27

A Code of Conduct for Committee of Creditors

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Appropriateness and fairness of decisions taken in a corporate insolvency resolution process (CIRP) have been an intensely debated question since the implementation of the Insolvency and Bankruptcy Code, 2016 (Code/IBC). Increasingly, dependence is being laid on the commercial wisdom of the committee of creditors (CoC) as the key decision-making body especially in the context of rescuing the corporate debtor (CD) through a sustainable resolution plan. Given their key responsibilities under the Code, the objectivity of the CoC in its decision making and its ability to best address the interests of the CD as well as all other concerned stakeholders is as important as the rescue of the CD itself. Against the backdrop of its current role and responsibilities, is it an appropriate time to adopt a code of conduct for the CoC to further strengthen the institution and ensure its smoother functioning leading to overall value maximisation for all stakeholders? How does the Indian experience compare with international jurisdictions, and can some inspiration be drawn from best practices across the globe?

ROLE OF CoC

The Code envisaged the CoC to be the supreme decision-making body during CIRP. The CoC is a transient heterogenous body consisting of financial creditors (FCs)[1] with diverse interests, which is dissolved on the conclusion of the CIRP. The Code and the regulations made thereunder bestow various powers on the CoC which includes appointing the Interim Resolution Professional (IRP) as the Resolution Professional (RP), supervising their functioning and conduct, and in the event, the conduct of the RP is not to its satisfaction, even replace the RP.[2] Even though it is the RP who is responsible for the management of the day-to-day affairs of the CD, it is the CoC which has

been bestowed with the power and responsibility to decide on all matters which are critical to the functioning of the CD. The Code[3] specifically lists down acts which can be undertaken by the RP only with the prior approval of the CoC such as creation of security interest over the CD's assets, change in ownership, capital structure or management of the corporate person, unearthing related party transactions, raising interim finance, delegation of powers of the RP to any other person and the like to ensure that commercially prudent actions are taken to preserve the value of the entity. The most important function of the CoC is, however, to determine the viability of the CD's business, examine the feasibility of future operations, the cost and expenses involved and accordingly, resolve to either proceed with the resolution process including the decision to extend the timeline[4] or opt to immediately liquidate the CD, where it is convinced that the resolution process is bound to fail.[5] Further, an application for withdrawal of the insolvency application after it has been admitted can be made by the applicant, only with the approval of 90% of creditors of the CoC.[6]

Once the CoC approves a resolution plan with the requisite majority, the RP is bound to place the same before the Adjudicating Authority (AA) for its approval.[7] In the matter of *K Shashidhar v. Indian Overseas Bank and Ors*.[8], the Hon'ble Supreme Court (SC) discussed the aspect of approval or rejection of resolution plan by the CoC in detail and very clearly stated that-

> There is an intrinsic assumption that financial creditors are fully informed about the viability of the corporate debtor and feasibility of the proposed resolution plan…The opinion on the subject matter expressed by them after due deliberations in the CoC meetings through voting, as per voting shares, is a collective business decision. The legislature, consciously, has not provided any ground to challenge the "commercial wisdom" of the individual financial creditors or their collective decision before the adjudicating authority. That is made non justiciable.[9]It is clear that the limited judicial review available, which can in no circumstance trespass upon a business decision of the majority of the Committee of Creditors, has to be within the four corners of section 30(2) of the Code, insofar as the Adjudicating Authority is concerned, and section 32 read with section 61(3) of the Code, insofar as the Appellate Tribunal is concerned.[10]Thus, while the Adjudicating Authority cannot interfere on merits with the commercial decision taken by the CoC, the limited judicial review available is to see that the CoC has taken into account the fact that the corporate debtor needs to keep going as a going concern during the insolvency resolution process; that it needs to maximise the value of its assets; and that the interests of all stakeholders including operational creditors has been taken care of.[11][Emphasis supplied]

In the matter of *The Committee of Creditors of Essar Steel Limited v. Satish Kumar Gupta*[12], the larger bench of the SC described the National Company Law Tribunal (NCLT) as having a 'hands-off' approach. The decision deliberated on the role of the CoC, the NCLT and the National Company Law Appellate Tribunal (NCLAT). In this judgment, the SC reiterated that the limited judicial review available with the AA can be exercised only where the CoC has abdicated its responsibility of considering important parameters such as maximisation of asset value, that the CD needs to keep going as a going concern, balancing the interest of all stakeholders, etc.[13]

Relying heavily on the *Shashidhar* judgment, the Hon'ble SC, in the matter of *The Karad Urban Cooperative Bank Ltd. v. Swwapnil Bhingardevay and Ors*.[14] held that-

> if all the factors that need to be taken into account for determining whether or not the corporate debtor can be kept running as a going concern have been placed before the Committee of Creditors and the CoC has taken a conscious decision to approve the resolution plan, then the adjudicating authority will have to switch over to the hands-off mode.[15]

The decisions of the SC in *Arcelor Mittal India Pvt. Ltd. v. Satish Kumar Gupta and Ors*.[16] and *Swiss Ribbons Pvt. Ltd. and Anr. v. Union of India*[17] lay emphasis on the role and responsibility of the CoC including but not limited to assess the feasibility and viability of a resolution plan, the eligibility of the resolution applicant (RA), all attempts to keep the CD as a going concern with liquidation as the last resort, safeguard the interest of all stakeholders and that the resolution plan to provide for fair and equitable treatment of operational creditors (OCs). While the commercial wisdom of the CoC is protected from judicial scrutiny, the decisions taken by the CoC while performing such other responsibilities in the course of the CIRP remain subject to challenge.

The SC in the matter of *Arun Kumar Jagatramka v. Jindal Steel and Power Ltd. and Anr*.[18] made an observation on the role of the NCLT and NCLAT functioning as the AA and Appellate Authority under the Code-

> ...the IBC was introduced in order to overhaul the insolvency and bankruptcy regime in India. As such, it is a carefully considered and well thought out piece of legislation which sought to shed away the practices of the past. The legislature has also been working hard to ensure that the efficacy of this legislation remains robust by constantly amending it based on its experience. Consequently, the need for judicial intervention or innovation from the NCLT and NCLAT should be kept at its bare minimum and should not disturb the foundational principles of the IBC. This conscious shift in their role has been noted in the report of the Bankruptcy Law Reforms Committee (2015)…

INTERNATIONAL PRACTICES

While deliberating on the powers and functions of the CoC, it will be worthwhile to refer to the practices in some of the other evolved jurisdictions which have a robust insolvency resolution regime. The resolution processes of three jurisdictions which are similar to the CIRP under the Code in India are analysed hereunder with an intent to study the best practices that have led to the success of the resolution process in such jurisdictions and those which probably could be adopted to strengthen the objectives of the Code.

Singapore

The formal insolvency process of Singapore is known as the judicial management process[19], which is supervised by the court. The judicial management process is akin to the CIRP where the ultimate objective is rehabilitation of a financially distressed company. The judicial management process is driven by a licensed Insolvency Practitioner called the Judicial Manager. The role and functions of a Judicial Manager are very wide and includes, *inter alia*, to do such things as necessary for the

management of the affairs, business and property of the company, take over directors' functions, perform all functions in the interest of the company's creditors, etc. In the matter of *Lim Siew Soo v. Sembawang Engineers*[20], the High Court held that-

> The roles and duties of a judicial manager are multi-faceted. One of the purposes of appointing a judicial manager is to rehabilitate a distressed company as a going concern, for the benefit of all stakeholders…A judicial manager is therefore empowered to continue the company's business. That includes causing the company to perform its existing contracts.'

In a nutshell, the Judicial Manager performs the functions of the RP as well as exercises the commercial wisdom of the CoC, all within the overall supervision and active involvement of the court.

United Kingdom

In the UK, the insolvency process under the formal insolvency regime[21] is called administration. The objective of the administration process, depending on the suitability and feasibility of the options, can either be to rescue the company as a going concern, attempt to achieve a better result for the company's creditors as a whole *vis-à-vis* winding up or realise the property of the company in order to make a distribution to one or more secured creditors.[22] The scope of administration is to rescue the company as a going concern while ensuring value maximisation and balancing the interest of all stakeholders.

The role of the Administrator as stipulated in the statute, requires him to act in the best interest of the creditors as a whole. He must act in good faith, fairly and honorably, and shall also be seen to be independent and impartial in his management of the company and its property. An Administrator is subject to a duty to perform his functions as quickly and efficiently as is reasonably practicable. The Administrator has a wide range of powers, he can do anything necessary or expedient for the management of the affairs, business and property of the company.[23] Thus, the broad scope of the Administrator's duties allows him to exercise good business judgement. The creditors of a company can establish a creditors' committee; however, their role is limited to assisting the Administrator in discharging his functions.

Given such wide powers of the Administrator, in order to avoid misuse, rights have been provided to a creditor to challenge the Administrator's conduct by applying to the court on the ground that his conduct has harmed the interest of a creditor unfairly or there has been misfeasance by the Administrator.[24]

Moreover, to streamline the conduct of Insolvency Practitioners (like Administrators, Liquidators, etc.) under the various insolvency processes, there is a statement of practice called the Statement of Insolvency Practice 15 (SIP) which sets out basic principles and essential procedures with which Insolvency Practitioners are required to comply. Departure from the standards set out in the SIP is a matter that may be considered by a Practitioner's regulatory authority for the purposes of possible disciplinary or regulatory action. The key compliance standards include, *inter alia*:

(a) Insolvency Practitioners should advise creditors, in writing, how they may access suitable information on the rights, duties and the functions of the committee prior to inviting nomination of committee members to enable creditors to make an informed decision on whether they wish to be nominated to serve on a committee.

(b) At the creditors' committee meetings, Insolvency Practitioners should discuss with committee members how frequently they wish to receive reports and obtain their directions.

(c) Where an Insolvency Practitioner considers their professional judgement should override the views of creditors' committee, the office holder should clearly document why it is inappropriate to follow the views of the creditors' committee and provide an explanation for the same.

Similar to the code of conduct stipulated for regulating the functioning of RPs under the Code in India, there is a code of conduct for the various Insolvency Practitioners, including Administrators, in the UK which stipulates best practices to enhance their functioning, ensure uniformity and develop accountability.

United States of America

Under the formal insolvency regime, the primary reorganisation tool for corporates is either Chapter 11- reorganisations or Chapter 7 -liquidations. Chapter 11 governs the reorganisation of corporate entities, similar to CIRP in India. The purpose of Chapter 11 is two pronged. On one hand, the automatic stay[25] provides a debtor with 'breathing space' so that the distressed entity can preserve its business as a going concern by preventing creditors from taking precipitative action against its assets and allowing the debtor to propose a plan of reorganisation. On the other hand, Chapter 7 is meant to maximise recovery for various creditors of the debtor *vis-à-vis* liquidation.

Under Chapter 11 the debtor remains in control of its business operations and repays creditors concurrently through a court-approved reorganisation plan. An officer of the US Department of Justice, called the US Trustee, is responsible for monitoring the progress of a Chapter 11 case and supervising the debtor-in-possession's operation of the business. In rare cases such as fraud, dishonesty, incompetence, or gross mismanagement by the debtor, the bankruptcy court may order the appointment of an Examiner to investigate the affairs of the debtor or a Trustee to take over management of the debtor's business. Upon the appointment of a Trustee, the debtor loses its right to be 'in possession' and is required to hand over the operation of its business to the Trustee. The Trustee substitutes the debtor's board of directors and assumes responsibility for the executive leadership and management of the debtor's business in a very similar fashion as the RP under CIRP in India.

The US law provides for the creation of a committee of unsecured creditors in order to represent the interests of all general unsecured creditors for the purpose of maximising returns to those creditors. The creditors' committee usually plays an active role in the interest of the creditors.

Once a plan of reorganisation is proposed by the debtor and if the requisite number of stakeholders vote in favour of the plan, a hearing to confirm the plan will take place (with notice to parties in interest). The US Bankruptcy Code provides that a court can confirm a Chapter 11 plan only if certain requirements are met, including that: (a) the plan and the plan proponent have complied with the applicable provisions of the US Bankruptcy Code and the plan has been proposed in good faith; (b) if there are classes that are impaired under the plan, then at least one impaired class has voted to accept the plan ('cram down'); (c) subject to the cram down requirements, each class has accepted the plan or is unimpaired; (d) the plan is in the best interests of the holders of claims or interests of any impaired class; and (e) the plan is feasible.

The insolvency process in the US is debtor friendly, unlike other jurisdictions, and the unsecured creditors' committee exercises some influence and plays an active role in the insolvency process.

The most important aspect in all the above examples is the unbiased, independent and objective conduct of the entity that is steering the insolvency resolution process. In the three jurisdictions that we have analysed above, while different players such as the Judicial Manager, the Administrator, are tasked with the proper conduct of the roles and responsibilities connected with the insolvency process, the conduct narrative is largely similar. It broadly encompasses:

- Suitability to drive the resolution process without any conflict of interest and in an objective and unbiased manner;
- Act in the best interest of the stakeholders' group as a whole;
- Act in good faith, fairly and honorably, and also be seen as independent and impartial;
- Must exercise good business judgement;
- Resolution is commercially feasible and viable, compliant with laws, and fair and equitable.

PROPOSED CODE OF CONDUCT FOR CoC

While there is no doubt that all stakeholders are vital, during the CIRP where the prime objective is revival/rehabilitation of a financially distressed company, the FCs play a very significant role as they have larger stakes involved, are equipped with the ability to decide on matters relating to commercial viability of the CD and display their willingness to take the risk of restructuring their debts in order to keep the CD a going concern. It may also be argued successfully that the FCs with 'skin in the game', like banks and financial institutions, are better placed to assess the feasibility and viability of a resolution plan for the successful continuance of a CD as a going concern. And if a CD revives successfully, it can as well be reasonably assumed that other stakeholders like OCs would also equally benefit from the revival.

The law in India has recognised the above and relies on the CoC to run CIRP and looks to them to set highest levels of standards in conduct and performance. The NCLTs in some cases have also recognised the diligence and roles played by the CoC. For example, in the matter of *Ashika Commercial Private Ltd*.[26], NCLT, Kolkata Bench observed;

> This is a case in which the COC has judiciously distributed the financial bids to the stakeholders according to their full entitlements. There is nothing in the plan, so as to disapprove it. The COC has very well deliberated with the two plans and decided the viability, feasibility and financial matrix of each plan and approved one…...

Similarly, in the matter of *Pawan Impex Pvt. Ltd.*[27], NCLT, Principal Bench at New Delhi observed that '*…the decision of the COC is a reasoned and self speaking one as required under provisions of regulation 39(3) of CIRP Regulations, 2016.*'

Having emerged as the most appropriate body to attempt to revive and rehabilitate distressed CDs in a commercially prudent manner, it may be worthwhile to consider steps that could be taken to further strengthen the framework of CoC under the Code. A possible way to achieve this objective could be to consider adopting a code of conduct along the similar lines of the SIP in the UK, which would set out the guiding principles for the conduct of the CoC and ensure that its commercial wisdom is largely confined to within the four walls of these guiding principles, with any deviations requiring proper justification or attracting incidental consequences.

Some of the guiding principles could include intent statements on the following areas:

(a) demonstrable transparency in the conduct of the CoC especially with regard to conflict-of-interest issues;
(b) all decisions of the CoC to be backed by fair reasoning and to be recorded;
(c) maintain arm's length with RPs in respect of jurisdiction and responsibilities, especially in respect of engagement of professionals and in the area of treatment of avoidance transactions;
(d) requirement for better due diligence of the RA as well as the CD;
(e) mechanism for resolution of deadlocks on matters where the CoC is unable to take decisions due to lack of requisite majority;
(f) mandatory disclosure of all information to the RP for assisting the RP in conducting the business of the CD such as technical reports, forecasts, etc.;
(g) appropriate penalties or disciplinary action for a CoC member on account of misconduct or malfeasance while being on the CoC of another CD, subject to carve out of decisions taken in good faith applying business judgement rule;
(h) strict adherence to timelines stipulated in the Code and the regulations made thereunder;
(i) commercial wisdom of CoC to be supported by suitable and reasoned back up information and data;
(j) minimum stipulated professional and empowered competency of the members representing the creditors in the CoC meetings;
(k) in respect of large resolutions, the CoC to be encouraged to have a heterogeneous composition such as involving experts from different areas of specialisation such as compliance, credit, risk, investment banking, legal and also suggest minimum thresholds of representation for such experts to encourage more diverse and multi-faceted discussions;

(l) encouraging entrepreneurial and business initiative by the CoC while exercising its commercial wisdom along with requisite immunities to protect them against unfavorable outcomes as an outcome of exercising such commercial wisdom.

CONCLUSION

There appears to be no global consensus on the optimum approach to achieve an objective and transparent CIRP. The Code, in India, imposes this duty largely on the CoC, which is best placed to maintain the CD as a going concern. An appropriate code of conduct for CoC members has the potential to support procedural certainty and fairness to the CIRP. The introduction of principles and processes such as transparency, prior due diligence and disqualification for misconduct, strengthen the ability of the CoC to exercise its commercial wisdom for the benefit of the CD, while also ensuring that the interests of all stakeholders are best served. Overall, the adoption of a code of conduct, along the lines suggested above, could greatly strengthen the CIRP, maximise value for all stakeholders with high levels of process conduct and bring the Indian insolvency law at par with established international jurisdictions.

NOTES

[1] There are certain specific scenarios stipulated in regulation 16 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) when the CoC constitutes of OCs instead of FCs.
[2] Section 27, IBC.
[3] Section 28, IBC.
[4] Section 12(2), IBC.
[5] Section 33, IBC.
[6] Section 12A of IBC read with regulation 30A of CIRP Regulations.
[7] Section 30(6), IBC.
[8] Civil Appeal No. 10673/2018, February 05, 2019.
[9] *Ibid*, para 52.
[10] *Ibid*, para 48.
[11] *Ibid*, para 54.
[12] Civil Appeal No. 8766-67/2019, November 15, 2019.
[13] *Ibid*, para 46.
[14] Civil Appeal Nos. 2955/2020 and 2902/2020, September 04, 2020.
[15] *Ibid*, para 13.
[16] Civil Appeal Nos. 9402-9405 of 2018, October 04, 2018.
[17] (2019) 4 SCC 17, January 25, 2019.
[18] Civil Appeal No. 9664/2019, March 15, 2021.
[19] Insolvency, Restructuring and Dissolution Act, 2018.

[20] [2021] SGHC 32, para118.
[21] Insolvency Act, 1986.
[22] Insolvency Act, 1986, Schedule B1, para 3.
[23] Insolvency Act, 1986, Schedule B1, para 99(4).
[24] n *Re Charnley Davies Ltd.* (No 2), the administrator sold the insolvent company›s business at an allegedly undervalued price, which creditors alleged breached his duty to not unfairly harm them. Millett J held that 'the standard of care was not breached, and was the same standard of care as in professional negligence cases of an 'ordinary, skilled practitioner'. He emphasised that courts should not judge decisions which may turn out sub-optimal with the benefit of hindsight. Here the price was the best possible in the circumstances.
[25] Section 362(a), US Bankruptcy Code.
[26] CP No. (IB) 600/KB/2020.
[27] CP No. (IB)-1396 (PB)/2019.