent. Approval of a repayment plan by creditors requires the vote of more than three-fourths of the value of the claims of creditors. The RP thereafter implements the plan and applies for the debtor's discharge at the appropriate time. Some additional aspects of the regime have been set forth in regulations and draft regulations. Other aspects remain unspecified, including whether and how creditors' claims will be verified, what income a debtor may keep under a plan, and the precise scope of some excluded assets.

**STANDARDISING REPAYMENT PLANS AND MANAGING IMPERFECT INFORMATION**

The default approach of Code's personal insolvency regime is to leave the contents of repayment plans that are not specified by the Code itself or regulation to negotiation between debtors and their creditors. The Code presumably gives the Tribunals authority to review plans for compliance with the relevant rules and regulations, but it is uncertain whether Tribunals have authority to review the terms of repayment plans and police for any egregious substantive unfairness to debtors or dissenting creditors.8

The Code's personal insolvency regime will apply to hundreds of millions of individuals. The DRTs that are the adjudicating authorities for the regime are already taxed with their caseloads. Even if rates of utilization of the Code are low, the absolute numbers could quickly and easily overwhelm the existing capacity of the Tribunals.8 And even if the capacity of the Tribunals increases, anything that streamlines the process of cases they must adjudicate will likely help improve the timeliness and effectiveness of the regime.
Debtors’ rates of literacy, social views of indebtedness and government assistance, as well as practical challenges for citizens in navigating physical distances may also pose fundamental challenges to the operation of the regime. Added to which, the availability of relevant information about debtors’ personal and financial affairs and creditors’ claims will be imperfect at best.

In additional to these concerns about institutional capacity, it is important to consider the likely motivations and incentives of debtors and creditors who might use the system. Around the globe, significant numbers of debtors in most regimes do not actually distribute payments to unsecured creditors because they have no surplus income under the applicable framework, and most debtors would not have meaningful surplus income under modestly more restrictive approaches. Furthermore, repayment plans have nearly universally low rates of completion. Among other things, this suggests that many creditors will have little or no motivation to invest time or attention in particular personal insolvency cases.

On the debtor side, unless the system is simply going to operate as a threat that creditors can employ to collect from debtors outside of the system, a regime that requires payments over a period of time must inevitably adopt a balance between austerity and generosity. This balance is necessary to increase the likelihood that repayment plans will not end in failure, to encourage debtors to voluntarily utilise the system when they really need to, and to maintain the perceived legitimacy of and public support for the regime.

With the foregoing factors in mind, the key design challenges for the regime are to steer those debtors who can plausibly repay some amount over the life of a plan into the system, to steer other debtors away from it, and to provide for plans that give debtors a feasible chance to complete them. To do so, it is necessary to determine how much debtors must repay, which is a function of the amount of future income that debtors are allowed to keep, the duration of plans, the treatment of secured creditors, and the amount of debtor’s assets that are exempt.

We believe that the core terms of repayment plans should be specified by the Board either in rules and regulations or through a model plan or protocol. A baseline degree of specificity will improve predictability and fairness of the system for both debtors and creditors. To begin with, this will help parties decide whether to employ the system to begin with. It will also reduce potentially significant transaction costs of negotiations and institutional and supervisory costs for judicial officers, RPs, and the Board. We appreciate that specifying rules could lead to ossification or could be over- or under-inclusive in particular cases. Yet such rules could provide for some degree of flexibility to address the unique or exceptional circumstances of particular debtors where appropriate. We acknowledge and anticipate that some routine practice among repeat players in the system would likely emerge in the absence of institutional specification to reduce costs and unpredictability to some extent. But we are concerned that such a process of organic standardization may not be an efficient or reliable pathway to predictability or fairness. This Part also proposes a liberal approach to the treatment of information provided by the parties. All of these proposals are generally consistent with global trends in personal insolvency and bankruptcy. The sections below provide a dynamic menu of institutional approaches to various aspects of repayment plan regimes in other jurisdictions as well as approaches to verifying creditors’ claims and supervising the plans.

Available income, budget

Determining how much a debtor should be required to pay creditors over the life of a repayment plan is probably the most significant question for policymakers designing such a regime. This question often
depends on how much income debtors are allowed to retain for their reasonable or necessary expenses, which inevitably raises fraught questions of fairness and about what constitutes adequate baseline support for individuals and families.

Not surprisingly, there are various approaches for determining how much income a debtor should be able to retain for personal and family requirements over the life of a plan. Some regimes employ a relatively fixed standard amount, often relying on general rules that limit the amount that creditors can garnish wages outside of the insolvency or bankruptcy system. Others provide a rule-based scheme for determining necessary expenses that depend on a debtor’s specific circumstances. Still others provide for a relatively discretionary determination of expenses by an authorized decision-maker, often a judicial officer. According to the World Bank Report,

One lesson that seems to have emerged most clearly from the last three decades of experience is that a flexible, discretionary approach, while theoretically attractive, is practically quite problematic.¹⁰

Such an approach leaves the system susceptible to errors in both directions, either allocating more or less income to debtors than they truly need for basic expenses. Allocating less than necessary appears to be a much more common, and is certainly a more consequential, error. The report observes that,

[m]any examples of constructing a basic consumer budget ... are available to policymakers interested in developing a sensitive and livable approach to payment plans.¹¹

Most jurisdictions set a pre-determined amount of income that the debtor must pay to creditors periodically over the life of a plan, while other jurisdictions require payments to creditors based on the actual income per payment period. A flexible approach may be better matched to a debtor’s actual circumstances, but it may also entail greater costs in monitoring and supervision. It may also have a negative effect on a debtor’s motivation to earn more income during the term of a repayment plan. Regimes that do not adopt a flexible approach nonetheless often allow modification of repayment plans if a debtor’s circumstance changes significantly. But this imposes monitoring and administrative costs on debtors and creditors alike.

In addition to differences in the process of determining how much debtors should repay in their plans, systems differ in the degree of austerity they expect from debtors. Systems that err on the side of more austerity may make too many debtors reluctant to seek relief when it is needed. They may also increase the number of plans that fail before completion and impose additional stress on debtors without significantly increasing the amount of distributions to creditors. Systems that require less austerity may generate moral hazard, although, again, there is little evidence of personal insolvency or bankruptcy regimes actually creating moral hazard.

The regulations for personal guarantors promulgated by the Board provide that repayment plans must provide for

a minimum budget for the duration of the repayment plan, to cover the reasonable expenses of the guarantor and members of his immediate family to the extent they are dependent on him, provided that at least ten percent of the realisable income of the guarantor shall be utilised for repayment of debts.¹²

We applaud the specification of a concrete minimum requirement, but this regulation still leaves a
significant amount of room for heterogeneous approaches and uncertainty. It appears to require a unique determination of reasonable expenses and a debtor's budget in each case, which might yield a debtor's allowed budget to be anything between ten percent of income and all disposable income. If guidance is not forthcoming, this approach would likely impose costs of tailoring and negotiation between debtors, creditors, and RP in every case.

We believe it would preferable for policymakers to adopt a semi-mandatory framework for determining debtors' budgets in repayment plans. Experience in other jurisdictions has shown that such a framework could yet include some limited flexibility. Some jurisdictions, for example, have established formulae for attributing budgets to debtors based on factors like family size and homeownership, all of which can be adjusted by region. This imposes some predictability and rough equality of treatment. Tribunals could be authorized to consider deviations from the framework if the amount generated by the formula turned out to be more or less than would be reasonable in a particular case. This approach could be adopted by regulation or by the Tribunals and should not require a formal amendment to the Code.

We are also concerned that in many cases, the amount necessary for reasonable expenses will be more than ninety percent of a debtor's income, in which case the debtor would not be able to propose a feasible repayment plan. This minimum requirement may not be suitable for the general population of personal debtors, who are much less likely than personal guarantors to have meaningful amounts of disposable income. These concerns would be assuaged if debtors who do not have enough disposable income to pay ten percent to creditors are thereby eligible for bankruptcy, as we discuss in more detail below.

**Assets, exemptions**

Rules that exempt assets from creditors' recoveries are central components of both 'straight bankruptcy' regimes and for repayment regimes that require debtors to offer creditors both future income and existing assets. Common examples of such exemptions include homes, cars, basic household goods, pensions, and property used in a debtor's trade. The scope of these exemptions is also relevant.

Historically, most systems set exempt property levels at very low levels ... There is a growing trend to liberalize property exemptions. When countries modernize their property exemptions, they generally increase the levels and scope of exempt property.13

In most jurisdictions, exemptions are ‘waivable’ to the extent that creditors can generally enforce secured claims against exempt property, although some jurisdictions provide that security interests in basic necessities are not enforceable. There is a variety of approaches to determining what property is subject to exemption, but almost all require valuing property that might be exempt. And valuation is itself time-consuming and imposes some costs on stakeholders and on the system. Thus, for example, raising levels of exemptions has the collateral effect of reducing the likelihood of uncertainty about whether particular assets are exempt, in turn eliminating the cost and burden of determining value.

Regarding assets, the Board's regulations for personal guarantors only provide that a repayment plan 'must provide the details of excluded assets ... of the guarantor' and ‘may provide for the ... transfer or sale of all or part of the assets of the guarantor.’14 Taken together, these provisions appear to envision that repayment plans will not include exempt assets and may provide for the liquidation of all non-exempt assets. But somewhat confusingly, the regulations do not expressly state that non-exempt assets cannot be included in a plan. Nor do they require that debtors must relinquish all of their non-exempt assets, suggesting that debtors might propose to keep some non-exempt assets under a
We propose, first, that the Board clarify both that excluded assets cannot be included in a plan. We also propose that the Board should specify an amount of non-exempt assets to be liquidated under a plan, perhaps all non-exempt assets or a set percentage of the debtors' indebtedness. If a standardised approach to assets and income is not adopted, it will be necessary to rely on ad hoc tailoring and negotiation between debtors, creditors, and the RP in every case. The easiest approach to administer would be to provide that debtors include all non-exempt assets in their plans. Yet, depending on the austerity of debtors' budgets and the scope of exempt assets, this approach may significantly reduce the amount of debt relief available to some debtors, which may cause those debtors to avoid the system when it would be broadly efficient for them to employ it.

Regarding debtors' non-exempt assets, much will depend on definitions of those exemptions. As with the income and budgets allowed to debtors, if exemptions are too austere, then debtors will be reluctant to seek relief when it is needed, and there will be a greater likelihood that approved repayment plans will end in failure. Furthermore, if exemptions require careful and elaborate valuations, then the time and cost of valuation itself can eat away at whatever recovery creditors might otherwise enjoy and limit the benefits of relief to debtors. This suggests that, where feasible, policymakers consider exempting categories of assets rather than an amount of value thereof. Where that is not feasible, policymakers might set the exempt value high enough so that most assets that fall within the relevant categories are obviously within the limit and do not require valuation.

The Code provides that excluded assets include:

- unencumbered tools, books, vehicles and other equipment as are necessary to the debtor or bankrupt for his personal use or for the purpose of his employment, business or vocation;
- unencumbered furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his immediate family;
- any unencumbered personal ornaments of such value, as may be prescribed, of the debtor or his immediate family which cannot be parted with, in accordance with religious usage;
- any unencumbered life insurance policy or pension plan taken in the name of debtor or his immediate family; and
- an unencumbered single dwelling unit owned by the debtor of such value as may be prescribed...

The Central Government has also promulgated Rules regarding these definitions specifying that the limit for the exemption for unencumbered personal ornaments is Rs. one lakh and that the limit on the exemption for dwelling units in urban areas is Rs. 20 lakh and for dwelling units in rural areas is Rs. 10 lakh.

We applaud the specification of the amount of value of homes and jewelry that are exempt from creditors' recoveries. But for two reasons, we are concerned that the limits may be set too low, especially for debtors other than personal guarantors. First, it is possible that these amounts are simply too austere, which might discourage debtors from using the insolvency system or might cause repayment plans to fail. Second, if the limits are somewhat higher, they may require valuation of assets less frequently. We encourage the Board to reevaluate these limits for personal guarantors regularly and to consider adopting higher limits for other debtors if the personal insolvency provisions are notified for them. For these same reasons, we do not believe the Board should adopt limits on the value of tools of the trade and household items that are exempt. Instead, the Board might consider specifying certain household and trade-related items that are exempt or adopting broad definitions for each that are designed to avoid the need for valuation.
Duration

For repayment plan regimes, an obviously crucial policy choice is how long to make the period of repayment, and yet this is a highly under-theorised and under-examined issue. There are two basic approaches among jurisdictions in this regard: first, to set one or more particular time periods in the law or rules of the regime or, second, to allow stakeholders, administrative officials, or judges to determine the length of individual debtors’ plans. For jurisdictions that adopt a rule on duration, there is general tendency to opt for three to five years, tending toward five. The World Bank Report observes that ‘existing evidence and widespread anecdotal reporting ... consistently indicate an inverse relationship between plan length and plan success.’

We believe that it will be important for India's personal insolvency system to adopt a common duration for repayment plans one way or another. This might be done by regulation, by the Tribunals, or by parties through conventions in practice. If the Board does not adopt a standard duration for repayment plans, however, then even if a standard duration is settled upon by Tribunals or the parties, that will require an unnecessary period of uncertainty and unpredictability.

Assuming that a standard duration is adopted, three to five years seems like a sensible range for a standard given the clear trend in global practice to specify a term for repayment plans within that range. As the duration of plans tends to be directly related to the rate of plan failures around the globe, a duration on the shorter end of that range may be advisable.

Treatment of secured creditors

Insolvency and bankruptcy regimes for both consumer and corporate debtors generally respect the rights of secured creditors, reflecting a widely-shared view of the financial and economic importance of secured lending both as a source of credit and an important stabilizing facet of the banking system. That said, many jurisdictions do provide for some involuntary adjustments to rights of secured creditors, such as staying foreclosure or repossession and allowing debtors to cure defaults, alter maturities, adjust the amount of secured claim, and override some security arrangements altogether, especially in the case of claims secured by basic necessities. In the recent global financial crisis, policymakers around the globe came to appreciate the potentially systemic utility of a regime that allows for adjusting secured claims to expeditiously allocate losses in a crisis situation.

The Code does not specify much about the treatment of secured creditors in personal insolvency cases. Presumably, secured creditors are stayed from enforcing their security during the moratoria that apply upon an insolvency application and admission of the application and last until the Tribunal approves a repayment plan. It also appears that a creditor's secured claim is limited to the value of the collateral. Secured creditors can choose to retain their right to enforce their secured claims during the repayment plan period or to participate in the voting on the repayment plan. This appears to mean that if secured creditors do not participate in voting, then their claims are not adjusted at all; and if secured creditors do participate in voting, then there is no formal limit on treatment of such claims.

We are concerned that this arrangement will lead to significant unpredictability about the treatment of secured claims in particular cases and across the system. Currently, most formal consumer debt in India is secured. For debtors, the amount of claims, payment terms, and interest rates for secured claims will, in the short run, often be the most consequential aspects of their repayment plans; the need to adjust these aspects of such claims may be a primary reason for seeking relief or a primary barrier to successful financial recovery. While, in most cases, secured creditors may be able to control the
outcome of voting among creditors, this may not always be the case. And in many cases, the costs of negotiating among creditors regarding the treatment of secured claims may be more than the overall value of the repayment plan to creditors. Finally, for secured creditors and markets for secured credit, uncertainty about the treatment of secured claims may have a more unsettling effect than certainty about a reasonable amount of adjustment of claims. We therefore propose that the Board consider adopting a standard framework for determining the amount of secured claims, the rate of interest allowed on those claims, the rights of debtors to cure defaults or missed payments over the life of a plan, and other similar matters.

Discharge of unsecured debt

A key feature of most consumer insolvency and bankruptcy regimes is the discharge of at least some unsecured debt. It is the primary way that these regimes reduce the personal and social costs of financial distress and aim to motivate debtors to return to economic productivity. The availability of discharge is limited in various ways under regimes around the globe. Most exclude certain types of debts from discharge, especially debt owed to the government or for family support and maintenance. Regimes that require debtors to submit repayment plans generally limit the availability of a discharge to those debtors who complete their plans, and some straight bankruptcy regimes require a minimum payment amount to obtain a discharge. In many regimes, discharge of debt is also premised on a debtor’s good faith in incurring debts and in performing obligations under the insolvency or bankruptcy regime. Some jurisdictions allow debtors to voluntarily agree to pay discharged debts, but those jurisdictions tend to police such agreements for egregious terms or uninformed bargaining.

The Code provides that some debts are non-dischargeable, including court-ordered fines or damages, maintenance obligations, and student loans. Beyond that, it does not specify that all dischargeable debts that are unpaid under a repayment plan will be discharged at the end of the plan; rather it appears to leave open the possibility that a plan could provide that some or all dischargeable debts that are not paid in full under a plan are not discharged. We believe that it is important for the Board to clarify that this is not permissible, and that dischargeable debts not repaid under a plan are discharged. Otherwise, a primary benefit of insolvency relief will be denied to debtors, which may discourage many from seeking relief or may undermine an underlying rationale of the regime. The government has the ability to specify additional categories of non-dischargeable debts if that is desirable. Furthermore, we propose that policymakers consider creating a formal and monitored process by which debtors can voluntarily agree to reaffirm discharge debts if they believe it is in their best interest to do so. That may require an amendment to the Code.

In the short term, because most debt owed to financial institutions in India is secured, this may seem like a minor issue. Yet the insolvency process will affect ‘informal’ debts, and the amount of institutional unsecured debt in India is growing. It is important for the development of unsecured consumer credit markets that the treatment of such claims in the insolvency and bankruptcy system is predictable. Expanding the availability of formal debt relief may seem antithetical to the growth of credit markets, but the availability of debt relief for individuals under insolvency and bankruptcy laws has, around the globe, expanded along with developing consumer credit markets. For one thing, individuals who qualify for such relief generally would not be able to repay much more, if any, outside of the regime. And secondly, the insurance effect of a reliable debt relief regime may make some debtors more willing to borrow in the first place, expanding demand. And once again, the potential moral hazard of making debt relief available and somewhat more generous is offset by many factors working against such hazard, including stigma.
**Information veracity**

Historically, many jurisdictions have provided a mechanism for verifying creditors’ claims against debtors in their insolvency or bankruptcy system. It appears that the contemporary trend is away from this, instead relying on the submission of information by private stakeholders, allowing other parties to challenge the information provided by others, and imposing a variety of consequences and sanctions for providing inaccurate information.

As noted above, there are reasons to anticipate pervasive problems in ensuring the accuracy of information provided by all private stakeholders in India’s personal insolvency system. Yet the costs of systematically addressing this problem will be large, especially compared to the value at stake in the discrepancies. Given that the accuracy of debtors’ income disclosures will often be difficult to verify, a system that requires threshold verification will be relatively costly to employ effectively. The error costs (up and down) of relying on debtors’ disclosures and putting the burden on creditors to challenge debtors’ assertions may be lower than the costs of up-front verification or of requiring creditors or IPs to monitor debtors’ actual income. If creditors are allowed to challenge information provided by their debtors, and if there are meaningful sanctions for deliberate – and perhaps negligent – errors, these error costs can be limited even further. Allowing for modifications to the terms of repayment plans in exceptional cases can further reduce the relative costs of a backward-looking approach.

A similar approach could be adopted for creditors’ claims – i.e., that they not require threshold verification but can be challenged by debtors or other stakeholders. The regulations for personal insolvencies involving guarantors require creditors to provide some proof of their claims, ‘on the basis of ... records available in an information utility, or ...any other documentary evidence which substantiates the existence of claim.’ \(^2\) \(^2\) RPs are charged with verifying these claims and can make estimates; they are also authorized to request additional information or clarification.\(^2\) We propose that the Board or RPs should specify these requirements somewhat further. They could clarify, for example, whether certain types of claims must be submitted with written documentation. Requiring that certain types of claims be submitted with written documentation might have the beneficial effect of motivating creditors to adopt written agreements where they are currently not doing so. For claims not required to be submitted with written documentation, policymakers might take a liberal approach to creditor claims, allowing them subject to objection by the debtor or some other party with an interest in the case.

In addition to reducing administrative costs, we believe that this approach would enhance the potentially beneficial role of information utilities, perhaps increasing pressure for the development of such entities.

**RECONSIDERING CREDITORS’ ROLE AND THE PATHWAY TO BANKRUPTCY**

**Who decides?**

If policymakers specify baseline requirements for personal debtors’ repayments plans under the Code, there would then be good reasons to consider reforming the role of creditors in the personal insolvency process, perhaps eliminating the requirement of their approval. While some jurisdictions do require that creditors vote to approve a debtor’s repayment plan, in most jurisdictions the terms of repayment plans, including what assets and income the debtor must give to creditors and what the debtor may keep for basic maintenance, are determined by courts or administrators or proposed by debtors pursuant to legal rules. Among other reasons for this, as noted above, creditors tend to recover little or nothing from most consumer insolvency or bankruptcy cases, so they have limited general motivation to participate in the process. In some jurisdictions that require a vote by creditors, some of those also
provide that debtors can proceed to a straight bankruptcy if their plans are not accepted, perhaps increasing creditors' motivation to approve the plans. In some systems that provide a state-determined repayment and discharge plan, a majority of creditors can agree to accept a debtor's alternative offer, binding the minority of creditors.

Eliminating the requirement that creditors have to vote to approve debtors' repayment plans would reduce the costs, delays, and uncertainty of debtors' insolvencies. If so, the reduction of administrative costs and delays could, alone, increase the amount and/or likelihood of creditors' recoveries, and it may reduce the chances that creditors will use their leverage to require onerous plans or discourage debtors from employing the system. If plans are subject to relatively clear rules and guidelines, as suggested above, there would be little left for negotiation between a debtor and his or her creditors to begin with. Perhaps a vote of creditors' vote might be utilised to allow creditors to approve plans that are more generous than the rules envision, i.e., to essentially allow creditors to waive their rights when a super-majority believes it is in their interest to do so. Given that debtors will be eligible for potentially far-reaching relief in bankruptcy if their plans fail, it may often be in creditors' individual and collective interest to do this.

**Fast-tracking some debtors to bankruptcy**

There are good reasons, based largely on experience in other jurisdictions, to believe that many individual debtors in India who would benefit from debt relief or who will enter the insolvency and bankruptcy system involuntarily will not have the capacity to repay anything to their unsecured creditors. For such debtors, the requirement of attempting a repayment plan in an insolvency proceeding will be an unnecessarily costly detour for all affected parties. This may justify providing a pathway by which debtors who are not eligible for a fresh start and who can show that they would not repay much or anything under a repayment plan could skip the insolvency process and go directly to bankruptcy.

We propose that the IBBI or the Tribunals establish a standard process for identifying debtors who are unlikely to be able to make any significant payments to creditors in an insolvency proceeding. These debtors could then be made immediately eligible for bankruptcy. If standard criteria for repayment plans are adopted, then it should be relatively straightforward to identify debtors who do not have meaningful amounts of non-exempt assets or income beyond what is necessary for their budgets. If so, then it would also be relatively easy to identify in advance which debtors are better candidates for bankruptcy than insolvency.

**CONCLUSION**

We assume that the goals of the personal insolvency system under the Code are to steer debtors into insolvency who can repay some meaningful amount of their obligations, to maximise the amount debtors can actually repay, and to make outcomes as predictable as possible for all parties involved. We propose that, to advance these goals, policymakers should specify significant aspects of the structure and content of repayment plans and that such specifications should be aimed at reducing the need for administrative functions and the impact of information constraints. Specifically, we propose that policymakers develop a baseline framework for repayment plans with regard to debtors' budgets; duration; the amount of non-exempt assets that are to be available to creditors; the treatment of secured claims; and the treatment of dischargeable debts. We also propose that, to avoid administrative costs of verification, information about creditors' claims and debtors' financial affairs be treated as presumptively correct unless challenged. If such approaches to the personal insolvency process are
adopted, then we further propose that policymakers reconsider requiring creditor approval of debtors’ repayment plans unless, perhaps, creditors might be given the right to vote to approve plans that provide more relief to the debtor than the specified baselines. Finally, we propose that the IBBI or the Tribunals adopt an approach to steer some debtors directly to bankruptcy, perhaps by creating a framework for RPs or Tribunals to assess insolvency cases at the application stage and determine that they be immediately eligible for bankruptcy.

NOTES

1 IBBI (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Regulations, 2019.
2 As an example of such a protocol, see e.g., the United Kingdom’s Individuals Voluntary Arrangement (IVA) Protocol, 2016, https://www.gov.uk/government/publications/individual-voluntary-arrangement-iva-protocol.
4 Id. at 58 (emphasis added).
5 Id. at 66.
6 Id. at 62.
7 In the U.S., empirical studies have consistently found that most filings are attributable to external shocks, such as a medical event, the loss of a job, or a divorce, and few though some filings appear to be opportunistic. In fact, one prominent study found that, contrariwise, a significant number of debtors who could benefit from bankruptcy relief do not file.
10 Supra Note 4, at 92.
11 Id. at 96-97.
12 IBBI (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors), Regulations, 2019.
13 Supra Note 3, at 75.
14 Supra 12.
15 Section 79(14), IBC.
17 Id. at 86.
18 Sections 96 and 101, IBC.
19 Sections 110(3), (4), IBC.
20 Section 110, IBC.
21 Section 79(15), IBC.
22 Supra note 12.
23 Ibid.
The Code is like another kind of ‘Swachhta’ drive to clean up non-performing assets and to put companies in the hands of capable and credible people.

- Dr. M. S. Sahoo, Chairperson, IBBI, Interview in the Business Insider, March 22, 2020.
Mediation in Insolvency Matters

Rajiv Mani

INTRODUCTION

A disability to repay what was borrowed is the root cause of any insolvency dispute. This disability could be a result of either circumstances beyond one’s control or a wrong decision making in the past, but the endpoint remains constant in all situations. When an insolvency case commences, the creditors compete for the limited pool of assets (estate), which is almost never enough to pay everyone (the common pool problem). Consequently, the debtor is liquidated, which means the end of the business, jobs and tax payments or tax revenue for the State. In terms of negotiation, it does not augur well for any of the stakeholders.

Since the evolution of bankruptcy norms, Courts have been empowered to decide on the disputes of insolvency. In most jurisdictions a separate wing of adjudication (commonly known as Bankruptcy Courts/ Tribunals) has been entrusted the responsibility to surveil the issues in insolvency cases. This is because adjudication ensures equality of the creditors’ claims, fair collection and distribution of the debtor’s assets, and prompt liquidation of the insolvent entity.

However, this perception has changed globally over the past few decades, when more insolvency disputes have been resolved not only by adjudication, but also by Alternative Dispute Redressal (ADR) mechanisms especially, Mediation. Mediation encourages the parties of the dispute to reach an agreement by negotiation and avoid adjudication.

INTERNATIONALLY RECOGNISED FORMS/MODES OF ADR

ADR is a set of methods or techniques that allows parties to a dispute to reach an amicable settlement. It provides for techniques of out-of-court settlement by avoiding lengthy litigation. ADR methods are now widely accepted and have been gaining recognition because of their wide applicability. The application of ADR is different in different jurisdictions due to the existing variations in established legal principles. The methods of settlement that are widely accepted are Arbitration, Mediation, Conciliation and Negotiation. Some aspects of these procedures are presented in table below.
In this context, it would be relevant to have a look at use of ADR mechanism in insolvency disputes in foreign jurisdictions. The same are discussed below.

**United States of America**

In response to the increase in civil disputes and socio-economic changes taking place, Mediation began to be used to resolve community and family disputes in the United States in the 1960s. In response to the increase in civil disputes and socio-economic changes taking place, Mediation began to be used to resolve community and family disputes in the United States in the 1960s. Though it gained early success, it took a while for it to be used in insolvency disputes. The watershed moment was the Pound Conference, where Harvard Professor, Frank Sander introduced the concept of ‘multi-door courthouse’ and encouraged looking for different dispute resolution methods. Instead of walking through the door of a courthouse and commencing adjudication, the parties should look for ‘alternative doors’ which would lead to the same result (resolution of the dispute). He emphasized that there is ‘a rich variety of different processes, which, I would submit, singly or in combination, may provide far more “effective” conflict resolution.’ This quote captures the three basic pillars of ADR:

- Firstly, different ‘doors’ (procedures) offer different dispute resolution mechanisms.
- Secondly, those mechanisms can be used ‘singly or in combination’, meaning that different ADR methods may be used for resolution of the same dispute (and ADR can intertwine with adjudication).
- Thirdly, it must be effective.

ADR (Mediation) in USA was introduced for insolvency cases in 1986, when the Bankruptcy Court for the Southern District of California established the Mediation program. A few years later, Mediation was used in the USA when Greyhound Lines Inc. went bankrupt and set up a pre-reorganisation Mediation plan for thousands of claimants who had brought personal injury and property damage claims against the company in connection with traffic accidents involving Greyhound vehicles. This case is a relevant example of multi-party dispute resolution in which the debtor dealt individually with each creditor.

The ADR procedure in the Greyhound dispute consisted of three separate stages, viz.:

- First, the creditor had to complete a claim form for lost wages, medical bills, and other damages (the ‘offer and exchange stage’).
- Second, the parties negotiated damages. If the creditor refused to participate in this stage or a final decision was not reached, the parties engaged in Mediation for sixty days.
- Third, if the parties failed to reach an agreement, they had to take recourse to arbitration. Half of the claims were resolved in the first stage. This is an example of a win-win negotiation which made it possible to resolve the case promptly, avoid adjudication and litigation costs, reconcile the interests of the parties, and end the dispute peacefully.

Considering the successful examples of ADR, the growing number of bankruptcy cases, and increasing litigation costs, a legal regulation for ADR was established. A major legislative leap towards the use of ADR in insolvency cases was the adoption of the Alternative Dispute Resolution Act in 1998, which required that each federal district court authorise ADR in ‘all civil actions, including adversary proceedings in bankruptcy’ For instance, in 2004 the Bankruptcy Court for the District of Delaware established that before certain adversary proceedings, the parties had to attempt to reach an agreement by Mediation. As a result, ADR was used in 60 per cent of reorganisation cases in USA from 2000 to 2011.
Mediation in Europe

ADR has gradually become accepted among the European Union (EU) Member States. This contrasts with ADR in the USA, where it emerged not from case law, but through legislation. Several EU Member States have introduced pre-insolvency dispute resolution methods which are primarily aimed at rescuing the debtor. For example, the French Insolvency law provides for two special procedures: the ad hoc mandate and conciliation. In Germany, the insolvency plan procedure enables the debtor and the creditors to conclude an insolvency plan (Insolvenzplan) by negotiation. The Italian insolvency system offers several possibilities to entrepreneurs facing financial difficulties to restructure their debt, all of which are conducted – totally or partially – out of Court.

Dwelling some more on the Italian model, the Italian Bankruptcy Law, (IBL-LeggeFallimentare) currently, provides legal instruments for restructuring, all of which have different characteristics depending on the process, on the degree of Court intervention, and on the applicability of the agreement contents to creditors who do not participate in negotiations. The choice between the different instruments depends on the type of the company, as on the measures needed to keep the business solvent.

The Recovery Plan, ‘piano di risanamentoattestato’, is an informal proceeding that can be started by the debtor, when (s)he is in a temporary crisis, through the submission of a plan certified by a qualified professional for debt recovery and for rebalancing the financial situation. The process for negotiating a Recovery Plan is entirely private and confidential; the contractual agreement is binding only upon the creditors involved in the negotiation and does not need a Court approval.

Debt Restructuring Agreement, ‘accordo di ristrutturazioneidedebiti’ (according to art. 182-bis, IBL), is a semi-formal (hybrid) proceeding: because the process for negotiating a Debt Restructuring Agreement preserves its private and confidential nature. The agreement is also binding only upon creditors who have participated in the negotiation. The Court takes a more supervisory role in order to control that the legal requirements are met.

The procedure gives the parties considerable freedom in deciding the contents of the agreement, which may consist of simple financial operations such as a rescheduling of payments or debts cancellation; or in a more complex strategy, such as a combination of debt restructuring operations with corporate reorganization measures (e.g. assets sale; substantial financing commitments; merger, or acquisition transactions). However, according to art. 182-bis, IBL, debtors are compelled to respect certain formalities; with regards to the agreement, it has to be signed by the creditors representing at least sixty percent of the debt exposure; the feasibility of the plan for debt recovery must be confirmed by a qualified professional; the agreement should be approved by the Court; the agreement has to be published in the Companies' Register, along with the relevant documentation (art. 161, par. 2, IBL).

Preventive Arrangement with Creditors, ‘concordatopreventivo’ (art. 160 et seq., IBL), the proceeding for Preventive Arrangement with Creditors has been significantly amended from 2005 to 2015, whereby the process became the Italian equivalent of US's Chapter 11.

In a nutshell, the procedure allows the debtor to seek an arrangement with creditors based upon a restructuring plan certified by a professional. The arrangement is submitted to a certain majority of creditors for approval and consists of a wide range of operations in order to satisfy in whole or in part the creditors; including the sale of assets and the allocation of shares or other financial instruments (the so called liquidation agreement). Despite the many legal changes to make the process more flexible and easier than it has been in the past, Preventive Arrangement with creditors remains a judicial procedure.
The Court must examine the petition and, if it concludes it to be complete and compatible with the applicable rules, it admits the debtor to the procedure for Preventive Arrangement with creditors whereby the restructuring plan is negotiated under the control of an appointed judge and a Judicial Commissioner.

The growing use of Mediation in insolvency disputes has been coupled with the need to reduce the number of insolvency cases and ensure stability in the market (the business rescue culture). Insolvency law is one of the key elements for a well-functioning system of civil and corporate law, and it has significant impact on the entire economic structure. In a socio-economic sense, preventing a company from going bankrupt (winding up) when it is facing financial difficulties provides the opportunity to continue employment, efficiently utilise all available sources (natural resources, technical equipment) and preserve relationships, such as with small suppliers of goods and buyers/customers of products and services. In larger insolvency cases where procedures can become more complicated, Mediation can speed up the process and make it more economical, leaving more value in the estate to satisfy the creditors.

In general, Mediation has witnessed a major shift in insolvency disputes over the past few decades. It has become a counterweight to adjudication and has gained recognition as a suitable mechanism for addressing the difficulties of insolvency disputes by allowing the parties to negotiate debt repayment instead of filing a lawsuit.

**ADVANTAGES OF ADR ESPECIALLY MEDIATION, IN INSOLVENCY CASES**

ADR differs from adjudication. It includes any process designed to resolve a legal dispute voluntarily with third-party assistance and without (significant) involvement of the judiciary. Various forms of ADR exist, but the participation of a third party (a conciliator, mediator, or negotiator) is usually indispensable. The success of resolution of the dispute through ADR depends primarily on the negotiation skills and good faith of the parties. This contrasts with adjudication, where the court conducts proceedings and the litigants must comply with strict procedural laws which may hamper creativity and the effectiveness of dispute resolution.

Firstly, ADR and especially Mediation, increases the likelihood of a win-win scenario and decreases the likelihood of a lose-lose situation. With ADR, both parties satisfy their principal claims by mitigating their demands to some extent (at least in the short term). This is based on negotiations between the parties, supervised by a third party. Negotiations make it possible to ‘separate the people from the problem’ and come to a mutual decision on the problem without (almost) any of the constraints established by law. Adjudication, however, is based upon a ‘winner/loser’ paradigm, meaning that one of the parties ends up losing the case. This can sever commercial relations and trustworthiness between business partners. Sometimes, adjudication results not only in financial, but also psychological stress upon the parties.

Secondly, ultimate resolution of the dispute is not the main goal in some cases. Mediation is often not binding upon the parties without their consent because neither the mediator nor the parties are authorised to resolve the dispute. Some scholars feel that ADR promotes settlement of the dispute rather than reaching an ultimate resolution (like a *res judicata* decision in court). In other words, Mediation allows the parties to assess their positions and consider the final resolution of the dispute in the future. Even if Mediation fails to bring a settlement immediately, the shift in the parties’ attitudes regarding their own positions can lead to a settlement in the future. Mediation encourages the parties
to bargain and find a mutual solution. In adjudication, a final and binding decision must be rendered in each case. When an insolvency (bankruptcy) case is commenced, it usually results in the winding up of the debtor and triggers the irresolvable common pool problem.

Thirdly, Mediation preserves a ‘normal’ relationship between the parties. It is usually a private procedure rather than a public one, allowing the parties to avoid publicity of the dispute. This is particularly a valuable incentive in business relations (securing commercial secrets and other relevant information). In contrast, all disputes that require adjudication become public (except in select cases), and the court, as a general rule, has to allow public access to proceedings.

Fourthly, Mediation is flexible—it allows the parties to reach an agreement through persuasion and promotes ‘party-driven solutions’. The parties can decide upon the procedural and substantive rules of dispute resolution. In adjudication (especially with insolvency cases), the parties are bound by strict procedural rules from which no derogation is permissible. The rules for civil (insolvency) proceedings may decrease the effectiveness of fast dispute settlement.

Overall, Mediation makes it possible to avoid some of the inherent shortcomings of adjudication (e.g., cost, publicity, lack of flexibility) in insolvency disputes. This is valuable because the debtor’s assets are not wasted on litigation, and other costs. The commencement of an insolvency case reveals the debtor’s problematic financial situation and hinders business. Mediation provides strong incentives for both parties to engage in fast and efficient dispute resolution and look for a common business solution.

INDIVIDUAL AND COLLECTIVE INTERESTS IN INSOLVENCY DISPUTES

Insolvency (bankruptcy) cases are collective proceedings in which numerous persons (the debtor, secured and unsecured creditors, a bankruptcy administrator (trustee), co-obligators, etc.) participate. There is, therefore, a dilemma of how ADR can reconcile the interests of all the creditors. Should each creditor participate in the ADR procedure? What effect does the agreement between the debtor and some of the creditors have on all the creditors?

The unique feature of ADR in insolvency cases is that not all the creditors usually participate in the dispute resolution. In contrast to insolvency adjudication, the debtor usually resolves the dispute with the principal creditors (who are likely to initiate insolvency proceedings), and a formal insolvency case is not initiated. For instance, in the USA, ADR is utilised in three contexts for insolvency disputes16:

• to resolve disputes and achieve a consensus with respect to plans for reorganisation;
• for single creditor disputes; and
• for multiple-creditor claims of the same nature.

The debtor can negotiate with each creditor individually (like in the Greyhound case), or with a group of creditors to come to a collective agreement. This situation is defined as a ‘cramdown’. A cramdown is the judicial power to confirm or amend a plan even against the wishes of certain creditors. Thus, when a debtor comes to an agreement with some creditors, the other creditors cannot challenge the agreement and must comply with it.

However, a cramdown is only possible in court-supervised ADR. If the court is not involved in the ADR (at least in the confirmation of an agreement between the parties), a cramdown is not possible, and thus has no effect over the creditors who did not participate in the ADR procedure. In other words, if the peaceful settlement ending the dispute is not confirmed by the court, it does not have effect over
MEDIATION AS AN EFFECTIVE ADR TOOL IN INDIA

In modern times to keep pace with the globalisation of commerce, the Government of India has taken several legislative measures to promote Mediation in the country. For instance:

- Section 442 of the Companies Act, 2013, which provides for referral of company disputes to Mediation by the National Company Law Tribunal (NCLT) and Appellate Tribunal read with the Companies (Mediation and Conciliation) Rules, 2016 (notified on September 9, 2016).
- Section 12A of the Commercial Courts Act, 2015 provides for Pre-Institution Mediation in commercial disputes.
- Section 32(g) of the Real Estate (Regulation and Development) Act, 2016, (RERA) provides for amicable conciliation of disputes between the promoters and allottees through dispute settlement forum set up by consumer or promoter associations.
- Section 37 and section 74 to 81 of the Consumer Protection Act, 2019 (which replaced the Consumer Protection Act, 1986 ) provides for reference of a dispute to Mediation as an ADR Mechanism and setting up of a Consumer Mediation Cell at each of the District Commissions, the State Commissions and National Commission.
- Section 18 of the Micro, Small and Medium Enterprises (MSME) Development Act, 2006 mandates conciliation when disputes arise on payments to MSMEs.
- Section 4 of Industrial Disputes Act, 1947 authorises the appropriate government to engage such number of persons as may be deemed necessary by notification in the Official Gazette as conciliation officers, for discharging the responsibility of mediating in and promoting the settlement of industrial disputes. Section 12 of the Industrial Disputes Act, 1947 provides duties of conciliation officers.

As of now Mediation has not been utilised for resolving of insolvency disputes. Currently insolvency disputes are resolved under the Insolvency and Bankruptcy Code, 2016 (IBC). Before the enactment of the IBC, there was no single legal framework in India that dealt with insolvency and bankruptcy. The provisions relating to insolvency and bankruptcy were scattered over many legislations like Sick Industrial companies (Special Provisions) Act, 1985 (SICA Act) ; The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002 and the Companies Act, 2013 etc.

Performance of IBC

The IBC has proved to be a landmark legislation that has produced potent outcomes in a short span of four years, According to the Reserve Bank of India, the recovery of stressed assets through the IBC route was nearly forty two percent as against an average of ten percent under the earlier methods to recover debts such as SARFAESI Act and Debt Recovery Tribunals (DRTs). The IBC has helped resolve some of the large non-performing asset (NPA) cases such as Bhushan Steel Ltd., Alok Industries Ltd., Essar Steel India Ltd., etc, recouping lakhs of crores of rupees back into the system. As of March, 2020, 3774 corporate debtors (CDs) have been admitted in the IBC process and of them 1135 have exited through resolution plans or liquidation. 221 CDs that have been resolved under the Code with creditors having recovered Rs. 1.84 lakh crore which is about 191 per cent of the liquidation value of those CDs. The Code has brought about a significant change in the behaviour of debtors and creditors.
alike. Thousands of debtors are settling their debts at early stages of defaults, on receipt of notice for repayment, before and even after admission of CIRP to avoid the consequences of the IBC process. Creditors are initiating CIRP at the early stages of default, avoiding ballooning up of unpaid debts.

While the Code has performed well over the last four years, there is still scope for improving outcomes under it. Time taken in concluding a CIRP has been a matter of contention and debate. According to the statute, the entire process of corporate insolvency should not take more than a period of 330 days (from earlier 270 days)\textsuperscript{17} in total, but it is seen that this time period has been exceeded in quite a number of cases due to practical difficulties. However, on an average, as of March, 2020, the time for completion of a process under IBC has hovered around 375 days for resolved cases and 309 days for liquidation cases. These timelines can be reduced further.

The Code has emerged successful in the face of numerous challenges over the past four years. The COVID-19 pandemic has posed a new challenge to the Code. Businesses have suffered tremendously on account of demand and supply chain disruptions and receding sales and revenue caused by the pandemic and the nationwide lockdown. In these trying times, if a firm does default and is pushed into insolvency proceedings, the chances of resolution are bleak as there may not be enough resolution applicants in the market to provide resolution plans. Thus, to prevent many businesses who are reeling under pandemic induced financial stress, especially MSMEs, from being pushed into insolvency, the Code has recently been tweaked to address this challenge. The threshold for initiating insolvency against a defaulting company has been increased from 1 lakh to 1 crore. Further, the provision of section 7, 9 and 10 of the IBC have been relaxed by insertion of section 10A which reads as under:

\textbf{10A. Suspension of Initiation of corporate insolvency resolution process.} - Notwithstanding anything contained in sections 7, 9 and 10, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after March 25th, 2020 for a period of 6 months or such further period, not exceeding one year from such date, as may be notified in this behalf:

Provided that no application shall ever be filed for initiation of corporate insolvency resolution process of a corporate debtor for the said default occurring during the said period.

Explanation. - For the removal of doubts, it is hereby clarified that the provisions of this section shall not apply to any default committed under the said sections before March 25th, 2020.

With the Code suspended for a period of six months, extendable by another six months, the opportunity is ripe to innovate and explore new ways of resolving disputes. Special out-of-court procedures such as Mediation can be explored. Mediation can help reduce the burden of increasing cases on the already over-burdened judiciary. In the context of the IBC, the Minister of State for Finance and Corporate Affairs, Shri Anurag Singh Thakur said in a written reply to the Rajya Sabha, ‘As per the data provided by National Company Law Tribunal (NCLT), total 19,771 cases were pending with NCLT benches as on September 30, 2019, which include 10,860 cases under Insolvency and Bankruptcy Code (IBC), 2016’: This reflects pending court-delays which can pose a setback to the outcomes of the Code that have been achieved so far.

Mediation can be a viable option in a country like India, where the population is enormous, and wealth is not equally distributed. It is an informal process that comes to an end in a few sittings and is very cost efficient compared to the formal process in the courts of law. Mediation has already been implemented
by the judiciary in cases of family and property disputes. This is because the focus of Mediation is on finding solutions that will resolve the concerns of both the parties concerned and parties are free to make their own decision. There is no blame game in a Mediation process. It is a voluntary process and the duty of the mediator is to bring the parties to a mutually agreed solution. Despite being beneficial, Mediation is still struggling in becoming a choice over litigation. On the contrary, in the USA, Mediation has proven to be in frequent use. In fact, court-ordered Mediation in the USA has been very successful in some of the most significant bankruptcy cases, such as Lehman Brothers, etc. and it is time that India should also try and resort to Mediation for the purposes of the corporate insolvency resolution process. Online Mediation has also gained popularity, allowing parties to reach a solution on virtual platforms on real time basis. This can prove to be particularly useful in the current scenario of the COVID-19 pandemic as the world is shifting to online platforms to maintain social distancing. E-Mediation is being resorted to in many cases. It may be noted that CJI Hon’ble Mr. Justice S. A. Bodbe, in an interview with Economic Times in November, 2019 has emphasised on the importance of Mediation as an ADR mechanism and observed that all (commercial) matters could be made to first go through pre-litigation Mediation.

As IBC is a new statute, the experience during its implementation has led us to correct its infirmities over the last couple of years and the jurisprudence on the subject is evolving. Since the IBC lacks provisions for special out-of-court structuring mechanisms such as Mediation, the stakeholders are forced to choose the only default option which is open to them i.e. a formal insolvency resolution procedure. In view of the aforesaid arguments for Mediation, perhaps it is time that the Code may suitably incorporate the same, acting as the link between a formal and an informal insolvency resolution process. Experience has shown that an informal procedure that is recognised by legislation gains more acceptance amongst the stakeholders. Amendments may be considered in the statute in order to inculcate the healthy, inexpensive, and fast practice of Mediation within insolvency process to the extent feasible. This hybrid structure comprising of both formal and informal method of resolution, would help in not only reducing the burden upon the courts/tribunals but save time and money of the stakeholders, as well.

The objective of the Code is to save the life of a distressed company. The Code in tandem with mechanisms such as Mediation, can achieve this objective more efficiently and effectively. The present scenario of the COVID-19 pandemic necessitates Mediation between parties so as to enable quick resolution of disputes. This mechanism can prove to be useful even in the post COVID-19 pandemic scenario to deal with the problem of debt-overhang especially individual financial distress resulting from the crisis. With technology developing at a fast pace, e-Mediation has the potential to pick up in the near future. As envisioned, Mediation coupled with formal insolvency procedure can become the go-to-option for stakeholders, enabling dispute resolution across cultures, jurisdictions and borders.
NOTES


3 Ibid.


10 Ibid.

11 Ibid.


14 Supra Note 1.


19 Ajmer Singh (2019), ” Commercial Disputes should go through Mediation first: Bobde”, Economic Times, 14 November.
Improvement in rankings in ‘starting a business’ and ‘insolvency resolution’ have contributed to the overall improvement in India’s ranking on Ease of Doing Business.

- Smt. Nirmala Sitharaman, Hon’ble Minister of Finance and Corporate Affairs during Part-5 Announcements of Atma Nirbhar Bharat Abhiyan, May 17, 2020
Along with globalisation spreading its wing rapidly, inherent fears of possible economic contagion like the one that unfolded in the form of the 2008 financial crisis also gained currency. It became increasingly evident that resorting to national solutions alone in relation to multinational players may not be effective. In turn, need for having robust institutional arrangement to deal with cross border insolvency issues in an efficient and swift manner gained momentum. The UNCITRAL Model Law (Model Law) was heralded as harbinger of standards which can be emulated by all the countries with suitable modifications as they may deem fit. However, even after over two decades, the number of countries who declared their affiliation with the initiative has just reached 47. In this backdrop, this article explores evolution of the UNCITRAL framework and alternatives which can be pursued in moving forward. Though the ongoing pandemic is compelling countries to scramble through and roll out suitable cross border insolvency frameworks, the difference in terms of integration with global economy and the maturity of financial and legal systems amongst various jurisdictions appear to be compelling enough to press for a framework that thinks beyond the Model Law.

INTRODUCTION

Globalisation – in normal parlance is defined as the state of being globalised especially, in the context of the positive shifts in production possibility curves through development of an increasingly integrated global economy marked especially by free trade, free flow of capital, the tapping of cheaper foreign labour markets, and removal of information asymmetries. Amartya Sen, while pointing out the efficacy of integrated global system highlighted, that presenting globalisation as an economic phenomenon is based on partial analysis. He opined, ‘Globalisation is a complex issue, partly because economic globalisation is only one part of it. Globalisation is greater global closeness, and that is cultural, social, political, as well as economic.’ However, the decade leading to 2020 and the recent pandemic, in particular, is leading us to think otherwise. Thoughts like ‘globalisation has peaked’ or ‘globalisation is dead’ are being deliberated and debated.

The pandemic-induced lockdown has brought economic activities to a grinding halt. Global growth in 2020 is projected at - 4.9 per cent and 2021 at 6½ percentage points lower than the pre-COVID-19 projections of January 2020. FDI flows are forecast to decrease by up to 40 per cent in 2020, by further 5-10 per cent in 2021 with a slow rebound in 2022. Global trade flows are projected to contract between 12.9 per cent (optimistic scenario) and 31.9 per cent (pessimistic scenario) in 2020 with gradual recovery in 2021. Looming uncertainty and bleak outlook have led to a new wave of pessimism, writing off globalisation. The impact of the pandemic is set to have long term scarring for businesses. As the pandemic continues to spread, market-led probabilities of default have increased in G-20 and...
cross border insolvency – a case to cross the border beyond the unictral

Emerging market economies alike. Bankruptcies are to become more common as firms exhaust cash buffers. The failure of a large multinational company can have widespread ramifications in the industry of which it is an integral part; in countries in which its operations are largely based and even the entire global market chain.

Excepting the recent (starting 2019) slowdown in global growth and trade, this decade saw world merchandise trade reach a record USD 19.67 trillion in 2018. India was 17th in the list leading traders of goods and services in 2008 and rose to 11th position in 2018. Global Foreign Direct Investment (FDI) flow was a record USD 1.41 trillion in 2018 and of which India received USD 42 billion and was the 8th largest host country for investments. The year 2018 saw cross border mergers and acquisitions valued at USD 816 billion and FDI greenfield projects of USD 999 billion announced across the world. There were an estimated 164 million people who worked in other countries in 2017 and in mid-2019, 5.2 million Indians were working abroad. By all measures India is today more integrated with the world than ever before and globalisation continues to be an irresistible force today as it was in 1991. Having an insolvency law that can deal effectively with cross border issues would provide necessary comfort, in a worst-case scenario where many multinational enterprises are forced into insolvency resolution proceedings.

The ongoing pandemic has posed several challenging questions regarding robustness of insolvency laws dealing with cross border insolvencies and has necessitated a comprehensive response. The choice of framework however depends on the country’s level of integration with global economy, maturity of insolvency system currently in place, maturity of legal systems in general etc., among other things. The Insolvency and Bankruptcy Code, 2016 (Code) sought to address cross border insolvency by enabling the Central Government to enter into agreements or reciprocal arrangements with other countries for enforcing provisions of the Code. It has also provided that the Adjudicating Authority (AA) under the Code can issue letter of request to a Court or an authority competent to deal with request for evidence or action in connection with proceedings under the Code in these countries. The Insolvency Law Committee in its October 2018 report on cross border insolvency recommended to the Government adoption of the Model Law.

With this backdrop, this article explores regional efforts to address cross border insolvency. In this regard, it also discusses the UNCITRAL framework and then evaluates the alternatives for India in moving forward. Following this introductory section, the next section presents the evolution of cross border insolvency measures including the Model Law. Section III assesses whether India needs a cross border insolvency framework and section IV assesses the alternatives available. The assessment favours bilateral arrangements over an overarching framework and we suggest that such arrangements may look beyond the Model Law for doing so.

Evolution of cross border insolvency regimes

Regional efforts since the 19th century

The earliest attempt to address international aspects of insolvency was made in Latin America in the South American Congress of Private International Law of 1888-1889. The Montevideo Treaty of 1889 provided rules for liquidation, the concept of unity of proceedings and vesting jurisdiction in the State of the debtor’s commercial domicile. The Treaty, revised in 1940, defined ‘commercial domicile’ and provided guidance for compositions, suspension of payments and analogous proceedings (Majumdar, 2009). Even as the Treaty existed, the Havana Conference in 1928 gave the Bustamante Code...
adopted by 15 Latin American countries. It provided both the concept of unity and universality for some countries. These were initial attempts to provide any guidance on insolvency matters between countries that were integrated economically and had similar legal cultures. These had broad application but gave preference to local creditors (Cunningham & Werlen, 1996) 18.

In 1933, the Nordic States of Denmark, Finland, Iceland, Norway and Sweden concluded a convention regarding bankruptcy. This convention was later amended in 1977 and 1982. The convention provided for amalgamation of assets into one estate and distribution according to the rules of the State where proceedings were opened in the bankrupt’s residence or registered office. It provided for recognition of bankruptcy proceedings in other states, judicial assistance, and recognition of judicial decisions.

In Europe work started in 1894 as part of the Hague Conference and in 1928 it was decided to transform the multilateral convention into a model bilateral treaty, which saw very little adoption. The Council of Europe concluded the European Convention on Certain International Aspects of Bankruptcy in 1990, which provided for ‘main and ‘secondary’ bankruptcy proceedings. In May, 2002 EU Regulation 1346 came into force repealed in May 2015 by the Regulation (EU) 2015/848 and issued a ‘Recommendation of 12.3.2014 on a New Approach to Business Failure and Insolvency.’ Regulation 1346 provided uniform rules for the settlement of cross border insolvencies and focussed on coordinating insolvency proceedings as they existed in member states rather than creating uniform rules, whereas Regulation 848 and the Recommendation ‘signal the new approach.’ The objective is to foster the creation of a homogenous legal framework for business restructurings across EU while also striving to promote a common and uniform legal, economic, and financial environment between the European Union and the United States (Manganelli, 2016) 19. The latest EU Regulation also is short on cooperation with non-EU countries in insolvency matters.

**UNCITRAL Model Law on Cross Border Insolvency**

At the Congress on International Trade Law in May 1992 in New York countries proposed that the UNCTRAL20 (Commission) to consider undertaking work on international aspects of bankruptcy. Work initiated in 1992 then led to the adoption of the Model Law on Cross-Border Insolvency on May 30, 199721. Working Group on Insolvency Law of the Commission continues to work on issues cross border insolvencies of multinational enterprises.

The Model Law22 is unlike other multilateral conventions merely offers legislative guidance for states. The objective of the law, as stated, is ‘to assist states to equip their insolvency laws with a modern, harmonised and fair framework to address more effectively instances of cross border insolvency.’ It focusses on encouraging cooperation and coordination between countries, rather than attempting unification, and respects the differences among national laws. The Model Law is based on four main principles23: Access, Recognition, Cooperation and Coordination. It allows foreign professionals and creditors direct access to domestic courts and enables them to participate in and commence domestic insolvency proceedings against a debtor. It allows recognition of foreign proceedings and enables courts to determine relief accordingly. It provides a framework for cooperation between insolvency professionals and courts of countries and for coordination in the conduct of concurrent proceedings in different jurisdictions. It appears to be a comprehensive instrument as it builds upon the prevailing bilateral frameworks and extends the flexibility for deviations as per the requirement of any particular jurisdiction. The Model Law, at best, provides a broad framework leaving individual jurisdictions to decide about the operational nitty gritty and altogether refrain from suggesting any mechanism through which differences in approaches within the ambit of Model Laws, as adopted by the various countries, can be resolved.
It has been adopted in 47 States in a total of 50 jurisdictions. An interesting mix of countries have adopted the Model Law. It includes advanced economies like UK, USA, Canada, Australia, New Zealand, Japan, Singapore and small developing economies like Chad, Chile, Congo, Togo, Myanmar, Uganda etc. The emerging market of BRIC economies (except South Africa), whole of ASEAN (except Singapore and Malaysia) and whole of European Union except for UK are yet to adopt the Model Law. Several economically advanced jurisdictions have refrained from joining the multilateral solution offered by the UNCITRAL Model Laws and their absence undermines the utility of the Model Law.

CROSS BORDER INSOLVENCY LAW IN INDIA

Efforts towards a cross border regime

India saw its first cross border insolvency in 1908, the Macfadyen & Co. case. The proceeding was the liquidation of an Anglo-Indian partnership, after the death of one of the partners. The London and Madras trustees came to an agreement, confirmed by Courts in both jurisdictions, on admitted claims and promised that surplus sums would be remitted to the other proceeding for a global distribution. When the agreement was challenged, the English Court stated that the agreement was ‘clearly a proper and common-sense business arrangement’ and that it was ‘manifestly for the benefit of all parties interested’ (Wessels et al., 2008).

In May, 2000, the Eradi Committee Report took into account the fact that globalisation of trade and opening up of the economy has taken place and with these sweeping changes, that the issues relating to cross border insolvency have become increasingly important and recommended that the Model Law be implemented in India by amending Part VII of the Companies Act, 1956. In the following year, the Advisory Group on Bankruptcy Law (Mitra Committee) stated that the Indian law, (as existed then) ‘is not comparable to the standard set in international legal requirement and as such stands apart and alone and has not taken into consideration of any cross-border relation.’ Both committees recommended adoption of the Model Law as well as the revamping of the domestic insolvency and bankruptcy laws. Despite several reports acknowledging the need for a cross border insolvency law and recommending adoption of the Model Law for more than two decades it is yet to be accomplished. This warrant answering the question: Whether such a law is required?

Economic imperatives

India’s economic interaction with the rest of the world has been increasing over the last three decades since the start of liberalisation and more so with deepening of the financial markets.

The Reserve Bank of India’s annual census on foreign liabilities and assets reported that 20,732 companies had FDI/ODI in their balance sheet in March 2018 and the total flow of FDI (inwards and outwards) was Rs. 33,526 billion. Indian companies continue to expand and operate across borders. Around 70 per cent of these flows happened in six countries namely, Mauritius, USA, UK, Singapore, Netherlands, and Switzerland.

Today, financial markets are a vast network consisting of credit (borrowing-lending relationships, counterparty exposures and implicit relationships), derivative contracts, collateral obligations, market impact of overlapping asset portfolios and the network of crossholdings interact in several complex layers across countries. The extent and magnitude of inter-connectedness in financial markets and institutions across countries has led to transmission of systemic risk and ensuing contagion which has been a cause of concern especially after the financial crisis (IMF, 2011). An assessment of cross
border inter-bank contagion risk analysis for Indian banking sector (Sharma, 2018), has brought out that the United States, United Kingdom, France, Germany and Japan are among the most important players in the cross-border banking network pertaining to India.

The banking channel remains predominant for cross-border capital flows with India, though external commercial borrowings have increased in the recent years. Global cross-border bank claims continued to expand rapidly, growing at 9 per cent year on year reaching USD 31 trillion at end-September 2019. Banks of Indian origin had an equity of USD 8.9 billion, which is 0.15 per cent of the total global bank equity. Total foreign claims of banks of Indian nationality stands at USD 212.8 billion (0.37 per cent of total foreign claims). Of this, non-bank private sector claims form the largest counter party at USD 33.5 billion. Other potential exposures include derivatives contracts of USD 58.9 billion, guarantees extended at USD 30.0 billion and credit commitments of USD 2 billion. Analysis by the Bank of International Settlement states that in India, the corporate sector has been the dominant recipient of debt flows, though bank flows increased considerably after 2010.

The share of India's merchandise exports in world exports has gone up from 0.5 per cent in 1990 to 1.7 per cent in 2018. Top ten trading partners supported half (49.6 per cent) of India's trade in goods, during the year 2018-19. India has trade deficits with eight of these countries and has trade surplus with only two of its top ten trade partners, namely USA and UAE. India's services exports have grown rapidly over the past two decades. At USD 81.9 billion, net services exports financed 45 per cent of India's trade deficit in 2018-19. At the global level, up to 80 per cent of trade is supported by some form of credit, guarantee or insurance. As far as the role of bank-intermediated cross border trade credit accounts for about one-third of the global merchandise trade credit. Importers in India meet their funding needs largely through buyers' trade credit which in turn may be influenced by both demand (e.g., size of imports) and supply-side factors (e.g., ability and willingness of banks to extend credit). A sizeable amount of cross-border trade credit raised by importers in India is intermediated by domestic banks though foreign banks hold a major share. Domestic banks generally cater to trade finance needs of importers from the MSME sector while large corporates are serviced by foreign banks with large international presence. Domestic banks with large overseas presence in the form of bank branches, overseas subsidiaries and representative offices have higher share in total trade credit approvals.

As all the above factors indicate, as India continues to grow, Indian businesses will expand operations across countries and with increasing financial market linkages, financing needs will also be met from resources across the world. With the growing international trade, domestic businesses will become embedded into global value chains hence exposing themselves to external influences. The Indian financial market continues to evolve and will see increasing connectedness with foreign markets and the Indian banks consolidating their position domestically will look to expand across boundaries. Cross border interactions, in the form of shareholder-management, creditor-debtor, supplier-buyer, value chain partners, distributors etc., would become the norm rather than the exception for businesses. Failures and insolvencies with cross border elements will be inevitable and India does need a regime that is internationally acceptable and is able to deal with the complexities these situations may present in the context with countries with which is economic interest of the country are of paramount importance.

**ASSESSMENT OF AVAILABLE ALTERNATIVES**

**Existing means for cross border judicial / legal cooperation**

India has acceded to the Hague Convention on the Service Abroad of Judicial and Extra Judicial Documents in Civil or Commercial Matters and the Hague Convention on Taking of Evidence Abroad in
Civil and Commercial Matters, 2007. They provide mechanisms for cooperation in accessing judicial systems across countries.

With respect to the civil matters, the Code of Civil Procedure (CPC) supports recognition and enforcement of foreign judgments. Judgments by foreign courts are considered generally conclusive for the parties with few exceptions identified in Section 13 of the CPC. Section 44A of the CPC provides that the decree of foreign courts may be executed in Indian territory, when conditions such as it being a decree from a superior court and from a ‘reciprocating territory.’ Such decrees will have the same effect as a decree of the local District Court in India. There are 11 countries recognised as such by the Central Government so far, the latest being the UAE. Some of the other countries notified as reciprocating territories include United Kingdom, Republic of Singapore, Federation of Malaya, and Hong Kong.

A decree from a non-reciprocating country can be enforced through a new suit filed before the relevant Court in India, based on the judgment from the foreign Court or the original cause of action, or both. Section 45 of the CPC provides for execution of decrees of an Indian Court outside the territory of India under conditions that the Central Government establish the transferee court in the foreign country and the State Government notify that the said decree will apply to the foreign court. The CPC also provides for simultaneous execution at more than one place. Section 51 provides for execution of decrees by delivery or sale of property for repayment of debt, appointment of a receiver, and arrest and detention with reasonable opportunity for judgement-debtor to present his side.

These sections are being used despite the wide differences in interpretation given by the Indian Courts in interpreting foreign judgments. The use of these sections for cross border insolvency issues (in India for foreign creditors and vice versa) will be further constrained by lack of clear understanding about complex foreign laws and the need to engage legal support in one or more territories. This has implications for cost of insolvency proceedings and may be prohibitive. Furthermore, this option is restricted to enforcement of Court decrees but not cooperation in proceedings, cooperation between courts/insolvency professionals etc., which are required in a cross border insolvency situation. The use is also constrained by long drawn judicial processes and is limited to enforcement of orders from courts only. In insolvency proceedings the insolvency representatives are also empowered to make decisions which are not enforceable through these sections. Enforcement of decrees from non-reciprocating countries is more constrained since a new suit in the Indian Courts is bound to be plagued by delays and consequent costs. Indian businesses use similar provisions available in other countries, (most common law countries have them) to enforce decrees of Indian Courts and would face similar constraints abroad. A mix of instruments, multiple authorities and Courts mean additional costs and delays for enforcing foreign Court orders in India and could be a significant factor influencing countries thinking of reciprocation arrangements with India.

**UNCITRAL Model Law**

The Model Law comes with strong recommendation as the global solution for resolving cross border issues. The World Bank noted that insolvency proceedings may have international aspects, and insolvency laws should provide for rules of jurisdiction, recognition of foreign judgments, cooperation among courts in different countries and choice of law. The IMF encourages its adoption as it would provide an effective means of achieving cooperation and coordination among courts and administrators of different countries. Questions of legitimacy are minimum, as India has been a member of the Commission and part of the consultation and drafting of the Model Law. However, the legitimate concern is that till date global consensus on the framework is lacking. Firstly, major economies which
are important from the point of view of economic interest for India, have not adopted the Model Law. These countries include European economies such as Germany, France and major economies like Brazil, Russia, and China. Secondly, even the countries which have adopted the Model Law have done so with tailor-made changes to foster their economic interests which may be difficult to comply at bi-lateral level.

The countries that have adopted the Model Law have done so for various reasons. USA adopted the Model Law and it is nearly verbatim in 2005 in Chapter 15 of its Bankruptcy Code. The introductory section details the rationale and benefits of adopting the Model Law and reflecting the reasons as cooperation, legal certainty, fairness, maximising value of debtor’s assets, and rescuing financially troubled businesses. While adopting the law, Australia saw it as a policy to promote efficiency, reduce legal uncertainties and transaction costs and enhance international trading efficiency (Government of Australia, 2002)\textsuperscript{47}. Malaysia, while considering the Model Law, has opined that the law represents perhaps the most important step taken thus far in trying to achieve a truly international framework for cooperation in insolvencies, in contrast to the limitations of uniquely domestic legislation as well as previous efforts on a regional scale, not all of which have met with success (Omar, 2000)\textsuperscript{48}. Singapore adopted the Model Law in 2017 and indicated that it provided a clear and internationally recognised framework (Government of Singapore, 2016)\textsuperscript{49}. ThLaw was considered a firmer and more predictable platform for cross border cooperation in insolvency matters, thereby lowering the risks and cost of international financing and reduced cost of litigation\textsuperscript{50}.

Access and recognition of Indian proceedings will be easier in the jurisdictions that have already adopted the Law. Of these jurisdictions, India has significant economic ties with six countries namely, USA, UK, UAE, Japan, Korea, Singapore, and Mauritius. It is stated that adoption of Model Law will serve as a strong signalling factor. It may be seen as a progressive and forward-looking market reform and will project a positive international image when its peers Brazil, Russia and China continue to have laws based on territorialism (Kargman, 2012)\textsuperscript{51}.

Russia’s bankruptcy law is silent on recognition of foreign proceedings (Trunk, 2007)\textsuperscript{52} and only recognises foreign judgments regarding insolvency where an international treaty exists with that country. Brazil has encountered from the growing number of mergers and acquisitions between local and foreign companies originating from Europe and the USA but so far has not moved for adoption of the Model Law even as it has regional agreements with other Latin American countries. As a general rule, Brazilian courts do not recognise foreign insolvency proceedings and do not coordinate and cooperate with courts and insolvency administrators from these states (Locatelli, 2008)\textsuperscript{53}. China enacted the Enterprise Bankruptcy Law in 2007 and removed the distinction between domestic and foreign creditors. The law is considered as an acknowledgment of the global nature of Chinese business operations and the need to protect Chinese creditors. As of 2013, China also had civil and commercial judicial assistance treaties/ agreements with 32 countries, often including provisions for cross border insolvency (Gong, 2013)\textsuperscript{54} despite which, cross border resolutions have not been smooth.

Advocacy in favour of adoption of the Model Law heavily rests on its flexibility and to accommodate our domestic laws (Code) with the necessary modifications. Nevertheless, the major issue is that it is more a procedural law than substantive, allowing for customisation. Such flexibility seems to militate against the objective of harmonisation across jurisdictions. The exceptions adopted by countries have been much wider than contemplated by the Model Law. The Model Law does not require reciprocity, there is no requirement that a foreign representative wishing to access facilities under it must have been appointed, or foreign proceedings commenced, under the law of a State which has adopted it. A
lot of the countries adopt Model Law with the reciprocity requirement incorporated in their modified model such as South Africa, Mexico, Romania, and Mauritius. Such reciprocity requirement can exist in different forms too for e.g. in some countries the reciprocity requirement is automatically met when other country adopts Model Law whereas in some countries the reciprocating requirement is met when the government of the enacting country notifies specific foreign countries. There is a lack of standard approach for interpretation of ‘public policy’ is a major hindrance in the Model Law. Many countries have dropped the word ‘manifestly’ while adopting law which has created a mismatch in the standard of care that a court need to apply while interpreting the term public policy.

Other concerns regarding the Model Law

Firstly, the role and powers granted to a foreign representative under the Model Law may not be very pleasing to legislators as it gives wide powers without any regulatory check on them. It fails to provide appropriate measures to curb the instances of misfeasance in cross border cases. The only check provided is Article 21(2) which requires the court to be satisfied that the interests of local creditors are ‘adequately protected' before the foreign representative is entrusted with the distribution of the debtor's assets within the State.

Secondly, in its present form, it fails to address the issue of conflict of laws in a cross-border insolvency proceeding and leaves the issue at the mercy of application of private international law by the Courts in respective jurisdictions. It does not expressly deal with conflict of laws; however, it does allow for cross border insolvency agreements which have been effectively used by parties to address the issue. Jurisdictions with different stages of maturity cannot protect the advantages emanating from Model Law uniformly.

Differing interpretations offered to crucial provisions of the Model Law by courts in the US and the UK despite both having adopted the Model Law early on has led to the question of whether the objective of harmonisation has failed. Case laws in the US and UK have been informing the UNCITRAL legislative and practical guides heavily and such differences in interpretation weakens the attractiveness of the Model Law.

At the core of any economic contagion are financial instruments and multinational enterprise groups with cross country value chains managed through subsidiaries. The Model Law does not have any clear solution to offer for these aspects.

Use of the Model Law in adopting countries

The USA is not only an early adopter, but the Model Law was substantially influenced by the US Bankruptcy Code 1978 (section 304 and 305). Model Law was later adopted as Chapter 15 of the US Bankruptcy Code and both offer cooperative territorial approach. Adoption of the Model Law led to increased willingness of Courts to recognise foreign proceedings (Westbrook, 2013) however has not led to adoption of all the principles in the right spirit. In order to obtain relief the foreign representative has to approach the US courts for recognition of foreign proceedings but the Courts are not required to adjudge the foreign proceeding as a main proceeding even if Courts in the other jurisdiction have done so. Sufficient protection of domestic creditors continues to be an important factor in the Court's decision to grant relief. Relief granted can be conditional, as found appropriate by the Courts including the giving of security or a bond. The Courts are not required to defer to foreign Court orders in terms of the distribution of assets to foreign proceedings. While the Model Law has been adopted almost verbatim but there is ‘significant rewriting to comport with procedural terminology and concepts in
United States vernacular’. An empirical study (Leong, 2010) finds that though Courts recognised foreign proceedings in almost every Chapter 15 case, assets were entrusted to foreign proceedings in only 45.5 per cent of cases. Even when entrusted, there were accompanying orders to protect US creditors by seeking that the distribution priority scheme be in accordance with US laws or assurances that they be paid in full or in priority. US Courts have also placed the requirement that an applicant seeking recognition of foreign proceedings should qualify as a debtor under the domestic Bankruptcy Code, which is not in line with the Model Law. Courts in the USA seem reluctant to relinquish control over assets to proceedings in other jurisdictions.

The Model Law was implemented in Great Britain through the Cross-Border Insolvency Regulations 2006 and added another law to deal with cross border insolvency framework provided by common law and section 426 of the Insolvency Act 1986. Though Courts have used the Model Law provisions to allow access to foreign representatives and relief to creditors in several cases there has been reluctance to implementing reorganisation plans approved in foreign proceedings without a parallel domestic proceeding. There is an emerging view that the Model Law is enabling softer form of cooperation which may not be aligned to implementing the Model Law in its spirit.

Divergence in the implementation strategies of the Model Law in Australia, Singapore, Japan, and Korea, are attributed to legal origin and path dependence, compatibility with approach to insolvency in the existing domestic laws, commitment towards adopting global norms and the changing judicial attitudes (Wan & McCormack, 2020). Whatever the explanation for the divergence, it is irrefutable that divergence exist, and that harmonisation has been limited in letter and more so in spirit.

PROTOCOLS IN CROSS BORDER INSOLVENCY

Protocols are agreements or arrangements entered in insolvency cases and may cover a broad range of issues arising in cross border situations. It was first used in 1991 for insolvency proceedings of Maxwell Communication Corporation plc for coordination between proceedings in the UK and USA and was accompanied by the appointment of an Examiner to facilitate such coordination. Since then protocols have been used by US Courts in many cross-border insolvency situations. Protocols have been used in complex cross border insolvency cases such as Lehman Brothers (2009), involving 2985 legal entities in over 50 countries. They have also been used successfully in complex cases such as Bernard Madoff, Nortel Networks, Singer International, and Owens Corning.

The Model Law in Article 27 (d) provides for ‘Approval or implementation by courts of agreements concerning the coordination of proceedings;’ as a form of cooperation between parties. This covers the use of protocols as well as.

Protocols offer a set of solutions designed to meet case specific needs and considers bankruptcy principally a private dispute between parties. They do not predetermine substantive legal issues but aim to harmonise management of the case even before conflict arises. They generally create a framework for communication, data sharing, asset preservation, claims reconciliation, and dealing with inter-company claims. Protocols provide necessary flexibility for amendments to accommodate the emerging needs as a proceeding may require. The use of protocol in the Everfresh case lead to an estimated aggregate value maximisation of 40 per cent.

Apprehension about effectiveness of protocols have been noted regarding cooperation between common law and civil law countries where the approach to insolvency and powers of the Courts vary.
widely regarding the making and enforcement of such arrangements/protocols. It is also observed that larger the number of territories and many-layered corporate structure of large multinational enterprises may require protocols that are complicated. The compatibility of protocols with national insolvency laws has also been raised along with the considerable cost and effort required to conclude successful negotiations of them.

Protocols are hence, seen as an imperfect yet effective tool in encouraging cooperation in cross border insolvency proceedings. The EU has considered detailed Guidelines for its member states on the framing and dealing of such protocols. These are case specific and are more complicated than bilateral arrangements. Given the complexities in cross border insolvency situations negotiating an agreement for every case could debilitate the process itself let alone the time required for such understanding.

THE JET AIRWAYS (INDIA) LIMITED CASE

The corporate insolvency resolution process of Jet Airways (India) Limited commenced on June 20, 2019 after application under section 7 of the Code filed by State Bank of India was admitted. The resolution professional (RP) set up an Asset Preservation Team.

It was later found that a Dutch Court had initiated insolvency proceedings earlier and appointed a Bankruptcy Trustee in Netherlands, the company’s Europe hub. The process was initiated based on claims of unpaid dues worth Rs. 280 crore by two European creditors and seizure of the company’s aircraft parked at Schiphol airport in Amsterdam was ordered. The Dutch administrator’s petition for recognition of the Netherlands proceeding was allowed by the NCLAT (earlier refused by the NCLT). The administrator was allowed to be part of the committee of creditors (CoC) and attend its meetings but with no voting rights. The Appellate Court directed the RP and CoC ‘to consider the prospect of co-operating with the Dutch Trustee so as to have a joint corporate insolvency resolution process of the company’ and ‘to reach an arrangement/agreement with the Dutch Trustee to extend such cooperation to each other, further allowing the CoC to guide the RP to enable him to prepare an agreement in reaching the terms of arrangement of cooperation with the Dutch Trustee in the best interest of the Company and all its stakeholders’.

The parties entered into the ‘Cross Border Insolvency Protocol’ with terms and conditions agreed upon; with a clear aim and purpose; communication and information; rights of the RP and Trustee to appear and attend in Courts of both jurisdictions; cooperation in preserving assets; collation and review of claims and costs; and COMITY (centre of main interest). Based on this Protocol, the Dutch Trustee and the RP collated claims in their respective jurisdiction and reviewed each other’s verification process of claim admission / disputes based on the sample received. Claims received have been recognised by courts of both jurisdictions.

The Protocol seems to be working successfully as seen from the fact that the resolution process has progressed since then. However, it remains to be seen if the Protocol will be flexible enough to allow for parties from other jurisdictions to be part of the process, what kind of cooperation will be extended by the other countries as part of such a Protocol and the effectiveness of such a Protocol in achieving the purpose of resolution of the impaired airline.

Purpose-specific bilateral agreements

India has certain purpose specific bilateral/multilateral arrangements. India has signed Mutual Legal Assistance Treaty in civil and commercial matters with six countries and Memorandum of
Understandings with seven others, for cooperation in the area of law and justice, exchange of information, legal assistance along with the Extradition treaties and arrangements. India has signed bilateral investment treaties with several countries and has investment chapters in its free trade agreements/partnerships which provide for protection of investments made in each other’s territories. These instruments are specific to the purpose and are on a reciprocating basis.

The Code enables the Government to enter into bilateral arrangements. If this option is to be used India would have to negotiate such arrangement with at least 15 countries to begin with as required by the extent of flow of capitals, trade links and expansion of Indian businesses. The constraint with these arrangements is that they require extensive negotiations and take years before common ground is reached. In a field as complex and dynamic as cross border insolvency finding common ground may be harder and require regular reviews. It would be a challenge to design a comprehensive instrument with flexibility that allows for customisation to individual reciprocating jurisdictions.

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Insolvency agreements are entered into for the purpose of facilitating cross border cooperation and coordination of multiple insolvency proceedings in different States concerning the same debtor.

**Evaluating the alternatives**

The suitability of any of the alternatives discussed above for adoption in India is considered through a cost-benefit framework. Adoption of any alternative involves costs in terms of framing of legislation, parliamentary approval, dissemination etc., and benefits in terms of flexibility in legislation, coverage in terms of jurisdiction, ease of use for stakeholders etc.

The existing means for cross border judicial/legal cooperation under the CPC does not require any new legislations or approvals but lack the kind of flexibility required for facilitating cooperation in insolvency proceedings. It is accessible to representatives from all jurisdictions but is dependent on an already excessively burdened Indian judiciary and will be constrained by all existing limitations of the system. The judiciary will be forced to rely on international experience in dealing with such matters but be left without adequate domestic legal backing specific to the domain.

The Model Law would require amendments to the Code and Parliamentary approvals for all related regulations. These regulations would have to be framed afresh and educating the stakeholders on these will be important factors for its successful implementation. It offers the most comprehensive of provisions and required flexibility for modifications, but international experience shows that such modifications tend to reduce the impact of the law’s adoption in the long run and reduces the universalist element of the law itself. There is also an undecided debate on the pros and cons of the deviations that countries have already used in their adoption of the Model Law. In terms of the technical and interpretative assistance for courts and other stakeholders the Model Law, provides ample material and guidance which cannot be said for any other alternative considered in this paper. In terms of jurisdictions covered the number is limited to 47 jurisdictions that have already adopted the law and these does not include countries that are significant for India in terms of its ties with them in the present and potential ties in the future.

Protocols in cross border insolvency have been successfully used internationally for resolving complex cross border insolencies. Use of these as the instrument of choice would require amendments to the Code and framing of regulations accordingly. The need for education and dissemination of stakeholders also follow. The judiciary and stakeholders have flexibility to tailor make the terms and conditions but will have to rely on international experience. The success of a protocol is ultimately dependent on the
willingness of parties - private, governments and judiciaries, to cooperate. The lack of cooperation from a single party can derail the entire proceedings and cost resolution of the debtor altogether. The time required for confirmations of these protocols can be prohibitive if early resolutions are the objective. The judiciary bears the entire burden with no statutory fall back that can help with case specific issues.

Insolvency-specific bilateral agreements as the instrument of cross border insolvency does not require any amendments to the Code. There will be considerable effort required to develop a model bilateral agreement that can be used with minimal modifications to suit the needs of the negotiating partner countries. India has experience with the model bilateral investment treaties that can be put to good use here. It will require establishment of basic principles in dealing with cross border insolvencies which can be based on the Code and the Model Law. In terms of coverage, prioritisation of countries that India has deep ties with becomes possible. There are limitations in terms of international experience in the use of this option but closer study of the regional agreements of Nordic countries and the EU Regulations will be of relevance.

CONCLUSION: GOING BEYOND THE ALTERNATIVES

Each of the alternatives considered have potential benefits and limitations. There is considerable advocacy for adoption of the Model Law but accounting for the fewer adoptions in the jurisdictions that are relevant for India is a dampener along with the evolving view that spirit of the Model Law is not reflected in the implementation of the Law in countries that have adopted it. It is difficult to discount the Model Law as it incorporates the distilled wisdom of cases over more than half a century and from a wide spectrum of countries with varying approaches to deal with insolvency but it still has glaring gaps in keeping out special types of entities such as banks. This gap is of grave concern as integration of the global economy is hastened by financial integration and leaving them out of cross border insolvency regime places it in a disadvantageous position. If India is looking for a regime that is more workable and extends the objectives laid down for domestic insolvency resolution to cross border situations, then the Model Law is clearly inadequate.

India will have to think beyond the Model Law. The Financial Stability Board (FSB), which works closely with the G20, in 2015 laid down a set of principles that would make cross border resolution of banks/financial entities practicable and effective. This set of principles draws from the Model Law but goes beyond it. It suggests that a statutory framework should provide for recognition of measures from foreign resolution actions that is supplemented with supportive measures and complemented with contractual arrangements. While prescribing a framework for an effective regime for India is beyond the scope of this paper it certainly finds that the Model Law is inadequate and crossing the border set by the Model Law in lines of framework proposed by FSB may be a good starting point for India. It will enable India to think beyond the Model Law yet incorporate the essential principles that the Model Law recommends. Keeping in view the economic interests of the country, adoption of country by country approach will be a bold move and shall be targeted and may become an example in the future world where globalisation in its current form is undergoing significant change owing to prevailing pandemic situation.
NOTES

2 An interview by David Barsamian with Amartya Sen from the April 2001 issue of “The Progressive”, 29 September.
5 IMF, 2020, World Economic Outlook Update, June.
8 IMF July 2020, G 20 Surveillance Note.
10 Ibid.
14 Section 234, IBC.
15 Section 235, IBC.
20 The Commission is the core legal body of the United Nations system in the field of international trade law and India has been a member since 1968 and membership continues till 2022. India is also a member of the Working Group on Insolvency Law and was part of the consultation and drafting of the Model law.
23 Supra Note 16.
29 The degree of openness of the economy, measured by the ratio of exports and imports of goods and services to GDP, has risen from 20 per cent in the first half of the 1990s to 44 per cent in the latest five-year period from 2014-19. Dimensions of India’s External Sector Resilience, Keynote Address by Shri Shaktikanta Das, Governor, Reserve Bank of India.
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30. Annual census of Foreign Liabilities and Assets of Indian Direct Investment Companies, 2017-18, reserve Bank of India. The census reports on Indian direct investment companies that have cross border liabilities and assets arising on account of FDI in India and/or overseas direct investment.


34. BIS Working Papers No 760, “Cross Capital Flows by Banks, Corporates and Sovereigns”.

35. Export Import Data Bank, Department of Commerce, Government of India.


54. Gong, Xinyi (2013), “To Recognise or Not to Recognise? Comparative Study of Lehman Brothers
Cases in Mainland China and Taiwan”, International Corporate Rescue 240.


63 Id at p. 46.


66 UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation, p. 28.


69 NCLAT order dated July 12, 2019 and August 21, 2019 in the Jet Airways (India) Limited case.

70 NCLAT order dated September 4, 2019 in the Jet Airways (India) Limited case.


72 Bahrain, France, Russia, Azerbaijan, UAE, Mongolian.

73 Turkey, China, Russia, Qatar, Morocco, UK, Uzbekistan.

74 India scrapped more than 80 bilateral investment treaties in 2015 and new treaties are being signed afresh with a host of countries. Arrangements in Bangladesh, Belarus, Colombia, Taipei, Congo, Bulgaria, Romania, Czech Republic, Brazil, are in force. Negotiations are underway with Iran, Switzerland, Morocco, Kuwait, Ukraine, UAE, Hongkong, Israel among others. https://dea.gov.in/bipa.

75 Comprehensive Economic Partnership Agreement with Japan and Korea, Comprehensive Economic Cooperation Agreement with Singapore and Malaysia and the India-ASEAN Free Trade Agreement.

76 United States of America, United Kingdom, Singapore, Mauritius, China, United Arab Emirates, Germany, France, Japan, Korea RP, Netherlands, Saudi Arabia, Hongkong, Indonesia, Switzerland.

77 Principles for cross-border effectiveness of resolution actions, Financial Stability Board.
Bank merger, GST, faceless Income Tax Assessment हो, हमने हमेशा सिस्टेम में सरकार के देखा को कम करने पर जोर दिया है, और private investment के लिए एक इको-सिस्टम (ecosystem) को प्रोत्साहित किया है।

- Shri Narendra Modi, Hon'ble Prime Minister of India at the inauguration of Annual Session of CII, June 2, 2020.
India’s Tryst with Cross Border Insolvency

Neeti Shikha

There has always been a constructive chaos to the conflict-of-laws process as most of the rules are applied in courts of law giving rise to subjectivity. In absence of a central conflict-of-laws arbiter, there have been many attempts, especially academic ones, at bringing an order to this chaos. Most of these have driven forward the discourse on the unification and harmonisation of laws but, in practice, have failed to obliterate the real problem at hand. This article attempts to evaluate whether the efforts in harmonising cross border insolvency laws through UNCITRAL Model law on Cross Border Insolvency (hereinafter ‘Model Law’) have been successful. The evaluation is critical as India is set to adopt the Model Law in backdrop of its recent insolvency regime and scanty jurisprudence on conflict of laws. The objective of this paper is not to dissuade or criticise India’s decision to join the pact but only to highlight a few challenges posed by the Model Law in the past, the understanding of which will help India prepare for a robust cross border insolvency regime.

INTRODUCTION

The phenomenal growth in international trade and investments has attributed to an increase in the incidence of corporate entities having businesses, assets, debtors and creditors in more than one country. Subsequently, it has also brought into light a major disadvantage, the consistent risk of cross-border insolvencies due to business risk failure (Cooper and Jarvis, 1996; Anderson, 2000).

There is prominent acknowledgment for an international resolution framework (Nadelman, 1944). Interestingly, cross-border insolvency seems to have been a part of the picture for more than 700 years now (Anderson, 2000, Kumar, 2018, Perezalno, 2012).

In the context of India, despite tumultuous growth in economics and international business, the efforts for a recognition for cross border insolvency framework was absent until 2016. Blame it on the legislative preparedness or the legislative lethargy that until enactment of the Insolvency and Bankruptcy Code, 2016 (Code), there was absence of explicit approach to deal with cross border insolvency issues. A comprehensive framework is still under way. Considering the flexibility offered by the Model Law while adopting its text, there is an opportunity to draft a framework for cross border insolvency that suits Indian business landscape and also offers India an advantage as a commercial centre. For this, both the challenges and opportunity of the Model Law is to be understood.

This article has four parts. The first part will discuss the challenges and opportunities that Model Law offers. The second part will discuss whether the Model Law on Insolvency-related Judgments (hereinafter as ‘MLJ’), the new chapter added to the Model Law has been successful in filling the gap. The third part evaluates the recommendations of the Committee on cross border insolvency in India to explore whether the Committee report has duly addressed the gaps discussed earlier in this paper. The last part will discuss the way forward for India and will offer some recommendations that may be adopted by India to create a robust cross border insolvency framework.
UNCITRAL MODEL LAW ON CROSS BORDER INSOLVENCY: CHALLENGES AND OPPORTUNITIES

The effectiveness of the Model Law depends much upon the conscience and willingness of the states and not alone in the letters of the law. Professor Wessels too opined that the success of the Model Law ‘is heavily dependent upon whether, and in what manner, countries choose to enact it.’ (Wessels, 2009). In view of the manner and degree of implementation of the Model Law by the 44 States, it indeed makes it difficult to share any optimism with regards its future.

The Model Law is premised on the assumption that States would wish to make modification to the uniform text given the variance in substantive as well as procedural approach to insolvency in their national laws. Nations may wish to exercise this flexibility wherein modifications need to be made to their national requirement related to procedural compliances. In order to facilitate this, Model Law provides for flexibility to countries adopting the provisions of its document with modifications. This also means that the degree of, and certainty about, harmonisation achieved through a model law is likely to be lower. For this reason, the Guidance note to the Model Law provides that States would make as few changes as possible in incorporating the Model Law into their legal systems. Further, it was hoped that overriding public policy considerations which is recognised as an unruly horse, would be used scarcely.

Ideally, States should have made as few changes as possible in incorporating the Model Law into their legal system (Melnik, 2012). However, a large number of adoptees ended up introducing significant amendments and changes to the Model Law to suit their necessities. Below are some instances how countries have modified their national laws while adopting the Model law. These instances illustrate that the original intention of Model Law to use modifications only to further the cooperation and coordination among nations has somehow been defeated.

However, before proceeding further, the author would like to submit that despite several changes, the benefit of the Model Law in providing for a procedural coordination of cross border insolvency is undeniable. The Model Law is an ambitious law, despite the fact that it is not a treaty and allegedly not even a soft law, it has been adopted by several jurisdictions (Sheldon, 2011). In response to the rising demand for a comprehensive legal framework, the Model Law was adopted in 1997 in the hopes of resolving the existing issues in cross-border insolvencies. Before coming of the Model Law such resolution often fell back either on ad-hoc court-to-court arrangements (e.g. protocols) or regional instruments (e.g. Bustamante Code), which remained few and relatively incompetent (Khumalo, 2004). In light of such drastically different national insolvency laws and territorialist stance on foreign insolvencies, the Model Law was seen as a bold innovation. Further, it went onto become arguably successful with 48 jurisdictions passing legislation on its basis, Dubai Finance Centre (2019), Israel (2018), Zimbabwe (2018) and Bahrain (2018) are the latest entrants in the list. Notable absentees include China, Russia, Brazil and India.

However, the effectiveness of the Model Law got blurred due to the flexibility and scope for modification that it offered to its member States. As such, it did not offer any unification of the substantive insolvency rules. Rather, it focused on the four key elements that lead cross-border insolvency cases: access, recognition, relief (assistance) and cooperation, to achieve coordination and cooperation between the members. But the fact is that a document which is neither a treaty, nor a convention, neither has force of hard law or soft law, loses its teeth if it adopts greater flexibility.
The non-restricting nature of the Model Law permitted the member countries to modify the original text. This flexibility has resulted in the imposition of the reciprocity requirement by a large number of states including but not limited to South Africa, Mexico and British Virgin Islands. Another concern that stems up is that even though the Model Law clearly covered judgments, the recognition and enforcement of such judgments in matters arising in the course of or closely connected to insolvency proceedings, remained less certain. For instance, while the US courts relied on Chapter 15 of the Model Law to enforce foreign claims resulting from transaction avoidance (US Bankruptcy Code, 2011), the UK approach turned out to be the direct opposite. This failure on part of the Model Law led to the development of a new Model Law in 2014 by UNCITRAL, which specifically addressed the recognition and enforcement of insolvency-related judgment which is discussed in the later part of the article. The Model Law has assuaged persistent problems by adopting a pragmatic legal framework (Silverman, 1999) that aides parties through many of the prickly issues that come their way in the international insolvency context.

‘Reigning’ the reciprocity

‘Reciprocity’ is frequently found in legislation in the context of recognition of judgments rather than recognition of insolvency proceedings. The concept of reciprocity has not been defined in the Model Law. However, it can be gathered from various cross border insolvency case laws that reciprocity is respect to jurisdiction that has passed an award in case of an insolvency proceeding. Professor Kennedy in one of his judgments said:

This is not reciprocity in the ordinary sense in respect to foreign judgments. There is no suggestion that we will only recognize foreign judgments if the foreign court will recognize ours. There is reciprocity in a sense with respect to jurisdiction. But even here it is more a question of equality or similarity of jurisdictional rules than reciprocity as such.

Comity and reciprocity are recognised as philosophical underpinnings of insolvency law by encouraging other countries to recognise domestic court’s orders. More than a third of the countries that have presently opted to adopt the Model Law in some form or the other have introduced a reciprocity requirement (Mohan, 2012). South Africa, Mexico, the British Virgin Islands, Romania and Mauritius have all legislated on the basis of reciprocity. For instance, mere adoption of the Model Law by a State, therefore, is no guarantee of reciprocity under South African law. The South African Insolvency Act applies only to countries that are designated by the Minister. Despite being one of the first few countries to adopt the Model Law, South Africa’s Cross Border Insolvency Act, 2000 that introduced the Model Law, has remained practically infructuous because of its reciprocity requirement. The British Virgin Islands too, using a ‘designated country’ approach to ensure reciprocity, is yet to bring into operation the Model Law provisions it adopted in its Insolvency Act, 2003 and has apparently still ‘no plans to bring it into force’.

In India, the Insolvency Law Committee (ILC) while considering the applicability of Model Law has mandated the requirement of reciprocity. The question worth considering is whether an absolute requirement of reciprocity as postulated under the draft will achieve the desired result? Especially given the fact that there are not more than 46 countries who have adopted the Model law and a fewer have mandated for reciprocity within their domestic legal regimes?

It is submitted that absolute reciprocity should be done away with as there are alternative mechanisms to achieve the desired results. For instance, bilateral cooperation, judicial discretion may be applied on a case to case basis. For instance, the UK court has observed that the court can use the discretion
provided to it by the system. Hence, by this approach, courts are allowed to cooperate and coordinate with those countries that are acquiescent to return the favour. Judicial discretion to courts to allow coordination and cooperation may be criticised on the ground of lack of clarity of law, certainty of outcome. It may also be seen as supporting territorialism. But legislative guidelines for the courts to consider while exercising its discretion may prevent any unwanted outcome.

One needs to understand the limitation of the absolute requirement of reciprocity which entails entering into a treaty with other countries thereby limiting its applicability to only consenting countries. More importantly, absolute reciprocity through treaty approach is in itself a time taking process.

**Avoidance of ‘One Size Fits All’ approach under the Model Law**

Article 1(2) of the Model Law provides for exclusion of certain entities whose proceedings are subject to a special state insolvency regime. This proposal has been stretched wide by States in order to exclude gamut of entities including banks, insurance companies and other financial institutions. The US has excluded investment institutions, stock exchanges, insurance undertakings, clearing houses, brokers and traders, banks, railroads, stockbrokers and commodity brokers but not foreign insurance companies.18 UK has excluded insurance companies, credit institutions and EEA (European Economic Area) and third country credit institutions and insurers which has resulted in created inconsistencies in the law, (Chan Ho, 201219). New Zealand has excluded banks from the operation of the Model Law provisions whereas Romania20 has excluded all financial institutions that provide credit or investment services, stock exchanges, brokers and insurance companies and agents. Further, in Mexico, insurance companies, surety companies and ‘unincorporated government enterprises’ have similarly been excluded (Bob Wessels, 2009).21

These exemptions are much more extensive than what the Model Law has anticipated. Scholars have argued that such varied approaches defeat the objective of adopting the Model Law i.e. to bring about standardisation and consistency in dealing with cross-border problems that may arise in dealing with assets in many jurisdictions. Such exemptions are muddled as to how adopting a framework barring of such a variety of institutions that have a potential to involve assets in multiple countries will really serve the Model Law’s purpose (Ho, 2012).22

ILC in its report noted that the Model Law allows enacting countries to exempt certain entities from the application of the Model Law.23 It noted that banks and insurance companies are mentioned as examples of entities that the enacting country may decide to exclude from the scope of the Model Law. The Guidance note to the Model law suggests that State might do so where the policy considerations underlying the special insolvency regime for those other types of entity (e.g. public utility companies) call for special solutions in cross-border insolvency cases.24 Further, insolvency of these entities may give rise to a particular need to protect vital interests of a large number of individuals or that the insolvency of those entities usually requires particularly prompt and circumspect action and may be subject to a special insolvency regime.

The Code currently already excludes financial service providers, such as banks, public financial institutions etc., from its application. The ILC refrained from elucidating entities that should be excluded stating that it may lead to inflexibility and delay as it may be possible that entities need to be excluded or included based on the experience drawn from enforcement of the proposed draft. However, considering the Guide to Model Law enactment that makes it clear that for making the national insolvency law more transparent (for the benefit of foreign users of a law based on the Model Law), it is advisable that exclusions from the scope of the law be expressly mentioned by the enacting States. It would be trite
to name entities than leaving it in abyss!

**The ‘Public Policy’ Exclusion**

Article 6 of the Model Law, known as the ‘public policy exception’ provides that ‘Nothing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of this State.’ Thus, though Model Law recognises foreign proceedings, there is an apprehension that a nation would be unwilling to recognise a foreign proceeding if it patently violates that nation’s public policy.

However, it was clear from the Guide to Enactment that the exception is to be interpreted restrictively and that Article 6 be used only in exceptional and limited circumstances (see paras. 101-104). This is made clear from the use of word ‘manifestly’ which is used in many other international legal texts as a qualifier of the expression ‘public policy’ to emphasise that public policy exceptions should be interpreted restrictively and that Article 6 may be invoked only in exceptional circumstances, concerning matters of fundamental importance to the enacting State. This deliberate attempt to not to define public policy is premised on the fact that international public policy is understood more restrictively than domestic public policy, which reflects the understanding that broadly defining international public policy would hamper international cooperation. A growing number of jurisdictions recognise dichotomy between the notion of public policy as it applies to domestic affairs and the notion of public policy as it is used in matters of international cooperation and recognition of foreign laws (Michael, 2015). Public policy considerations may also arise when the non-uniform insolvency laws of other nations are allowed to be enforced procedurally around the globe (Shahid, 2010). A question worth consideration is how states have adopted Article 6 in their domestic cross border framework within their domestic laws.

Mexican Commercial Insolvency Law (Mexican Commercial Insolvency Law, 2000; Perezalnso, 2012; Khumalo) vide Article 283 has adopted a much broader exception than Article 6 of the Model Law. It restricts the acknowledgement of any foreign judgment or the application of any foreign law which disregards ‘the fundamental principles of Mexican law.’

Similarly, nations like Japan and Poland have replaced the term ‘Public Policy’ with the term ‘Public Peace’ or ‘Public Order’ to incorporate Article 6 (Garza, 2015). The term ‘Public Order’ is generally used in civil law countries to and the term refers to the many exceptions that enable a court to refuse to recognize or enforce a judgment, or apply foreign law to a pending proceeding, on the grounds that the judgment or law conflicts with a more fundamental policy of the forum court (Choudhury, 2011).

The best possible explanation of the Public Policy Exception has been widely litigated. Some cases to this point are *In re Vitro S.A.B. de CV*, 2012; *In re ABC Learning Centres Ltd*, 2010; *In re Gold & Honey, Ltd*, 2009; *In re Toft*, 2011.

In line with the spirit of the Model Law, the Committee had recommended India to mirror Article 6 of the Model law and retain the word ‘manifestly’. The Committee noted that while several countries including the US, UK and South Africa have retained the word ‘manifestly’, certain countries such as Singapore have omitted it. The Committee in its proposed draft has suggested that in line with the spirit of the Model Law, the language used in Article 6 of the Model Law must be retained as it is, including usage of the term ‘manifestly’. The Committee rightly notes that interpretation of ‘public policy’ must be narrow.
Recognition of foreign representative

The spot for the most controversial provision of the Model Law’s draft has been awarded to the provisions relating to the role and powers of the foreign representative and the protection of local creditors and thus, they were subject to various changes during the Working Group’s sessions.

A foreign representative’s right of access to the courts under Mexican legislation, for example, is subject to various restrictions. If a foreign representative has to make urgent applications for interim relief he can do so only through the local Inspector or Receiver and cannot make the application directly to the State courts (Mexican Commercial Insolvency Law, 2000). Polish law too has sought to deny the foreign representative any pre-eminent role in insolvency matters in Poland (Khumalo, 2004). In the US, however, these rights of the foreign representative are conditional upon the foreign proceeding being recognised by US law (US Bankruptcy Code, 2011). Section 1512(b) further provides that upon recognition of a foreign proceeding the court may entrust the distribution of the debtor’s assets in the US to the foreign representative ‘provided that the court is satisfied that the interests of the creditors in the US are sufficiently protected’.

The ILC interestingly notes that foreign representatives may form a separate class of professionals akin to insolvency professionals in India and may therefore not have a legal bar to access courts in India. However, it concluded that it may be desirable to adopt a conservative approach in providing access to foreign representatives till the development of infrastructure regarding cross-border insolvency in India. It was also noted that a possible option may be to allow foreign representatives access to courts, and exercise of their powers under the draft Part Z, through domestic insolvency representatives. However, the Committee deemed it appropriate for the Central Government to provide the extent of the right to access, in this regard, through subordinate legislation.

NEW MODEL LAW: SMOKE OR MIRROR OR MORE?

In summer 2018, UNCITRAL adopted a new Model Law on recognition and enforcement of insolvency-related judgments with the aim to fill the gap in international insolvency law. The new Model Law aimed at making cross-border insolvency resolution more expedient, predictable and efficient. It was designed to assist States to equip their laws with a framework of provisions for recognising and enforcing insolvency-related judgments that will facilitate the conduct of cross-border insolvency proceedings and complement the UNCITRAL Model Law on Cross-Border Insolvency. MLJ aimed to play a gap filling and supplementing role to the Model Law, and yet is fit to be embraced on a stand-alone basis.

One has to agree that despite being a positive development in the history of cross-border insolvency regulatory regime, MLJ continues to be a child of political compromise. (Khumalo, 2004) This is argued on two counts: firstly that the status of Model law as a soft law is missing and hence the intended harmonisation under the parent model law is left to the cooperation of the member states. Secondly, under applicable national regimes, some States will only enforce foreign judgments pursuant to a treaty regime, while others will enforce foreign judgments more or less to the same extent as local judgments. In want of such a treaty, harmonisation of insolvency decisions only presents a smoke and mirror situation.

Harmonisation of insolvency decisions have even been typically excluded from The Hague Conference instruments on the ground that those matters may be seen as very specialised and best dealt with by specific international arrangements, or as closely intertwined with issues of public law. The efficacy of
the new Model Law addendum is no silver bullet!

Further, the inherent flexibility that is attributed to MLJ is a double edged sword. On one hand, it enables the widest possible adoption of its provisions and on the other hand, it becomes the leading cause of differences in the interpretation and application. For example, the MLJ includes an optional provision that permits recognition of an insolvency-related judgment to be refused when the judgment originates from a state whose insolvency proceedings are not susceptible to recognition under the Model Law, e.g. because the originating state is neither the location of Centre of Main Interest (COMI) nor of the debtor’s establishment (current US approach, see *In re Creative Finance Ltd.*). Thus, the same judgment may be capable of recognition in some states, but not in others.

In addition to the ‘traditional’ public policy exceptions, MLJ also has several other reasons for refusing recognition of judgment. They include cases where the defendant in the proceedings giving rise to the insolvency-related judgment was not properly notified of the proceedings; or where there is a conflict between the judgment for which recognition and enforcement is sought and another judgment given in a dispute between the same parties. It further includes situations where the judgment interferes with insolvency proceedings or otherwise implicates (infringes) the interests of creditors and other stakeholders.

The basis of jurisdiction of the originating court is disputable (‘inadequate jurisdiction’) is also a ground for refusal for recognition of foreign judgement. Even though MLJ has expanded the horizon of available refusal grounds, it is evident that the grounds so provided are very broad, all-encompassing and potentially unpredictable in their application. Therefore, the questioning of the desired efficiency of the new provisions is a valid and reasonable apprehension. Another limitation of the MLJ is its explicit exclusion of interim measures of protection. The new Model Law fails to define ‘interim measures’ which when combined with the lack of clarity and consensus amongst different legal systems regarding the characterisation of such measures leads to the creation of an extremely uncertain situation. Consider a case where courts provide for an interim measure in the form of moratorium but is not recognised in another state. This may put the creditors' interest at high risk.

Further, MLJ is only applicable in situations where there is a court-supervised collective insolvency proceeding. This means that under MLJ only a voluntary or out-of-court restructuring agreement which has been referred to the court for approval in formal proceedings is recognised. This is yet another challenge for the MLJ. Thus it is clear that despite the celebration of the most laudable Model law on Recognition of Insolvency related judgment, there is ample clarity needed to ensure that the cross-border insolvency resolution process is more expedient, predictable and efficient.

Now that the limitation of both UNCITRAL Model Law and the MLJ has been assessed, the next part of this article will critically evaluate whether the proposed framework in India has heeded to these concerns.

**INDIA’S ADOPTION OF UNCITRAL MODEL LAW**

Discussing India’s response to adoption of Model Law may seem an attempt to count the chicken before they hatch. The cross border insolvency framework in India is still not in place. But one would appreciate that it’s never too early to flag the concerns that may arise in future. Before evaluating the proposed draft on cross border insolvency and evaluating its proposed efficacy to deal with issues above, it is important to understand the broad array of some key recommendations of the Report.
The ILC submitted its second report to the Ministry of Corporate Affairs recommending insertion of ‘Part Z’ in the Code, based on an analysis of the UNCITRAL Model Law on Cross-Border Insolvency, 1997. The Model Law provides a legal framework that states may adopt in their domestic legislation to deal with matters relating to cross-border insolvency. While some of the recommendations have already been discussed in the earlier section of this paper, it is worth taking a deeper look into some other key recommendations that is discussed below:-

(a) The ILC recommended that at present, draft Part Z should be extended to corporate debtors only. However, the definition of ‘corporate debtor’, for the purpose of Part Z, was to include foreign companies as well. The Committee believed that this would allow the foreign companies to approach adjudicating authorities in India for cooperation or recognition of foreign proceedings to avail the required relief.

(b) The ILC noted that the Companies Act, 2013 also contains provisions to deal with insolvency of foreign companies. It observed that once Part Z is enacted, it will result in a dual regime to handle insolvency of foreign companies. In order to avoid the same, it suggested that such provisions in the 2013 Act be re-assessed and in case of overlapping, the provisions of the 2013 Act be dispensed and the matters pending under such provisions of the 2013 Act, be transferred for adjudication.

(c) It was recommended that the Central Government must be empowered to notify the exclusion of certain entities from the application of draft Part Z.

(d) Reciprocity indicates that a domestic court will recognise and enforce a foreign court's judgment only if the foreign country has adopted a similar legislation as to the domestic country. The Committee recommended that the Model Law may be adopted initially on a reciprocity basis and the same may be subsequently re-examined and diluted accordingly. Further, the Committee has also suggested that sections 234 and 235 be amended in order to limit its application only on individual and partnership firms.

(e) Existence of COMI and establishment plays an important role in invoking the right to commence main and non-main proceedings. Under the Model Law, such classification only allows recognition of foreign proceedings. Relief may be provided if the foreign proceeding is a main proceeding or non-main proceeding. Foreign proceedings will be recognised as main proceedings if the domestic courts determine that the debtor has its COMI in a foreign country. This recognition will result in certain automatic relief, such as allowing foreign representatives greater powers in handling the debtor’s estate. For non-main proceedings, it must be proved that the debtor has an establishment in the said country. The relief provided in such cases is at the discretion of the domestic court. The Committee recommended that a list of indicative factors such as location of financing, location of debtor's records and books etc. comprising COMI may be inserted through rule-making powers. Further, it was recommended that relief given in foreign non-main proceedings must relate to the assets to be administered in such proceedings, according to the laws of the enacting country. As a preventive action the Committee also suggested proactive enquiry by adjudicating authorities and a look back period of 3 months must be adopted while enforcing the COMI presumption.

(f) Committee suggested that the adjudicating authorities may consider the existing international laws and jurisprudence in light of the domestic interpretations of the public policy. The Committee further noted that actions contrary to this interpretation can then be struck down by the adjudicating authorities by the power granted under Part Z. They also recommended that in proceedings where the Authority is of the opinion that a violation of public policy may be involved, a notice must be issued to the Central Government and they must also be awarded with an opportunity of being heard. If the
adjudicating authority does not issue a notice, then the Central Government may be empowered to apply to it directly. The Committee also deliberated upon the prospective of empowering the Central Government to ‘suo moto’ apply to the adjudicating authorities if it is of the opinion that an act is contrary to public policy and a notice for the same has not been issued by the adjudicating authorities.

(g) On the issue of recognition of foreign insolvency professionals, the Model Law allows foreign insolvency professionals and foreign creditors to access the domestic courts to seek remedies directly. Direct access with regards to foreign creditors is envisaged under the Code even presently. Further, the Committee has recommended that the power to formulate a mechanism, that is practicable in the current Indian legal framework, must be given to the Central Government.

(h) The ILC adopted the view that the authenticity of documents submitted with application for recognition must be presumed and the process of legalisation of the same must be done away with. It further recommended that the English translation of documents submitted by the foreign representatives should be mandated along with details of any pending foreign and domestic insolvency proceedings against the corporate debtor. The two kinds of relief available include:

- Mandatory relief on recognition as a foreign main proceeding.
- Discretionary relief on recognition as either foreign main proceeding or foreign non-main proceeding.

(i) The ILC adopted the view that while providing discretionary relief the adjudicating authority shall consider both limitations as well as inclusions to the scope of moratorium.

(j) The Model Law lays down the basic framework for cooperation and communication between domestic and foreign courts, and domestic and foreign insolvency professionals. In light of the evolving infrastructure of the adjudicating authorities under the Code, the cooperation between adjudicating authorities and foreign courts is proposed to be subject to the framework to be notified by the Central Government, in consultation with adjudicating authorities and in interest of all the stakeholders.

(k) The Committee has recommended that the guidelines laid down by the Judicial Insolvency Network for Communication and Cooperation between Courts in Cross-Border insolvency could be considered for adoption as a framework.

(l) Under the Model Law permission has been provided for multiple proceedings to take place in various jurisdictions by enabling communication and cooperation of such proceedings. It also provides a framework for commencement of domestic insolvency proceedings, when a foreign insolvency proceeding has already commenced or vice versa. It also provides for coordination of two or more concurrent insolvency proceedings in different countries by encouraging cooperation between courts.

(m) With regards to payment in such proceeding, the Model Law provides for the ‘hotch pot rule’ which the committee recommended be adopted but with two modifications, which were as follows:

- Payment to creditors under the insolvency resolution process will be made in accordance with the resolution plan.
- In case of liquidation under the Code, the threshold for comparison may be creditors of the same class and ranking.

(n) Further, the Committee also suggested that instead of a test of insolvency, recognition of a foreign main proceeding may be presumed to be proof of default by the corporate debtor for the purposes of
commencement of corporate insolvency resolution process (CIRP).

The recommendation of the ILC has been in tune with the objective of the Model Law and the adoption of the Model Law in India's domestic framework exhibits a conservative rather than a pragmatic approach.

In the present draft, there is no express provision dealing with the proceedings against personal guarantors of corporate debtors whose assets are in the foreign jurisdiction (Kumar, 2018). Further, the draft provides supremacy to proceedings initiated under the Code. Therefore, there is no mandatory unification of the domestic insolvency regimes of different states. Moreover, the laws present in the draft need greater clarity with respect to situations where one of the simultaneous proceedings against the same corporate debtor is concluded (Khumalo, 2004). Similarly, with regards to the discretionary powers of the National Company Law Tribunal (NCLT) in recognition of foreign proceedings are concerned, it is provided that the NCLT's action would depend on whether the same would be in tune with the public policy of India; however, no active attempts have been made to define what constitutes public policy and its scope especially in the arbitration law context.

The draft law has left a lot of particularising and detailing to the subordinate legislations which is to be brought in by the Central Government and Insolvency and Bankruptcy Board of India (IBBI). It needs to be ensured that these amendments and declarations of rules and regulations must fall in line with the vision of the Model Law. (Kumar, 2018). Further, there are reservations with respect to the efficiency of the applicability of the rule of reciprocity. India, till date has only notified 50 countries as reciprocating countries, which is less than one-third of the countries which have ratified the New York Convention. Thus, drawing attention to the general hesitation in implementing reciprocity provisions given India’s past experience with reciprocity requirements.

WAY FORWARD

In the end, one truism of a free market economy is that there will be insolvencies (Gaa, 1993). The flexibility to adapt the Model Law to the legal system of the enacting State should be utilised with due consideration for the need for uniformity in its interpretation and for the benefits to the enacting State of adopting modern, generally acceptable international practices in insolvency matters. Thus, it is advisable to limit deviations from the uniform text to a minimum. This will assist in making the national law as transparent as possible for foreign users.

In words of Lord Justice Kennedy, Model Law would bring ‘enormous gain to civilised mankind.’ (Kennedy, 1909). However, whether the benefit that Lord Kennedy talks about has translated through the Model Law in the area of insolvency is still open to debate. This question is critical for a country like India, which is earmarked by a very underdeveloped private international law jurisprudence and an equally lethargic court system. Adoption of Model Law on insolvency is no panacea to all the future cross border issues. In order to make the Model Law effective, it is important that rules of private international laws are well developed with a certain degree of unison of development of its jurisprudence with that of the commercial laws. India should aim to develop a cross border framework with greater procedural flexibility but predictability of law and legal provisions. On the sidelines, legislative guidance needs to develop to aid the courts in interpretation of laws relating to cross border insolvency.
NOTES


4 Supra Note 2.

5 Supra Note 3 (Examining the Pope’s coordination of the insolvency of the Ammanati Bank involving assets in Italy, Spain, England, France, Germany and Portugal in 1302).


12 Rubin V. Eurofinance, 46 (UKSC 2012).


14 Ibid.

15 Cross Border Insolvency Regulations, (2006), Schedule1, Article 1(2).


18 U.S Bankruptcy Code (2005), Section 1501, Chapter 15, effective from October 15, 2005.


21 Supra Note 7.

22 Mexican Commercial Insolvency Law (2000), Article 298 and 300, ‘This hardly supports the objective of ‘harmonising’ insolvency procedures in different countries and can create confusion. For example, Gltinir banks Icelandic insolvency proceedings were recognized as a foreign main proceeding under chapter 15 of the US Bankruptcy Code but would not be eligible for recognition under the British Model Law provisions as it is an EEA credit institution. Similarly, the Icelandic insolvency provisions of Landsbanki Islands if have been recognized under chapter 15 of the US law and the Canadian and Australian enactments of the Model Law but not under the British Model Law’. See Supra
Note 20 (n 63) pp. 144-145 for details of these and other examples.

23 Para 2, Article 1 of the Model Law.

24 Supra Note 8.


26 Id.


28 Supra Note 6.

29 Supra Note 11.

30 Supra Note 26.


33 In re ABC Learning Centres Ltd, 445 (United States Bankruptcy Court for the District of Delaware 2010).

34 In re Gold & Honey, Ltd, 410 (United States Bankruptcy Code, Eastern District of New York 2009).

35 In re Toft, 453 (United States Court of Bankruptcy, Southern District of New York 211).

36 Section 1506, Chapter 15, Title 11, US Code.


38 Section 6, Cross-Border Insolvency Act, 2000.


40 For example, the UNCITRAL Guide to Enactment in para 103 states, ‘...international cooperation would be unduly hampered if ‘public policy’ were to be understood in an extensive manner’; in para 161 it states, ‘As a general rule, article 6 should rarely be the basis for refusing an application for recognition, even though it might be a basis for limiting the nature of relief accorded.’

41 Supra Note 11.

42 Supra Note 11.


45 Supra Note 43.

46 Supra Note 44.


49 Kennedy, L. J. (1909), “The Unification of Law”, Journal of the Society of Comparative Legislation, 10, pp. 214-215. “Conceive the security and the peace of mind of the shipowner, the banker, or the merchant who knows that in regard to his transactions in a foreign country the law of contract, of moveable property, and of civil wrongs is practically identical with that of his own country.”
With the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/Code), insolvency regime has been brought into being in the legal landscape of India. This has enabled India to be ranked as 63rd country in terms of ease of doing business and 52nd country in 'resolving insolvency' according to the World Bank Ease of Doing Business Report, 2020. This shows the magnificent success of this law in a short span of time. Nevertheless, the insolvency legislation of India does not have an unswerving provision on the cross-border insolvency. However, few legal bases can be made in the IBC. Under section 234 and 235 of the IBC, the Central Government can enter into agreements with countries outside India to enforce the provisions of the IBC. The concept of bilateral agreement and reciprocal arrangement in the IBC may not meet the global challenges of cross border insolvency and may defeat the main purpose of the law. In the present scenario, the inclusion of cross border insolvency in the bankruptcy law of India is on the top agenda of the country. At this juncture, while India is in the process of adoption of the UNCITRAL Model Law on Cross-Border Insolvency (Model Law) and there is a lot of speculation regarding the acceptance of the Model Law and at the same time, the Lehman Brother's Holdings Inc. bankruptcy proceeding protocol and the Jet Airways protocol have made everyone wary for a cross border insolvency legislation.

In January, 2020 a panel was appointed by the Ministry of Corporate Affairs (MCA) under the chairmanship of Dr. K. P. Krishnan to recommend the rules and regulations for the smooth functioning of cross border insolvency. The committee submitted its report to the MCA in May, 2020. Prior to this panel, a committee which had been constituted under the chairmanship of Mr. Injeti Srinivas had already recommended for the adoption of Model Law in 2018. The second part of the report of the said committee also proposed a draft legislation on cross border insolvency. At the same time, some legal challenges can be foreseen in the Indian legal landscape with the adoption of the Model Law. The cross border contractual issues, jurisdictional issues, choice and application of law issues, existence of arbitration clause, stay of proceedings, criminal proceedings, international sales contracts with the Incoterm clause etc. are some examples. This article will analyse the legal issues with the adoption of Model Law on cross-border insolvency in the Indian legal landscape. Attempts have been made to examine the advantages and challenges with the adoption of the Model Law in the Indian context. The article aims to answer these two questions:

- Why India should adopt the Model Law on cross border insolvency?
- Will India have any legal challenges with the adoption of the Model Law?
CROSS BORDER INSOLVENCY: AN INTRODUCTORY APPROACH

‘Cross border insolvency’ is usually understood as a scenario, where the assets of the corporate debtor (CD) are situated in different jurisdictions other than the country of CD or the creditors are from different jurisdictions or the business activities of the CD are in existence in different jurisdictions. Once a petition has been admitted and moratorium is declared by the adjudicating authority (AA) for an insolvency resolution process, the next step may warrant the issues related to cross border insolvencies depending upon the nature and facts related to the CD. The proceedings include several elements like foreign and domestic proceedings, locality of creditors, multiple litigations, debtor’s choice of forum, taking the custody of assets, determining the claimants and claims etc. The concurrent insolvency and bankruptcy proceedings in more than one jurisdiction may lead to unsatisfactory consequences like extra costs, disadvantages to the creditors and the CDs, and contradictory orders. In a very old case Re Crawford and Co\(^3\) a Canadian court held that certain creditors were entitled to a preference under a local statute, which was subsequently given up by a court in Scotland.

In a cross-border insolvency matter, cooperation between courts, legal systems, companies and insolvency administrators is required. Referring to the Lehman Brother’s Holdings Inc. bankruptcy proceeding, one can understand the multiple issues involved in such insolvency proceedings. The Lehman Brother’s Holdings Inc. was the fourth largest United States of America (US) Investment Bank. Lehman operated in over 40 countries and had more than 650 legal entities outside of the US. The bankruptcy filing resulted in over 75 separate proceedings, with more than 16 administrators playing multiple roles. Proceedings were adjudicated by tribunals in nine countries, and the law in each country varied widely. For example, the applicable laws included the Dutch Bankruptcy Act, the German Insolvency Code, Swiss Law on Banks and Savings, Civil Rehabilitation Law of Tokyo, French Financial and Monetary Code, Hong Kong Companies Ordinance, Singapore Companies Act, and the Australian Corporations Act. Accordingly, coordinating an international bankruptcy of this size and scope was a daunting task. To facilitate the process, interested parties entered into a private agreement, called the ‘Cross-borders insolvency protocol for the Lehman brothers’ group of companies’ (the ‘Lehman Protocol’\(^4\)).

There are mixed views about the nature of cross border insolvency law related to public law and private law. As described by Vesna Lazic (1998)\(^5\) the discussion on the question, whether the insolvency procedure is of a public or private nature might, in a simplified way, be reduced to two basic views:

- The bankruptcy is a privilege given to the creditors by the public authorities which supervise and control the exercise of this privilege (the public view).
- The bankruptcy is the right of creditors to decide on the distribution and the right of each individual creditor therein (the private view).

Various theories of international cross border insolvency laws are recognised and identified. Generally, reference has been given to two theories i.e. ‘Universal approach’ and ‘Territorial approach’. The ‘Universal approach’ refers to recognition of one insolvency proceeding by all other jurisdictions, where the assets of the CD are situated or the CD carries on the business. On the other hand, the ‘Territorial approach’ refers to multiple jurisdictions in multiple insolvency proceedings over the insolvency of one CD. It also appears that few other approaches have emerged and have been identified in addition to these two approaches. These include Universalism theory, Modified Universalism theory, Territorialism theory, Cooperative Territorialism theory, Universal Procedural theory as identified by Sefa M Franken (2014)\(^6\).
Territoriality: The mutual regard and access should lie at the heart of choice of law doctrines. This principle leads to each country claiming plenary power over assets located in that country and ignoring what rulings other countries may have made. Further, each country often gives no attention to whatever foreign interests may be involved, except, perversely, to prefer local creditors over foreign ones.7

Unity and Universality: The alternatives to territoriality are the principles of unity and universality. Unity means a single bankruptcy proceeding, with all assets assembled in a single administration and all creditors and other interests represented in that proceeding. Universality means both (a) that a single bankruptcy proceeding affects assets wherever located, and (b) that the actions taken in the single proceeding are effective in all other proceedings8.

Every insolvency proceeding involves three fundamental functions: administration, distribution, and adjudication of entitlements. Administration involves protecting and realising the assets. For example, someone must keep the remaining inventory safe from the elements and fully insured. Some government official, typically a Judge, must supervise whoever does these things. These aspects of administration present practical problems and call for practical cooperation among courts and liquidators in various countries. Choice of law relates to these matters only in so far as conflicting legal positions may impair cooperation.9

JOURNEY OF UNCITRAL MODEL LAW ON CROSS BORDER INSOLVENCY

With the aim to harmonise and to bring the countries to a common legal platform on the International Insolvency Law, the Model Law was adopted in 1997. Up until now, a total of 48 countries have adopted the Model Law. During 2000-2009, 16 countries adopted the Model Law; during the period between 2010-2019, 31 countries adopted the law and in 2020, till today one country i.e. Myanmar became a member. This is an indicator that the Model Law has been well accepted and influential in a short period of 20 years. However, if we see the year-wise adoption, then there is a big divergence.

The year-wise adoption/accession to the Model Law shows that the number of memberships by the countries was below five every year since 1997, except in the year 2015. Also, there was no new membership during six years: 1997, 1998, 1999, 2001, 2012 and 2014. In the absence of any research output, it is difficult to understand the reason as to why it was so.

The Model Law10 was adopted with the object of cooperation and coordination. The objectives raise a number of issues that relate to the extent to which courts, in exercising their powers with respect to administration of the cases before them, are permitted or authorised to interact with or relate to foreign courts that might be administering a related case involving the same debtor. For example, to treat common stakeholders equitably, give foreign stakeholders access on the same basis as domestic stakeholders or permit another jurisdiction to take principal charge of administering reorganisation? Experience has shown, for example, that some courts are often reluctant or unable to defer to a foreign court and may therefore prefer parallel insolvency proceedings or treat main and non-main proceedings, where provided for under the relevant insolvency regime, as if they were concurrent or parallel proceedings. Such a preference may be based upon applicable law or a desire to protect the interests of domestic creditors11.
UNCITRAL Model Law on Cross Border Insolvency in the Indian Legal Landscape

Figure 1: Continent-wise adoption of Model Law

The continent-wise adoption of Model Law shows that maximum number of countries (24) belong to Africa and the lowest number is from South America (1) (Figure 1). Most of the countries have adopted the Model Law in between 2010 to 2019. After going through the said data, a pertinent question comes to the fore: whether the domestic legislative environment of African countries is more favourable to adopt the Model Law?

CROSS BORDER INSOLVENCY LAW IN INDIA

The ‘insolvency resolution’ has been an important component in the process of internationalisation of trade and cross-border insolvency has been the cogwheel in the process of resolution of insolvency, bankruptcy and liquidation. In the present-day practice, the overseas assets and properties are the main components of the assets of the corporate entities. So, in the process of insolvency resolution and liquidation, it is a challenge for the insolvency resolution professional or the liquidator to prepare the insolvency resolution report or liquidation estate without considering the cross-border assets and properties and must be same with the foreign jurisdictions. A comprehensive framework on cross border insolvency is exigent need in India. Justice V. Balakrishna Eradi Committee (2000) and the Prof. N.L Mitra Committee (2001) had great concern for the reformation in bankruptcy laws and recommended for the adoption of the Model Law on cross border insolvency.

The IBC does not provide any comprehensive mechanism for cross border insolvency. Section 234 and 235 of the IBC speaks about the requirement of bilateral agreements by the Government of India with the foreign countries to enforce the cross-border insolvency laws with reciprocal arrangements. Supplementary to this, on the basis of request made by the insolvency resolution professional or liquidator, the AAs [National Company Law Tribunal (NCLT)/Debt Recovery Tribunal (DRT)] may write letters to the respective courts of the foreign countries (with whom agreements are signed under section 234) for their cooperation in the insolvency resolution process or liquidation process. The
bilateral treaties, on the basis of negotiations, depending upon the diversified legal practices of different countries, may create anomalies and the whole purpose of the Code may be futile. Another challenge is the recognition of foreign judgements with the help of the Civil Procedure Code of India which is the prevailing practice in India.

In this backdrop, the Insolvency Law Committee (2018) (ILC) chaired by Mr. Injeti Srinivas, in its report had emphasised on cross border insolvency, nonetheless did not cover the topic in detail. The committee was of the view that the two provisions in the IBC (section 234 and 235) are inadequate to deal with the cross-border insolvency issues. Since it is a complex area, the committee preferred to submit a separate report on this. Further, the committee endorsed the need to attempt for a framework based upon the UNCITRAL Model Law and to insert that as a separate chapter in the IBC. Without a special legal framework on cross border insolvency, the Code will be half-finished.

**UNCITRAL MODEL LAW IN THE INDIAN LEGAL LANDSCAPE**

Consequent to the ILC, 2018 report, a subcommittee was constituted and a draft chapter was formulated in the line of the Model Law (June 20, 2018), as it is one of the successful international legal instruments. Countries like the US, United Kingdom and Singapore are examples of successful member countries who have adopted the Model Law. It is with the aim to adopt the Model Law that the draft chapter had been drafted in line with the Model Law. The core principles of this draft chapter are regard to be given to international origin, uniformity and observance of good faith. The subcommittee was of the opinion that adoption of the Model Law would be beneficial to India in the areas of ease of doing business, priority to the domestic proceedings, empowering insolvency representatives, mechanism for cooperation, protection of Indian creditors, remedy in jurisdiction with reciprocity, etc. As per the draft framework, the cross-border insolvency law would be applicable in certain circumstances and to the countries which have adopted the Model Law and also the countries with which India had entered into agreements. The Central Government could notify from time to time the name of the countries to whom this law is not applicable. The Government may also notify factors to be considered by the AA (NCLT) to refuse the action to be taken under this chapter if contrary to the public policy of India. The draft legislation discoursed the right of the foreign insolvency officials for direct access to domestic courts, recognition of foreign proceedings based upon the recognition, cooperation between the foreign and domestic courts as well as the domestic and foreign insolvency professionals and concurrent insolvency proceedings, etc. The interplay between winding up under the company legislation and liquidation under the IBC were not covered under the draft legislation.

Regardless of the proposed legislative framework, India may face some risks in the process of cross border insolvencies i.e. identification of the assets and properties, valuation, claim by the foreign creditors etc. Nevertheless, the draft chapter on cross border insolvency on the lines of the Model Law, is expected to spur the insolvency resolution process in India. Another challenge before India is the cooperation of the countries who have not adopted the Model Law. If in a corporate insolvency resolution process or liquidation process, the assets and properties of the CD are situated in multiple jurisdictions or in particular in both the countries (countries who have adopted the Model Law and the countries who have not adopted) then it would be very difficult to proceed for the insolvency resolution process under the proposed draft legislation. India may adopt the Model Law in totality.
Time-bound Procedure: Vakil and Krishnan have opined that:

a system of rule makes it safe for someone to participate in the market as simply as possible as opposed to transacting outside of the marketplace or engaging in strategic behavior that reduces overall welfare. When people do not play by the rules, parties will resort to the legal system for remedies. This prolongs the process and leads to congestion in the market. The legal system should trust the process of the IBC. Permitting exceptions on a case by case basis is a dangerous path to go down.

Some important points like the pendency of arbitration proceedings, the resolution process involving multiple jurisdictions (parties and non-parties to the Model Law), compliance of time bound completion of the cross-border insolvency proceedings have to be addressed in the draft legislation. Another question is whether individual insolvency will be covered under the draft legislation? This question arises because the Indian insolvency law includes both corporate entities and individuals. Amongst the business entities, the AA for the corporate entities is the NCLT and the AA for the partnership firms is the DRT. So, clarity is required about the jurisdiction in the cross-border insolvency legislation. The observance of ‘good faith’ in the Model Law may led to the harmonisation of the international insolvency law and promote the international trade law. The role of the regulators like the Reserve Bank of India, Securities and Exchange Board of India and the Insolvency and Bankruptcy Board of India have to be determined in the draft legislation. As a whole, the adoption of the Model Law will solve the differences amongst the various jurisdictions, as it gives flexibility to apply the domestic legislations and expedite the insolvency resolution process and solve the Non-Performing Assets issues in India.

Cross Border Insolvency and International Contractual Issues

Cross border insolvency is a big challenge for the CD during a corporate insolvency resolution process under IBC because multiple cross border disputes may create problems. The international contractual issues which includes international sales contract, contracts with International Chamber of Commerce (ICC) Incoterms, insurance contracts, contracts with arbitration clauses are conflicting areas in cross border insolvency matters for India. In India, we do not have any uniform international contract law for international contracts. India has, also, not ratified the United Nations Convention on Contracts for the International Sale of Goods (CISG). In case of breach of contract with the Indian CD, if the other party will be a party to the CISG, and the jurisdiction lies with the member country of the CISG, then settlement of those issues may take a long time.

Many unsettled legal issues have remained unanswered. While incorporating the Model Law, these issues must be taken care of, especially if conflict in jurisdiction in those circumstances would arise. In case of pending contractual disputes using ICC Incoterm, whether the aggrieved party can make claim as operational creditors? The Gibb’s principle is one of the classic examples to understand the conflicting contractual issues in international contractual matters.

Public Policy and Cross Border Insolvency

Public Policy exception (Article 6) has been a challenge in most of the jurisdictions while applying the Model Law. In Re Zetta Jets Pte Ltd., the Singapore High Court (HC) observed that ‘foreign insolvency proceedings instituted in the breach of an injunction order granted in Singapore could not be recognized in Singapore on the ground that it was contrary to public policy.’ Chapter 11 bankruptcy proceedings (restructuring) had been filed against Zetta Jet Singapore and its USA subsidiary Zetta Jet USA Inc. before the bankruptcy court. Asian Aviation Holdings Pte Ltd., shareholder of Zetta Singapore made injunction application for an alleged breach of a shareholders’ agreement before the Singapore
HC, which granted the requisite injunction restraining Zetta Jet Singapore and its subsidiaries from taking further steps with respect to US proceedings. The US proceedings nevertheless continued and converted into liquidation proceedings and accordingly a trustee was appointed who commenced recognition proceedings. The Singapore HC took the view that recognition cannot be granted as it would be contrary to public policy due to the grant of injunction. The trustee accordingly filed application to set aside the injunction.

In *re Toft*, the question was raised whether granting interim relief would amount to violation of public policy? The creditors of Dr. Jürgen Toft filed a bankruptcy petition in a German insolvency court hoping to collect debts owed to them by Toft. The German court appointed Dr. Martin Prager as insolvency administrator to investigate Toft's affairs and attempt to locate Toft's assets. Toft proved to be uncooperative and evasive and began selling estate assets without the German court's permission, and squandered the opportunity for his creditors to receive any sort of recovery. In an effort to prevent further loss of estate assets, Prager obtained orders in Germany and England that allowed him to intercept Toft's postal mail and e-mail, and provided information for his investigation. Prager filed a Chapter 15 petition for recognition of a foreign main proceeding with the Bankruptcy Court for the Southern District of New York. Along with the petition, Prager sought *ex parte* interim relief in the form of a Court order allowing him access to Toft's two e-mail accounts stored on servers located in the US.

The Court held that the requested relief would be manifestly contrary to public policy because disclosure of Toft's emails would violate the Electronic Communications Privacy Act (Privacy Act) and a bankruptcy trustee would not be entitled to such relief. It found that allowing Prager secret access to Toft's e-mail accounts would compromise Toft's privacy rights, which are protected by a comprehensive statutory scheme founded on the fundamental rights protected by the Fourth Amendment. Only law enforcement officials and in most instances, parties obtaining search warrant under Federal Rule of Criminal Procedure can be granted search access under the Privacy Act and a bankruptcy trustee is not one of those parties.

In *re Qimonda AG*, the question was raised as to whether recognition would result in undermining fundamental US policy. A manufacturer of semiconductor memory devices headquartered in Munich, Germany, filed an insolvency proceeding in Munich and the insolvency administrator filed a petition for recognition under Chapter 15 of the US Bankruptcy Code before the Eastern District of Virginia. The bankruptcy court recognised the Munich proceedings as foreign main proceedings. Qimonda owned thousands of patents, including US patents. After being unable to sell small packages of the patents, the administrator decided that the best way to realise the value of the patent portfolio was to license the patents and re-negotiate existing patent agreements to achieve greater royalties. The administrator provided notice that Qimonda would not perform under their existing patent licenses pursuant to German Insolvency Code which provides that executory contracts are automatically unenforceable unless the insolvency administrator affirmatively elects to perform the contracts. Two US patent licensees, Samsung and Elpida Memory responded to administrator's notice by asserting that they were entitled to the protections of Bankruptcy Code section 365(n). In an effort to convince the bankruptcy court that he did not intend to take advantage of the US Licensees, administrator filed pleadings committing to re-license Qimonda's patent portfolio at a reasonable and non-discriminatory royalty to be determined through good faith negotiations or through arbitration.

The Court determined that the application of section 365(n) to the US patents was required to ensure that the interests of the US Licensees were 'sufficiently protected' under Bankruptcy Code, section 1522(a) [public policy exception]. It explained that the public policy exception to granting comity to
applicable foreign law must be limited to the most fundamental policies of the US, and the fact that application of foreign law results in a different outcome than applying US law is insufficient to deny comity. The Court explained that in order to be manifestly contrary to public policy, foreign law must either (a) be procedurally unfair or (b) severely impinge a US statutory or Constitutional right in a way that would offend the most fundamental policies and purposes of such right. The uncertainty resulting from not applying section 365(n) would slow the pace of innovation to the detriment of the US economy and ‘severely impinge’ an important statutory protection accorded to licensees of US patents, thereby undermining a fundamental US public policy promoting technological innovation.

In *Rubin v. Eurofinance*¹⁹, the issue was that whether enforcing the US judgment would amount to violation of public policy of English Common Law? In a Chapter 11 proceeding in the US, a plan of liquidation was approved by the US Bankruptcy Court. Following the approval of the liquidation plan, a judgment was obtained from the US Bankruptcy Court against several parties, based on, among other things, US transaction avoidance provisions. At first instance, the English court recognised the US bankruptcy proceedings but, while recognising the transaction avoidance proceedings, refused to enforce the judgment against parties who had not submitted themselves to the jurisdiction of the US Court. An appeal and a cross-appeal were filed in which both the decision to recognise the transaction avoidance proceedings and the decision to refuse to enforce the judgment were challenged.

At first instance, the judge accepted that the proceeding in which judgement was entered was ‘part and parcel’ of Chapter 11 insolvency proceedings in the US. While accepting, as a matter of English law, that the Court could give effect to orders made in the course of foreign insolvency proceedings, the judge drew a distinction between a case in which an order was made to provide a mechanism of collective execution against property of a debtor by creditors whose rights had been admitted or established and a judgement for money entered in favour of a single creditor. The judge considered that the order made in the Chapter 11 proceedings fell into the second category, meaning that the judgement could not be enforced under the terms of the Model Law. For enforcement purposes, the usual rules of English private international law continued to apply.

**CONCLUSION**

Public policy exception under Article 6 of the Model Law has been one barrier for maximum countries. The proposed draft rule by the ILC, 2018 had decided to go with the word ‘manifestly contrary’ to the public policy of the States. Many other countries have omitted the word ‘manifestly’. Japan, South Korea and Singapore have adopted the exception to public policy omitting the word ‘manifestly’. A decision to decide public policy may take a longer time. The time-bound process under the IBC may not be complied with. India can be open for Model Law and also bilateral treaties or individual protocols as happened in Jet Airways case. To determine contrary to public policy, the Central Government may create panel with experts of commercial law, to decide the public policy exceptions in India. Mostly the matters are commercial in nature. So ‘commercial wisdom’ and ‘creditor’s interest’ should be the yardstick to decide the public policy exception issues. Forum shopping may be an issue in certain circumstances. A bold step has to be taken regarding change or choice of forum.’ In order to battle so called ‘forum shopping’, the French Court in agreement with the European Court of Justice (Staubitz - Schreider case) ruled that the transfer of the Headquarter of a company or a group of companies cannot be used to change the debtor’s center of main interest (COMI) once insolvency proceedings have begun, (or within the proceeding of six months of the bankruptcy proceeding).²⁰The provincial Courts have consistently followed the British rule that a bankruptcy or liquidation order issued in the
country of the debtor’s domicile will be recognised by the forum with respect to the debtor’s movables and will entitle the representatives to take possession of the property and to realise it in accordance with the law under which he was appointed.21

Serving of notice and other legal documents may be one of the issues in cross-border insolvency proceedings. The Indian Insolvency law relating to notice and other legal documents may not match and satisfy the stakeholders in other jurisdictions. An all-inclusive approach in the Indian cross border insolvency legal framework will make the proceedings smooth. Bilateral agreements with the countries, who have not adopted the Model Law may create conflicts on various points because of the different culture, language domestic legislation etc. India may prefer a ‘Cross Border Insolvency Protocol’ at the regional level instead of bilateral agreements. Regional protocol will be a uniform approach to all the countries in that region. The Organization for the Harmonization of Business Law in Africa (OHBLA/OHADA) is a regional economic framework between certain African nations for establishing legal certainty and simplified economic integration.

The European Union (EU) Regulation, *inter-alia*, provides the general recognition of the commencement of insolvency proceedings in all European community member states; rules regarding the international jurisdiction in insolvency proceedings and the competence of the insolvency administrator.22 The provincial courts have consistently followed the British rule that a bankruptcy or liquidation order issued in the country of the debtor’s domicile will be recognised by the forum with respect to the debtor’s movables and will entitle the representatives to take possession of the property and to realise it in accordance with the law under which he was appointed.23 Similarly, human rights issues may be attracted in the cross border insolvency proceedings in some states. Some space should be given to avoid the interventions of criminal proceedings against the CD or director or promotor of the CD because the criminal liability generally does not affect the property of a CD.

Conflict between Universalism and Territorial approach may arise. When different countries have different approaches, which one should be considered? Different countries have different approaches like that of the US jurisdiction wherein the countries having assets of CD are required to transfer them to the main proceedings. In traditional Territorial approach like Singapore, (which changed in 2017 to universalism), parallel proceedings continue. Different kinds of regulations/legal Frameworks provide different kinds of cross border insolvency proceedings. India needs to decide the kind of proceedings to be recognised. EU Regulation provides 3 kinds of proceedings. India may consider all approaches of cross border insolvency proceedings like the EU Regulation.

The Lehman Protocol was an innovative idea and good archetypal protocol. There are various regional instruments. Regional multilateral treaties on insolvency include, in Latin America, the Montevideo Treaties of 1889 and 1940 and, in the Nordic region, the Convention between Denmark, Finland, Iceland, Norway and Sweden regarding Bankruptcy (concluded in 1933, amended in 1977 and 1982).24 The Government of India can make a study about the influence of Model Law on African countries, since 24 countries from Africa, out of 58 countries have adopted the Model Law and in most of the countries, the Uniform Insolvency Act has been referred as the legislation after the adoption. The decision for the adoption of Model law by India is a welcome step to enable India to participate in global trade and commerce. A robust training will be required for the advocates, insolvency professionals and other related members in an insolvency proceeding. The NCLT members should be given exposure to the interpretation of Model Law on cross border insolvency. The Model Law provides the provisions for cooperation, access, recognition etc. but does not provide the procedural aspects. The determination of COMI would be the discretion of the tribunals based on the facts and circumstances of the cases. Afterall,
the adoption of the Model Law would bring consistency at international level. As the Dr. K. P. Krishnan Committee has already submitted its report, it is possible many points might have been covered and a detailed analysis would be possible after the publication of this report.

NOTES

3 NFLD LR 100.
8 Jacob S. Ziegel and Susan Cantlie (1994), Current Developments in International and Comparative Corporate Insolvency Law, New York, Oxford University Press.
9 Id. at 655.
10 The UNCITRAL Model Law was adopted by the Commission in 1997. As stated in its preamble, it focuses on the legislative framework needed to facilitate cooperation and coordination in cross-border insolvency cases, with a view to promoting the general objectives of:
Cooperation between the courts and other competent authorities of the enacting State and foreign states involved in cases of cross-border insolvency;
Greater legal certainty for trade and investment;
Fair and efficient administration of cross-border insolvency proceedings that projects the interests of all creditors and other interested persons, including the debtor;
Protection and maximisation of the value of the debtor’s assets;
Facilitation of the rescue of financially trouble businesses, thereby protecting investment and preserving employment.
15 Antony Gibbs & Sons v. La Societe Industrielle et Commerciale des Metaux (1890) QB.
17 453 B.R. 186, 201 (Bankr. SDNY 2011).
21 Williams v. Rice [1926] 3 D.L.R. R. 225 (Man.);
In re Eades Estate (1917) 33 D. L. R. 335(Man.).
22 Supra Note 18, at p. 224.
In re Eades Estate (1917) 33 D. L. R. 335(Man.);
Re IIT (1975) 19 C. B. R. (N.S) 263 (Ont.);
24 Supra Note 11.
INTRODUCTION

The process of ‘creative destruction’ represents a crucial pillar of economic growth in market economies. Austrian economist, Joseph Schumpeter, described creative destruction as a ‘process of industrial mutation that incessantly revolutionises the economic structure from within, incessantly destroying the old one, incessantly creating a new one.’ It brings new firms into the markets, which compete with existing firms and lower prices for consumers. It brings dynamism to the marketplace that keeps firms on their toes, always on the lookout for the next big way to serve consumers. It has only one pre-requisite – competitive and unfettered markets that facilitate easy entry and exit. The Economic Survey 2019-20, in its chapter 3 titled ‘Pro-Business vs Pro-crony’ lays down that India’s aspiration to become a USD 5 trillion economy depends critically on promoting ’pro-business’ policies that unleash the power of competitive markets to generate wealth, on the one hand, and wean away from ‘pro-crony’ policy that may favor specific private interests, especially powerful incumbents, on the other hand.

Given India’s tryst with socialist policies post-independence, the Indian experience of ‘entry and exit’ of firms has been intertwined with complications, with entry being licensed and exit being next to impossible. The 1991 reforms gradually liberalised entry in most of the sectors of the economy but ‘exit’ still posed a problem. The enactment of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) is, therefore, a watershed moment for the Indian economy. The IBC was enacted, with the following objective:

An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto.

It has reconceptualised the framework to deal with the insolvency of individuals and corporate entities, thereby facilitating the process of ‘exit’. It envisages a market mechanism to rescue firms in financial distress and to facilitate closure of firms in economic distress, in accordance with the processes under
the Code and rules and regulations made thereunder. ‘Faster resolutions and value maximisation’ are
the two stated objectives of the IBC.

EASE OF DOING BUSINESS
IMF and World Bank has praised the IBC regime in its Financial Sector Assessment Program 2017 quoting:

India is moving towards a new state of the art bankruptcy regime. Making use of the recently
enacted IBC, the RBI has identified several accounts that are non-performing and asked banks
to follow up with NCLT for resolution/ insolvency in accordance with the time-bound process
laid down in the Code. The move is expected to make a significant dent to the quantum of NPAs
starting next year.

According to the World Bank, before IBC, the time taken to resolve stressed loans was 4.3 years and
recovery rate was 26 per cent for financial creditors. Four years into IBC, recovery rate has improved to
45 per cent with the time for resolution being about 1-1.5 years through the IBC (based on data from
250 resolution cases). Since 2016, India’s ranking under the Resolving Insolvency head in the World
Bank Group’s Doing Business report has sharply risen from 136 to 52. As the process to resolve cases
is time-bound within 180 days (extendable to 330 days), the IBC has significantly contributed to India’s
ranking in the Ease of Doing Business surveys. In 2018, India has been also awarded with the Global
Restructuring Review (GRR) Award for the Most Improved Jurisdiction in restructuring and insolvency
regime.

ENHANCING EFFICIENCY
IBC has bought about a paradigm shift in the recovery and resolution process by introducing the concept
of ‘creditor in control’ instead of ‘debtor in possession’. This has encouraged value enhancement of the
corporate debtor once the process starts. In addition to reviving ailing firms, the insolvency proceedings
under the IBC have returned 210 per cent of liquidation value for creditors. Earlier mechanisms resulted
in an average recovery of 23 per cent to lenders as against nearly 43 per cent under the code. IBC
regime has also led to nearly 94 per cent reduction in the insolvency resolution process cost which
stood at 9 percent under the previous insolvency framework to 0.5 per cent of the realisation by the
creditors under IBC. Time spent on proceedings under the Code has been significantly reduced to
average about 340 days, including time spent on litigation, in contrast with the previous regime where
processes took about 4.3 years. IBC has been able to resolve the Non-Performing Assets (NPA) issue
to an extent, as witnessed by decline in NPA ratio from 11.5 percent in 2017-18 to 8.5 per cent in
2019-20 along with enhancement in quality of asset held with bank.

Bringing Behavioural Change
The biggest gains for the economy come from the extent to which the threat of the IBC modifies
behaviour on the part of managers and lenders. To be sure, IBC has been able to do the unthinkable—
put Indian corporates on tenterhooks with the message that either pay up your debts to the banks in a
stipulated time frame or get ready to be liquidated or acquired. IBC has indeed set alarm bells ringing
with almost every debt-stricken company trying its hand at debt restructuring or putting up distressed
assets on sale. India’s crème de la crème could no more walk away from their debt without facing
In fact, IBC actually recoded business relationships in India. It also unleashed corporate animal spirits—outdoing each other via bids or pursuing a back-door entry or even challenging the law in some cases in pursuit of the asset. With interest from global stressed asset investors, deep-pocketed institutional investors and corporates trying to make the most of this once-in-a-lifetime opportunity, IBC accounted for a third of domestic mergers and acquisition in terms of volume and value in 2018.

In fact, the Reserve Bank of India’s (RBI) direction to the banks to go after the ‘dirty dozen’—the list of 12 companies that make up 25 per cent of the NPA—was a monumental step in changing the psyche of lenders and promoters. Prior to this, lenders were hesitant to go after big corporates, but this changed quickly. And the fear of losing control set in—in insolvent corporates are reaching out to potential investors for fresh funds to settle their outstanding dues or negotiating a restructuring plan. Driven by fear of insolvency action and losing control of their assets, debtors who were earlier unwilling to repay, paid back Rs. 2.2 lakh crore to banks by March, 2019.

Previously, in the absence of an exit mechanism, several systematically important private firms were nationalised in order to restore the trust and economic health of the nation. This ensured the promoters that they need not exit the firms irrespective of their performance and conduct. However, implementation of IBC has led to the establishment of exit mechanism, which in turn has helped in eradicating crony capitalism from the economy. The Economic Survey 2019-20 shows that crony lending that led to wilful default, wherein promoters have collectively siphoned off wealth from banks, led to losses that dwarf subsidies directed towards rural development. As of 2018, wilful defaulters owed their respective lenders nearly Rs. 1.4 lakh crore. Had this money siphoned away by wilful defaulters stayed in the economy, the resulting wealth would have been equivalent in value to that needed to double the allocation towards health, education and social protection, double the allocation towards rural development, or triple the allocation towards MGNREGA.

**Escalating distressed asset acquisition**

The Code has been a crucial driving force as a mechanism for price discovery and recovery of distressed assets in the defined timeframe. Since the inception of IBC, distressed asset acquisitions have grown significantly. From January, 2015 to April, 2019, there were seven large deals amounting to USD 23 billion in deal value. These were primarily in the areas of power, cement, and steel industries, which were struggling with significant overcapacity, high capex intensity and under-capitalised parent companies. Distressed deal contributed around 70 per cent to the growth in M&A activity in 2018, enabled through the corporate insolvency resolution process under IBC.

**Boosting corporate bond market evolution**

Experience across the world has demonstrated how effective bankruptcy laws can help deepen the bond market. In countries such as Brazil, Russia, United Kingdom and China, the corporate bond market as a percentage of GDP has significantly increased after implementing bankruptcy reforms. After enactment of IBC in India, the corporate bond market share has increased from a mere 11 per cent in 2010 to 15 per cent in 2016 and 17 per cent in 2018. Thus, development of the Indian bond market depends critically on the effective implementation of the IBC in the future.
STREAMLINING LEGAL PROVISIONS FOR INSOLVENCY

There were several attempts and legal provisions before IBC to deal with insolvency.

The Sick Industrial Companies (Special Provisions) Act, 1987, popularly known as ‘SICA’ was enacted to address sickness in the industry. It was under this enactment that the Board for Industrial and Financial Reconstruction (BIFR) was formed to oversee the rehabilitation of sick units. However, instead of addressing sickness in the industry, BIFR itself became a sick institution and a refuge ground for defaulting borrowers who tried to take advantage of the indefinite moratorium under SICA. The Act was repealed on January 1, 2004, and BIFR was dissolved on December 1, 2016 to give way to the IBC.

The Recovery of Debts and Bankruptcy Act, 1993 (RDBA) provided for establishment of Debts Recovery Tribunals (DRTs) with original jurisdiction and Debts Recovery Appellate Tribunals (DRATs) with appellate jurisdiction, for expeditious adjudication and recovery of debts due to banks and financial institutions, insolvency resolution and bankruptcy of individuals and partnership firms and connected matters therewith. However, delays and some inconsistencies in decisions have reduced the effectiveness of the DRTs.

Then the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act) was enacted to let banks as well as other financial institutions of India auction commercial or residential properties for the purpose of loan recovery. However, SARFESI too had its own set of limitations in terms of its ineffectiveness in recovering bad loans since banks did not have the bandwidth to run the companies.

**Case of Merging RDBA and SARFAESI Act within IBC**

According to RBI report⁵, under IBC, Indian Scheduled Commercial Banks were able to recover Rs.70,819 crore of stressed assets in FY 2018-19 with a resolution rate of 42.5 per cent. Recovery under other methods such as Lok Adalats stood at 5.3 per cent, DRTs was 3.5 per cent, while SARFAESI Act was able to recover 14.5 per cent.

The RDBA / SARFAESI Act have envisaged a judicial-centric proceeding leaving little role for other stakeholders. Courts control the entire process of resolution/recovery, leaving no scope for decision making by other stakeholders. However, IBC separates commercial aspects of insolvency and bankruptcy proceedings from judicial aspects. The Adjudicatory Authority has been given only powers to pass judicial decisions and not on credit decisions. It puts the entire process at the disposal of the stakeholders and motivates them with incentives and disincentives to complete the process at the earliest. The financial creditors have been given absolute freedom to accept or reject a resolution application. The commercial decisions of the committee of creditors are not generally open to any analysis, evaluation or judicial review by the Adjudicating Authority or the appellate authority⁶.

IBC has consolidated multiple schemes announced earlier and focussed on a time-bound resolution coupled with maximisation of value. The RBI, in order to align the resolution mechanism with IBC subsequently withdrew all circulars such as the Corporate Debt Restructuring (CDR), the Flexible Structuring of Existing Long Term Project Loans, Strategic Debt Restructuring (SDR), Change in Ownership outside SDR, 5 by 25 scheme and Sustainable Structuring of Stressed Assets (S4A). The Joint Lenders’ Forum (JLF)—as an institutional mechanism for resolution of stressed assets was also discontinued.
Section 14(1)(c) of the IBC, 2016 clearly provides that during the insolvency resolution process as defined in the Code, the Code takes precedence over the RDB Act and SARFAESI Act:

Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely: - Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002.

Consolidation of these Acts into IBC will have various pronounced benefits for the economy. First, it will lead to significant reduction in resolution time as code works under definite timelines. Currently, cases can be submitted under RDBA or SARFAESI Act and if the entity is not satisfied with the result it can go further and submit its case under IBC. This whole cumbersome process leads to wastage of time and effort of not only stakeholders but also of judicial officials along with eroding the value of the asset. Second, exploitation of SARFAESI or RDBA by wilful defaulters in order to delay or get away with the debt obligation along with continuation of ownership will not be able to succeed under IBC. Third, consolidation of acts will further promote efficient use of resources along with widening the pool of resources available at the disposal. This will ease some pressure on overburdened judicial system. Lastly, faster resolution will help the banks and Non-banking Financial Corporations in cleaning their balance sheet that in turn will further strengthen the backbone i.e. the banking sector of the economy.

**Capacity Development**

To enhance the efficiency of the IBC mechanism, there is a dire need to increase the number of Insolvency professionals (IPs) and National Company Law Tribunal (NCLT) benches. Currently, there are 3,128 registered IPs and 16 NCLT benches operational across India. An IP requires a range of skills to perform his role well. Integrity and experience of IPs is central to the functioning of the insolvency system. An IP must possess not only qualities such as resourcefulness and business acumen, but also a good sense of judgment and fairness when balancing the interests of stakeholders inter se or against other interests and statutory objectives. He/she also needs written and interpersonal skills to deal with creditors, anxious directors, concerned employees and a range of other stakeholders in the business. He/she must have a fair degree of appreciation of cultures, social and other factors surrounding an insolvency proceeding. To cater the demand of such skilled professionals, IBBI has designed a 24-month Graduate Insolvency Programme (GIP). The Indian Institute of Corporate Affairs commenced the first batch of GIP on July 1, 2019. This capacity building needs to be strengthened to create professionals with range of essential skills required to enhance the efficacy of the Code.

**ROLE OF IBC DURING COVID-19: PROVIDING SUPPORT TO THE INDUSTRY**

Mankind is experiencing an unprecedented time due to nationwide lockdowns and subsequent unlockings to curb the COVID-19 disease. Most businesses are faced with a liquidity crunch making it difficult for them to survive. Micro, Small and Medium Enterprises (MSMEs), which comprise 93 per cent of the total firms providing employment to 12 crore workers, are most vulnerable due to lower cash reserves and smaller margin in their businesses.

In order to provide the liquidity support to businesses, RBI has come up with several measures such as putting moratorium on loan repayment for three months, conducting open market operations (Targeted Long term repo operations) of Rs 1.5 lakh crore, easing working capital financing and so on. As a relief
to COVID-19 affected industries, Government exercising its power under IBC has raised the threshold limit of defaults to Rs. 1 crore as against the earlier limit of Rs. 1 lakh in order to prevent triggering of insolvencies to safeguard MSMEs from the brunt of lockdown. IBBI has inserted a new regulation which states that the lockdown period will be excluded from the timeframe of 330 days to complete the resolution process in respect of about 2,000 cases in pipeline. Also, government has decided that no new cases will be entertained for next six months with suspension time can be extended up to 1 year. These measures will surely provide adequate time for businesses to recover and strategize for future along with creation of positive work environment.

CONCLUSION

Implementation of IBC has been a key economic reform which has helped the economy in fixing various issues such as twin balance sheet actions, long-standing ‘exit’ problem. IBC has successively addressed the logjams in the recovery of stressed assets and resolution timelines as per its intended objectives. It has shifted the balance of power to the creditor from the borrower and significantly instilled a better sense of credit discipline – a big plus. It has acted as a remedial measure to the prevailing malpractices in the Indian banking and corporate sector. This gets reflected in slower accretion of new non-performing assets in the Indian banking system. Combined with the said changes, IBC has led to significant improvement in ease of doing business conditions which in turn has promoted entrepreneurship at grassroots levels. All these aspects need to be strengthened further to realise the objectives of the Code and lend a hand to a dynamic growing Indian economy.

NOTES

3 Report on Trend and Progress of Banking in India 2018-19, Reserve Bank of India.
5 Supra Note 3.
About the Contributors

Dr. M. S. Sahoo

Dr. M. S. Sahoo serves as Chairperson of the IBBI. He has served as a Member of the Competition Commission of India, Secretary of the Institute of Company Secretaries of India, Whole Time Member of the Securities and Exchange Board of India, Economic Adviser with the National Stock Exchange of India and held senior positions in Government of India as a Member of Indian Economic Service. He also had a brief, but eventful legal practice.

Dr. Sahoo has been a Member / Chairman of several committees set up by Government of India and Regulators. These include Chairman of the Committees (Sahoo Committee I, II and III) on Depository Receipts, Domestic and Overseas Capital Markets, and External Commercial Borrowing and Chairperson of the Committee of Experts on Institutional Framework for Valuation Profession. As a Member of the Competition Law Review Committee and of the Insolvency Law Committee, he played a key role in development and refinement of regulatory architecture.

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Dr. Rajiv Kumar is Vice Chairman, NITI Aayog, in the rank and status of a Cabinet Minister.

He also serves as the Chancellor of Gokhale Institute of Politics and Economics, Pune. He has wide experience of having worked in Government, academia, industry as well as in multilateral institutions. A distinguished economist, Dr. Kumar was a Senior Fellow at CPR and earlier the CEO of Indian Council for Research on International Economic Relations. In the Government, he was Economic Advisor with Department of Economic Affairs, Ministry of Finance. He was Principal Economist at Asian Development Bank, Manila where he spent 10 years.

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Ms. Divan regularly writes for leading law journals and newspapers. She is the editor of The Indian Advocate, a journal published by the Bar Association of India. She has been a guest lecturer at several law colleges across India and has participated in several law conferences as a speaker on media law and gender rights.

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Mr. Injeti Srinivas is currently the Chairperson of the International Financial Services Centres Authority, which has been established in the month of April this year under a statute passed by the Parliament of India. He belongs to the 1983 batch of the Indian Administrative Service (Odisha cadre) and retired from the service in May, 2020 after serving nearly 37 years in the Union Government of India and the Government of Odisha in various capacities. He is economics (honours) graduate from the Shriram College of Commerce (Delhi University) and did his masters in business administration from Strathclyde Graduate Business School, the UK. Mr. Srinivas has played a key role in the implementation of some of the major economic reforms carried out by the Union Government, including the IBC, which is considered as one of the deepest reforms in the country that has positively impacted the borrowing culture at large and helped banks in effectively dealing with their problem of high NPAs. He is also credited with taking several initiatives that enhanced the ease of doing business at all stages (entry, operation and exit), including decriminalisation of offences of technical and procedural under the Companies Act. Earlier in his career, in the late nineties, he played a significant role in the liberalisation of the Foreign Direct Investment (FDI) Policy and is also credited with the inclusion of brownfield FDI as part of FDI inflows reporting into the country.

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Mr. Sumant Batra is an insolvency lawyer of international repute, social commentator and thought leader. He is the Past President of INSOL International. As senior consultant to the World Bank Group, the IMF, OECD and other developmental institutions, he has worked extensively on policy matters in Africa, Eastern Europe, Middle East and South Asia. Rated amongst the top 100 insolvency lawyers globally by GRR, Mr. Batra is an independent insolvency consultant and leads the insolvency practice of Kesar Dass B. & Associates, a leading Indian law firm co-founded by him in 1993. He is the author of the best seller ‘Corporate Insolvency – Law & Practice’. He is President of SIPI – a think tank on insolvency. A cultural champion, Mr. Batra is the founder and architect of several innovative creative projects.

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He has been a member of the South Asia Chief Economist’s Advisory Council of the World Bank, advisor to the Competition Commission of India, member of the Board of the Centre for Analytical Finance, ISB, the international adviser of the Centre for Law and Economics of Financial Markets at the Copenhagen Business School and a member of the Bankruptcy Task Force of IPD, Columbia University. Currently, he is on the International Advisory Committee of the School of Business, Economics and Law of the University of Gothenburg.

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Dr. Ajay Shah studied at IIT, Bombay and USC, Los Angeles. He has held positions at CMIE, IGIDR and the Ministry of Finance. He is Professor at NIPFP in New Delhi. He does academic and policy-oriented research on India, at the intersection of economics, law and public administration. His second book, co-authored with Vijay Kelkar, is “In service of the republic: The art and science of economic policy”, and was published in 2019 by Penguin Allen Lane. His areas of focus are macroeconomics, finance, health,
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Dr. Susan Thomas holds degrees in civil engineering and economics from IIT, Bombay and University of Southern California, Los Angeles. Since her return, she has been faculty at the Indira Gandhi Institute for Development Research, Bombay (IGIDR). Her research is on financial markets, household finance, finance and firms, and policy questions of financial markets and microstructure. Her recent work is on the Indian insolvency and bankruptcy reform. She was a member of the Bankruptcy Legislative Reforms Committee set up by the Ministry of Finance which gave the first draft of what was enacted as the Insolvency and Bankruptcy Code in May 2016. Her academic and policy work is available at http://www.ifrogs.org on the web.

Dr. Shashank Saksena

Dr. Shashank Saksena, an Indian Economic Service officer from the 1987 batch, has served the Government of India in various capacities. Currently, he is an Adviser in the Department of Economic Affairs, Ministry of Finance and is involved with the formulation of policy reforms including legislative reforms for the financial sector, financial stability and cyber security for financial sector and currency and coins sector. He has also been associated with the formulation of policy reforms in the areas of Agricultural Price Policy, Capital Market, External Commercial Borrowings, Banking Sector, Pension Reforms and State Finances in various Central Departments and Ministries. He has over 25 years of work experience in different Departments of the Ministry of Finance. He has been a Member of several Expert Committees in the financial sector. He has been involved with the formulation and enactment of over dozen financial sector legislations with respect to the securities market, the banking sector, payment system, financial markets and pension sector and the delegated legislations made thereunder during this period. He has also published several technical papers in the edited Books and News Magazines.

Dr. Saksena is an ex-officio Member of the Governing Board of IBBI since May, 2017. He is also the nominated Director on the Board of the Deposit Insurance and Credit Guarantee Corporation and Part-time nominee Director on the Board of the Security Printing and Minting Corporation of India Limited.

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Prof. Adam Feibelman is Sumter Davis Marks Professor of Law at Tulane Law School. His teaching and research focus on bankruptcy law, regulation of financial institutions, legal issues related to sovereign debt, and international monetary law. Prior joining the Tulane faculty, he was a faculty member at the University of North Carolina School of Law and at University of Cincinnati School of Law and taught as a Bigelow Fellow at the University of Chicago Law School. In 2016, he was a visiting scholar at the National Law School University of India, Bangalore, and at the Centre for Law and Policy Research, Bangalore, and he is currently studying India's Insolvency and Bankruptcy Code and its related legal ecosystem.
Dr. Renuka Sane

Dr. Renuka Sane is an Associate Professor at the National Institute of Public Finance and Policy. Her research interests lie in household finance and financial regulation of credit, pensions, insurance and equity markets. She is a member of the Pension Advisory Committee of the Pension Fund Regulatory Development Authority, and a member of the IBBI’s Working Group on individual insolvency. She has a Ph. D in Economics from the University of New South Wales.

Dr. Rajiv Mani

Dr. Rajiv Mani is an officer of the Indian Legal Service and is presently working as Joint Secretary and Legal Adviser in the Department of Legal Affairs, Ministry of Law and Justice, Government of India. He is presently looking after the advisory work of various Ministries of the Government of India including Ministry of Finance, Ministry of Corporate Affairs etc. He is closely associated in carrying forward the legislative initiatives of the Government of India in strengthening the Ease of Doing Business environment and to promote institutional arbitration and other measures that facilitates easy resolution of commercial disputes through ADRs and under the Commercial Court Act 2015. Dr. Mani, in addition is also looking after the work of Law Commission of India (LCI) as Joint Secretary in charge of the LCI. He is an *ex-officio* member of the Governing Board of IBBI since February, 2019.

Mr. Sudhaker Shukla

Mr. Sudhaker Shukla took charge as Whole Time Member, IBBI in November, 2019. Mr. Shukla served as a member of the Indian Economic Service for over 34 years in various capacities across Ministries and Departments of the Government of India and represented India, in the Board of the African Development Bank. He is currently looking after Research and Regulation Wing comprising Corporate Insolvency, Corporate Liquidation (including Voluntary Liquidation), Individual Insolvency and Individual Bankruptcy, Research & Publication, Data Management & Dissemination and Advocacy. In addition, he is also handling Human Resources, National Insolvency & Graduate Insolvency Programmes, Continuing Professional Education and Knowledge Management & Partnership divisions in the IBBI.

Dr. Neeti Shikha

Dr. Neeti Shikha is Head, Centre for Insolvency and Bankruptcy, Indian Institute of Corporate Affairs, Government of India. She serves as an Advisory Board Member to the Centre for Civil Society, New Delhi and as Academic Council Member to India School of Public Policy. She also is Life Member of FORE Society, parent body of India’s leading private business school, Fore School of Management. She has published extensively in area of corporate law and governance. She has given lectures at leading law schools in India and Singapore. Her research interest includes policy and law. She holds Ph.D. from National Law University Jodhpur and LL. M from University College London, UK.
Prof. (Dr.) Mamata Biswal

Prof. (Dr.) Mamata Biswal is working as a professor of Law and Dean, Academic Affairs at Gujarat National Law University. Her areas of expertise are Corporate Laws, International Trade Law (International Sales Law), Insolvency and Bankruptcy Laws. She is the Centre Director of the Centre for Corporate and Insolvency Laws at GNLU. She was awarded the ICSSR Senior Fellowship award in 2016-17 in the topic, ‘Legal Challenges before India to ratify the United Nation’s Convention on Contracts for the International Sale of Goods (CISG): A Critical Analysis’. She has been inducted as an independent woman director in the Gujarat based PSUs i.e. GSPC Pipavav Power Company Ltd, Gujarat State Energy Generation Limited and GSPC LNG Limited.

Ms. Surbhi Jain

Ms. Surbhi Jain is an Indian Economic Service officer of the 2001 batch currently working as Adviser, Department of Economic Affairs, Ministry of Finance. She is currently handling the Macro-economic Unit in Economic Division of the Department. She is a post-graduate from Delhi School of Economics after doing graduation from Lady Shri Ram College, Delhi. During her Service, she has worked in various Departments like DPIIT, Commerce, Agriculture and School Education. She has varied experience of working in various areas of governance. She has widely contributed to papers and articles in many newspapers, national and international journals. Recently, she has co-authored a book titled ‘Exploring Life @2050’.

Ms. Sonali Chowdhry

Ms. Sonali Chowdhry works as Consultant with Office of Chief Economic Adviser in Department of Economic Affairs, Ministry of Finance. She has more than 3 years of experience and her area of interest includes macroeconomic analysis, waste management and energy. Previously, she worked as an Officer (Economist) in Infrastructure Leasing and Financial Services (IL&FS) contributing to various verticals. Sonali holds Master’s in Economics from Dr. B. R. Ambedkar University (Scholarship Holder) and Bachelor’s in Economics (Hons) from Indraprastha College for Women, Delhi University.