VIII. THE SILENT STAKEHOLDERS: EXAMINING THE CASE OF PUBLIC SHAREHOLDERS IN THE CIRP OF LISTED COMPANIES

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ABSTRACT

In the high-stakes arena of corporate insolvency, shareholders often stand on the periphery, powerless as their investments plummet and decision-making shifts firmly into the hands of creditors. This unsettling reality came into sharp focus during the Electrosteel Steel insolvency resolution, where public equity holders watched as their stakes dwindled and recovery prospects vanished. The Insolvency and Bankruptcy Code (IBC) operated on "creditor-in-control" model, relegating shareholders to the lowest rung in the liquidation hierarchy and excluding them from influential roles such as Committee of Creditors (CoC). This approach, while essential for efficient debt recovery, has left retail and minority shareholders vulnerable to severe financial losses with little to no recourse.

In response to this imbalance, the Securities and Exchange Board of India (SEBI) proposed a framework allowing public shareholders to acquire equity in restructured entities under favourable conditions post-resolution. This article critically examines SEBI's Proposal against the IBC's creditor-centric framework, questioning if and how shareholder protection can be reconciled with the overarching goals of insolvency resolution. At its core, this exploration delves into the delicate trade-offs between efficient debt resolution and fair treatment of shareholders, assessing the feasibility and implications of granting shareholders a stake in post-resolution entities. By analysing SEBI's Proposal, this article seeks to spark a broader discussion: Can public shareholder protection be meaningfully integrated into the IBC without destabilizing its fundamental purpose?

Keywords: IBC, Public Shareholders, Listed Companies, SEBI Proposal

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I. INTRODUCTION

"Under insolvency, all shareholders stand in the same dock, accused of owning a company that has defaulted on its debt," writes a column in *LiveMint*, capturing the grim reality for investors during Electrosteel Steels insolvency resolution.[1] The company lost substantial market capitalization, and shareholders saw a significant drop in equity value. Shareholders, despite their stake in the company, are often rendered powerless during insolvency proceedings. As the company faced a sharp decline in market capitalization, equity holders saw their investments severely diminished, with little to no recourse in the recovery process. With no active role in the resolution mechanism, shareholders are often left with little to no returns, especially in cases of liquidation or asset recovery.

[1] Ravi Ananthanarayan, *Investors in IBC companies face a harsh reality*, LiveMint (April 22, 2018) <https://www.livemint.com/Money/RMjRc05F9KLw40WQBlwTxK/Investors-in-IBC-companies-face-a-harsh-reality.html> accessed on Oct 5, 2024.

In a listed company, equity owners retain control as long as debt obligations are met, as the company operates like a contract between equity and debt. However, when a default occurs, this balance shifts. Creditors move to the forefront, and equity owners are pushed to the side lines. This dynamic is at the heart of the Insolvency and Bankruptcy Code ("IBC"),[2] which follows a "creditor-in-control" model. Equity shareholders are excluded from key decision-making processes, such as the Committee of Creditors ("CoC") that approves resolution plans, and they occupy the lowest rank in the liquidation waterfall—a mechanism that prioritizes assets and funds distribution in case of asset recovery.

Given the minimal or zero payouts often received by non-promoter shareholders, particularly retail investors, the Securities and Exchange Board of India ("SEBI") proposed changes[3] ("Proposal") to allow such shareholders a chance to acquire equity in the post-resolution entity, under more favourable conditions. This proposal aims to address the exclusion of public shareholders in the current process and offer them some definite form of participation.

Yet, this raises a critical dilemma: while the IBC prioritizes creditors in insolvency to ensure an efficient resolution, ignoring the concerns of public shareholders could lead to financial hardship for retail and minority investors. How much protection should be extended to public shareholders without undermining the core objectives of the insolvency framework? Or is it even

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[2] The Insolvency and Bankruptcy Code, 2016 (31 of 2016).

[3] Framework for protection of interest of public equity shareholders in case of listed companies undergoing Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code (IBC) (November 10, 2022) < https://www.sebi.gov.in/reports-and-statistics/reports/nov-2022/framework-for-protection-of-interest-of-public-equity-shareholders-in-case-of-listed-companies-undergoing-corporate-insolvency-resolution-process-cirp-under-the-insolvency-and-bankruptcy-code-ibc-_64850.html> accessed on Oct 5, 2024.

appropriate to extend protection to public shareholders in insolvency resolution proceedings?

Against this complex backdrop, this article critically examines the position of public shareholders[4] within the current insolvency regime along with SEBI's Proposal and its potential impact on the corporate insolvency landscape. Central to the discussion would be the novel proposition of mandating the offering of shares to existing shareholders in the restructured entity post-resolution.

This article will anchor its exploration around the SEBI Proposal, aiming to answer the broader question of whether shareholder protection can, and should, be integrated into the architecture of insolvency resolution without destabilizing its fundamental purpose.

II. THE INSOLVENCY REGIME VIS-À-VIS PUBLIC SHAREHOLDERS

The capital structure of a company is a delicate balance of debt and equity, both of which are vital for fuelling growth, innovation, and expansion. In today's fiercely competitive business landscape, raising capital in the right form, at the right time, and at the right price can mean the difference between the success and failure of a commercial enterprise. When a company goes public, its ownership is split between promoters—the founders or controlling shareholders—and non-promoters, which include public investors and minority shareholders. The protection of these shareholders' interests is at the core of both company law and securities regulation, ensuring that market confidence remains intact.[5]

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[4] In this essay, the terms "public shareholders," "non-promoter shareholders," and "minority shareholders" will be used interchangeably to collectively refer to all public equity shareholders who do not hold a controlling interest in the listed company.

[5] Robert Parrino, *Fundamentals of Corporate Finance* (November 11, 2011).

However, when a company stumbles into financial distress and triggers the insolvency process under the IBC, this balance shifts dramatically. The IBC introduces a fundamental change by moving from a debtor-in-possession model—where management retains control—to a creditor-in-control framework. This shift hands the reins to the creditors, who have provided the financial backbone of the company, while equity shareholders, including public and minority investors, see their influence and control severely reduced.

A. The Current Legal Framework

The IBC empowers the resolution applicant with broad discretion in crafting a plan to revive a corporate debtor. Regulation 37 of the IBBI Regulations, 2016 ("CIRP Regulations") underscores this flexibility by allowing any measures that enhance the value of the debtor's assets.[6] This includes the option to cancel or delist the company's shares if deemed necessary for its recovery.

1. MAINTAINING LISTED STATUS POST-RESOLUTION

When a corporate debtor aims to retain its status as a listed company after implementing a resolution plan, the resolution applicant faces the challenge of complying with the continuous listing obligations set forth in Regulation 19A of the Securities Contracts (Regulation) Rules, 1957.[7] Typically, a publicly listed company must uphold a minimum public shareholding of 25%. Should this public ownership dip below the required threshold, the company is compelled to restore it within 12 months to safeguard its listing status.[8]

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[6] IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg. 37.
[7] Securities Contracts (Regulation) Rules, 1957, Reg. 19A.
[8] ibid.

However, recognizing the unique challenges faced by companies undergoing insolvency, an amendment in 2018,[9] further updated in 2021,[10] introduced more lenient requirements. For companies that have implemented a resolution plan approved under Section 31 of the IBC,[11] the minimum public shareholding can be as low as 5%. The company then has a three-year window to gradually increase public shareholding to 25%.[12] Additionally, if public ownership drops below 10% during this three-year period, the company must bring it back up to 10% within 12 months of the decrease.[13]

2. Delisting a corporate debtor under the resolution plan

Regulation 37 of the CIRP Regulations grants resolution applicants the flexibility to delist a listed corporate debtor as part of their resolution strategy. Typically, the delisting process is governed by SEBI's Delisting of Equity Shares Regulations, 2021 ("Delisting Regulations"). However, Regulation 3 of the Delisting Regulations[14] clarifies that these provisions do not apply when delisting occurs under a resolution plan approved by the National Company Law Tribunal ("NCLT") in accordance with Section 31 of the IBC.

For this exemption to hold, two key conditions must be met:

a. *Exit Opportunity for Public Shareholders*: The resolution plan must offer an exit to public shareholders at a price not lower than the price offered to any other shareholder, directly or indirectly.

[9] Securities Contracts (Regulation)(Second Amendment) Rules, 2018.
[10] Securities Contracts (Regulation) (Amendment). Rules, 2021.
[11] The Insolvency and Bankruptcy Code, 2016 (31 of 2016) § 31.
[12] Securities Contracts (Regulation) Rules, 1957.
[13] ibid.
[14] SEBI (Delisting of Equity Shares) Regulations, 2021, Reg. 3.

b. *Disclosure Requirements*: Full details of the delisting process, including a justification for the exit price, must be disclosed to the stock exchange(s) within one day of the resolution plan's approval.

In typical insolvency cases, the corporate debtor's assets are valued lower than its liabilities, leaving the resolution applicant with limited options to fully cover outstanding debts. As a result, the company's equity holds little to no value and is usually written off entirely. Despite this, public shareholders are still considered to have received value equivalent to the exit price (even if that price is zero), fulfilling the conditions necessary for delisting under the Delisting Regulations.

B. SEBI Proposal

The cornerstone of the SEBI Act of 1992 ("SEBI Act") is rooted in investor protection. The Preamble of the Act defines its objective:[15]

> *"An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto*."

Under Section 11(1) of the SEBI Act,[16] SEBI is entrusted with the duty to implement rules and regulations that safeguard the interests of investors while also fostering the growth and regulation of the securities market. This mandate empowers SEBI to take proactive measures to ensure that the securities ecosystem remains robust and secure for all participants.

[15] The Securities And Exchange Board Of India Act, 1992 (15 of 1992).
[16] The SEBI Act, 1992 (15 of 1992) § 11(1).

In its consultation paper dated November 10, 2022[17] the SEBI outlined how equity shareholders, being invested in risk capital, occupy the last position in the waterfall mechanisms prescribed in insolvency or liquidation scenarios. The resulting hardships worsen in the cases of minority shareholders and retail investors. Acknowledging these concerns, SEBI came up with the following suggestions for consideration in the current framework:

a. *Opportunity for Public Shareholders to Participate*: Non-promoter public shareholders should be given the opportunity to acquire up to 25% of the fully diluted equity in the newly restructured entity post-resolution. This acquisition would be offered at the *same pricing* terms as the resolution applicant, ensuring that public shareholders are not side-lined and can participate in the new entity on equal footing.
b. *Mandatory Minimum Public Shareholding*: To maintain its listed status, the restructured company must ensure that at least 5% of its shares are held by non-promoter public shareholders. If the company fails to secure this 5% threshold after offering shares to public shareholders, it would be required to delist from the stock exchange, effectively losing its public market status.
c. *Modification in Delisting Exemptions*: SEBI has also proposed a narrowing of the exemptions under Regulation 3 of the Delisting Regulations. These exemptions would only apply in two specific cases: (a) if the corporate debtor enters liquidation, or (b) if, despite offering shares to public shareholders on the same terms as the resolution

[17] Framework for protection of interest of public equity shareholders in case of listed companies undergoing Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code (IBC) (November 10, 2022)< https://www.sebi.gov.in/reports-and-statistics/reports/nov-2022/framework-for-protection-of-interest-of-public-equity-shareholders-in-case-of-listed-companies-undergoing-corporate-insolvency-resolution-process-cirp-under-the-insolvency-and-bankruptcy-code-ibc-_64850.html > accessed on Sept 14, 2024.

applicant, the company is unable to meet the 5% minimum shareholding requirement.

When SEBI's Proposal is examined through the lens of Section 11(1), it becomes evident that the regulator is fulfilling its statutory obligation by seeking to protect public shareholders—those who stand to lose their investments when a company enters the Corporate Insolvency Resolution Process ("CIRP"). SEBI's intervention aims to prevent public shareholders from being disproportionately affected by the financial distress of a listed company.

According to SEBI, this proposal offers several advantages. Firstly, it enables the corporate debtor to retain its listed status by maintaining a minimum public float, ensuring the company's continued presence and visibility in the market. Secondly, by allowing public shareholders to participate in the restructured entity, the proposal alleviates the capital burden on the resolution applicant, opening additional channels for raising capital. Lastly, it creates a level playing field for existing public shareholders, granting them the opportunity to invest in the new entity at the same terms as the resolution applicant.

The proposal of offering shares of the restructured entity to the existing shareholders mirrors the practice of rights offerings in U.S. Chapter 11 bankruptcy cases[18] during exit financing, in which existing shareholders are offered an opportunity to acquire shares in the reorganized company.[19] The

[18] 11 U.S. Code Chapter 11 – REORGANIZATION.

[19] Paul M. Green, *Rights Offerings in Bankruptcy: More Than New Capital*, Journal of the Association of Insolvency & Restructuring Advisors reprinted in Jones Day Business Restructuring Review (January 1, 2011) <https://www.jonesday.com/en/insights/2011/01/rights-offerings-in-bankruptcy-more-than-new-capital-ijournal-of-the-association-of-insolvency--restructuring-advisorsi-reprinted-in-ijones-day-business-restructuring-reviewi >accessed on 10 October 2024.

U.S. securities law[20] further incentivises this practice by exempting newly offered securities under a reorganization plan from registration requirements with the Securities Exchange Commission. Nevertheless, it should be noted that rights offering is typically a part of reorganisation plan and takes place with the consent of the creditors. Hence, it's not an entitlement, but rather a negotiated outcome that varies case by case. Similarly, in other prominent jurisdictions, including the United Kingdom,[21] European Union,[22] Germany,[23] France,[24] and Japan,[25] public equity shareholders do not enjoy an automatic, direct, or guaranteed right to participate in the post-resolution entity through share acquisition. In these systems as well, such involvement of existing shareholders in the reorganized company remains conditional, subject to the discretion of creditors and the overall structure of the resolution plan.

III. ASSESSING THE POSITION OF PUBLIC SHAREHOLDERS IN THE INSOLVENCY RESOLUTION

The expression "Shareholders usually get burned in bankruptcy court,"[26] colourfully captures the precarious position of shareholders in insolvency resolution proceedings. Building on this, we will delve into the vulnerabilities they face in the turbulent waters of insolvency resolution in which the shareholders find their investments at risk and navigate a system that frequently overlooks their interests. However, the recent SEBI Proposal

[20] U.S. Code Title 11. Bankruptcy § 1145.
[21] Insolvency Act 1986 (c 45).
[22] Regulation (EU) 2015/848 of the European Parliament and of the Council on insolvency proceedings [2015] OJ L 141/19.
[23] Insolvency Act (Insolvenzordnung) 1999 (BGBl I S 1546).
[24] Code de commerce (Commercial Code), art L. 620-1 et seq.
[25] Bankruptcy Act (Act No. 75 of 2004).
[26] Bill Alpert, *Shareholders Fight to Keep Peabody Stock*, BARRON'S (Jan. 14, 2017), <http://www.barrons.com/articles/shareholders-fight-to-keep-peabody-stock-1484378078> accessed on 15 Sept, 2024.

seeks to shine a light on these grievances, advocating for safeguards for public shareholders in the resolution process of listed companies. While the intention behind this proposal is commendable, we must critically assess the friction it could create within the established insolvency ecosystem.

A. Understanding the Grievances of the Shareholders

When a publicly listed company undergoes a resolution plan approved by the NCLT, there are typically two broad scenarios:[27]

a. *Retention of Listing with or without Capital Adjustment*: The Company may continue to be listed, albeit with a substantial reduction in its capital as outlined in the resolution plan.
b. *Delisting or Liquidation*: Alternatively, the resolution plan might lead to the company being delisted or entering liquidation.

Currently, public equity shareholders hold a highly relegated position under the IBC scheme. According to the waterfall mechanism laid out in the IBC,[28] equity shareholders are the last in line to claim any remaining assets of a company after dues to government authorities, financial institutions, banks, creditors, and bondholders have been fully settled. They are also not entitled to representation before the CoC,[29] nor is their consent required for the approval of a resolution plan. Lastly, they endure the greatest losses when the company gets delisted. The plight of retail investors is particularly precarious, with their capital often dismissed as "dumb money" — a term reflecting the stereotype that retail investors inevitably lose out.[30] This perception is further compounded by the fact that their access to key information and internal

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[27] ibid.
[28] The Insolvency and Bankruptcy Code, 2016 (31 of 2016) § 53.
[29] Dr. Ravi Shankar Vedam v. Tiffins Barytes Asbestos and Paints Limited [MANU/NL/0581/2023] <https://updates.manupatra.com/roundup/contentsummary.aspx?iid=43121&text=>.
[30] https://www.livemint.com/mint-top-newsletter/easynomics07082024.html.

insights about the company remains heavily restricted and prone to manipulation.

A stark example of this sidelining can be seen in the case of ***Dewan Housing Finance Corporation Ltd***. (DHFL).[31] The NCLT approved a resolution plan that allowed for DHFL's delisting from stock exchanges, a decision that was later challenged by retail investors in the Supreme Court. Under the approved resolution plan, Piramal Capital and Housing Finance Ltd. (PCHFL) acquired DHFL, and the company's equity shares were to be reduced to zero. Retail investors, who had hurriedly purchased DHFL shares in the hope of making substantial gains under new management, were left with nothing as the stock was delisted. This left both long-term shareholders and speculators—those who stayed loyal to DHFL during its peak, and those misled into believing that the company would remain listed under new ownership—stranded. As one Gurgaon-based investor remarked, "In DHFL's case, most retail investors were of the impression that it will remain listed like Ruchi Soya, Alok Industries, and Essar even after insolvency resolution, and SEBI cannot wash away its responsibility."[32] This investor lost ₹204,000 out of a ₹300,000 investment, showcasing the devastating impact of delisting. Many retail investors and minority shareholders, who have limited access to insider information and lack a deep understanding of complex insolvency

[31] Muhabit ul Haq, *Minority investors often get a raw deal during insolvencies. Can Sebi's new proposal change things?*, Economic Times India (December 6, 2022) <https://economictimes.indiatimes.com/prime/corporate-governance/minority-investors-often-get-a-raw-deal-during-insolvencies-can-sebis-new-proposal-change-things/primearticleshow/96015757.cms> accessed on Sept 25, 2024.

[32] Anirudh Laskar, *DHFL investors to move Supreme Court against plan to delist stocks*, Hindustan Times (July 18, 2021) <https://www.hindustantimes.com/business/dhflinvestorstomove-supreme-court-against-plan-to-delist-stocks-101623980444103.html#:~:text=%E2%80%9CIn%20DHFL's%20case%2C%20most%20retail,%E2%82%B9300%2C000%20investment%20in%20DHFL> accessed on Sept 20, 2024.

regulations, often hold the mistaken belief that companies undergoing CIRP will continue to remain listed post-resolution. In a parallel case, the capital raising for the restructuring of ***Yes Bank*** also severely diluted the value of existing shares. The issuance of new shares—intended by the RBI to ensure capital stability and protect depositors' interests—led to a sharp reduction in the ownership stake of minority shareholders, diminishing their influence in corporate decisions. The bank's stock price plummeted from ₹186 in 2019 to ₹12.4 in 2020, with retail investors suffering steep losses as their stakes were significantly diluted, leaving their capital exposed and unprotected.[33]

A similar situation arose in the case of ***Jaypee Kensington Boulevard v. NBCC (India) Limited***,[34] where the resolution plan also proposed a complete reduction of paid-up share capital at a negligible cost. The Supreme Court upheld this plan, reaffirming that the IBC does not provide explicit protections for minority shareholders,

"…when the promoters' shareholding is extinguished and cancelled in toto without any consideration, even nominal exit price of INR 1 crore for minority shareholders cannot be termed as unfair or inequitable."[35]

The decision illustrated how equity holders, especially minority shareholders, could see their entire investment wiped out during insolvency proceedings with no recourse for compensation. The same phenomenon

[33] Kushal Singh, *Whether Minority Shareholder's Rights Do Matter in Public Listed Companies under SEBI's Framework*, IIPRD Blog (September 26, 2024) <https://iiprd.wordpress.com/2024/09/26/whether-minority-shareholders-rights-do-matter-in-public-listed-companies-under-sebis-framework/#_ftn23 > accessed on 11 Oct 2024.
[34] Jaypee Kensington Boulevard v. NBCC (India) Limited [AIRONLINE 2021 SC 224].
[35] ibid.

unfolded in the delisting cases of ***ICICI Bank***[36] and ***Reliance Capital Ltd,***[37] which saw protests from minority investors post-resolution approval from NCLT.

These cases demonstrate the vulnerable position of public shareholders, particularly minority and retail investors, within the IBC framework. As the process currently stands, they face considerable hardships, including but not limited to:

1. EROSION OF SHARE VALUE

During insolvency proceedings, a company's financial instability often leads to a dramatic fall in its share price. This depreciation reflects the declining market confidence and the diminished value of the company's assets. Shareholders may find that their investments lose most, if not all, of their value as the company's financial situation worsens.

2. DISPARITY IN VALUE FOR SMALL SHAREHOLDERS

Although regulations stipulate that public shareholders should receive at least the liquidation value of their shares,[38] this value is often very low. In cases where the company's assets have been significantly depleted or where liabilities exceed assets, the liquidation value might be insufficient to offer fair compensation to shareholders. Consequently, when a company is in financial distress, its shares are often sold at deeply discounted prices as part of the

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[36] *ICICI Securities minority investors to challenge delisting*, The Economic Times (April 24, 2024)<https://economictimes.indiatimes.com/markets/stocks/news/icici-securities-minority-investors-to-challenge-delisting/articleshow/109546297.cms?from=mdr> accessed on 11 Oct 2024.

[37] Hitesh Vyas, *Why is a Reliance Capital Ltd investor challenging its resolution plan*? The Indian Express (September 13, 2024) <https://indianexpress.com/article/explained/explained-economics/reliance-capital-ltd-challenge-resolution-plan-9305148/> accessed on Sept 25, 2024.

[38] Supra note 7.

resolution plan. This is particularly problematic for small shareholders who, due to their limited influence and bargaining power, find themselves sidelined. The large stakeholders, such as financial institutions or major investors, can acquire shares at low prices, effectively diminishing the value of the investments held by smaller shareholders. This inequitable treatment means that while large investors may benefit from the restructuring, retail shareholders are left with minimal or no compensation for their equity.[39]

3. ALLOCATION OF SHARES IN THE NEW ENTITY

When a company undergoes a resolution, it might be restructured or merged into a new entity. If retail shareholders are not allocated shares in the new entity, they lose their investment with no opportunity to benefit from the potential success of the restructured company. This exclusion from the new entity can lead to substantial financial losses for these investors, who may have held their shares through the difficult period of insolvency, expecting some form of recovery or participation in the future growth of the business.

4. SUDDEN LOSS OF SHARE VALUE WITHOUT PRIOR INTIMATION

The process of delisting during insolvency can be swift and lacks adequate notification to shareholders. As a result, equity shares may become worthless overnight, without giving investors the opportunity to sell their shares or take other actions to mitigate their losses. This sudden devaluation can be particularly damaging for retail investors who may not have the

[39] *IBC is not fair to retail investors*, The Hindu Business Line (October 9, 2023) < https://epaper.thehindubusinessline.com/ccidist-ws/bl/bl_chennai/issues/55028/OPS/G0TBRRGOT.1+GJLBRSK08.1.html > accessed on Sept 25, 2024.

resources or access to information to manage their investments effectively during the insolvency proceedings.[40]

5. Opportunity to make representation

Shareholders, particularly minority and public shareholders, are not granted formal representation in the insolvency resolution process under the IBC. The control of the corporate debtor shifts to the CoC,[41] which consists primarily of financial creditors, and the resolution applicant negotiates directly with them. Shareholders' interests are deemed secondary to those of creditors, which is why they are not afforded representation or voting rights in the CoC or resolution plan approval. This approach is designed to ensure that creditors, who bear the majority of the financial risk, control the fate of the insolvent company. [42] The commercial wisdom of CoC is accorded supremacy,[43] hence creditor-driven decisions and plans become exceptionally difficult to challenge.

This lack of representation means that shareholders have little to no say in the final outcome of the resolution process, including delisting, restructuring, or the sale of assets, often leaving them with significantly diminished or no returns.

B. The SEBI Proposal: Does the Pendulum Swing Too Far?

Before evaluating SEBI's Proposal aimed at protecting public shareholders during the insolvency process of publicly listed companies, it is

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[40] Diane Lourdes Dick, *'The Bearish Bankruptcy'* (2018) 52 Ga L Rev 437.

[41] The Insolvency and Bankruptcy Code, 2016 (31 of 2016) § 21.

[42] Dr. Ravi Shankar Vedam v. Tiffins Barytes Asbestos and Paints Limited [MANU/NL/0581/2023] <https://updates.manupatra.com/roundup/contentsummary.aspx?iid=43121&text=>.

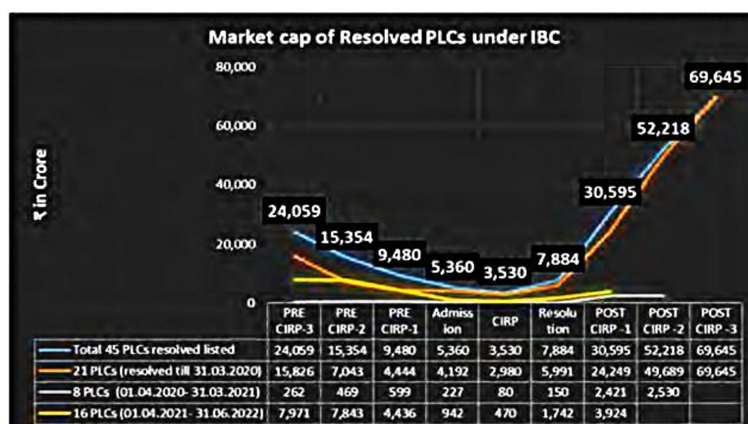
[43] Kalpraj Dharamshi Successful vs Kotak Investment Advisors Limited [AIRONLINE 2021 SC 206].

worth reflecting on the financial performance of publicly listed companies in the existing insolvency resolution regime.

Public Limited Companies possess a critical advantage—the ability to raise capital by issuing securities on financial markets. This capability is fundamental to financing new projects and driving business expansion. Market capitalization (market cap) serves as a key indicator in evaluating these companies. It reflects not only the price investors are willing to pay for a company's stock but also the market's perception of the company's overall worth and future potential.

The data presented in Fig. 1 highlights a striking upward trend in market capitalization among 45 Public Listed Companies under IBC, from the date of Resolution to three years post-resolution.[44] The market cap surged from approximately ₹7,800 crore to ₹69,600 crore, more than a sevenfold increase. This sharp rise reflects growing investor confidence and optimism in the companies' recovery prospects. It underscores the effectiveness of resolution plans under the IBC, as these companies emerge from financial distress with greater stability and market confidence. The consistent upward trend in market capitalization for these companies is a testament to the success of the existing framework. This data holds relevance in the context of SEBI's recent proposal to amend the shareholding framework of the post-resolution entity.

[44] Ajanta Gupta and Ritesh Kavdia, *Insolvency of Public Listed Company,* Emerging Ideas on IBC by Insolvency and Bankruptcy Board of India (2023).



	PRE CIRP-3	PRE CIRP-2	PRE CIRP-1	Admission	CIRP	Resolution	POST CIRP -1	POST CIRP -2	POST CIRP -3
Total 45 PLCs resolved listed	24,059	15,354	9,480	5,360	3,530	7,884	30,595	52,218	69,645
21 PLCs (resolved till 31.03.2020)	15,826	7,043	4,444	4,192	2,980	5,991	24,249	49,689	69,645
8 PLCs (01.04.2020- 31.03.2021)	262	469	599	227	80	150	2,421	2,530	
16 PLCs (01.04.2021- 31.06.2022)	7,971	7,843	4,436	942	470	1,742	3,924		

Fig. 1- ***Source***: Data published in *Insolvency of Public Listed Company,* Emerging Ideas on IBC by Insolvency and Bankruptcy Board of India (2023)

As such, before the implementation of any change that hits the root of the insolvency resolution process of listed companies, one may contemplate whether intervention is truly warranted. Unnecessary alteration pandered at catering to the interests of a minority segment might risk disrupting the delicate equilibrium of the insolvency ecosystem, which is currently yielding positive outcomes for public-listed companies undergoing resolution under the existing scheme.

In the following discussion, we will embark on a three-pronged critique of SEBI's Proposal. First, we dive into the mechanics of economic risk allocation in the insolvency resolution framework. Next, we explore the pivotal role of the resolution applicant, dissecting how their decision-making power could be impacted by the proposed measures. Lastly, we challenge the legality and rationale behind extending protections to shareholders, examining whether it stands in harmony with the core tenets of insolvency law.

1. ECONOMIC RISK ALLOCATION IN INSOLVENCY RESOLUTION

Equity and debt represent two fundamental types of financial contracts in corporate finance, and their distinction is crucial in bankruptcy proceedings. Equity gives holders a share in the company's potential profits

without fixed limitations, but it also exposes them to higher risks, as they stand last in line during insolvency. Debt, on the other hand, provides creditors with fixed returns, like interest, and is governed by regulatory rules such as usury laws. In bankruptcy, debt claims take priority over equity, making the difference between the two especially significant. [45] The UNCITRAL Legislative Guide on Insolvency Law (2005) emphasizes this hierarchy,[46]

> "*Owners and equity holders may have claims arising from loans extended to the debtor and claims arising from their equity or ownership interest in the debtor. Many insolvency laws distinguish between these different claims. With respect to claims arising from equity interests, many insolvency laws adopt the general rule that the owners and equity holders of the business are not entitled to a distribution of the proceeds of assets until all other claims that are senior in priority have been fully repaid (including claims of interest accruing after commencement). As such, these parties will rarely receive any distribution in respect of their interest in the debtor*."

A just insolvency process must ensure that creditors' rights take precedence over those of shareholders—whether public or private—especially when the risk shifts from creditors to equity holders. SEBI acknowledges this distinction in its Proposal, describing equity as "risk capital." This concept reflects a fundamental principle: shareholders, who direct the company's

[45] Robert Parrino, Fundamentals of Corporate Finance (November 11, 2011).
[46] UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, Legislative Guide on Insolvency Law (2005) <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf >.

operations and leverage creditors' funds to generate returns, should bear the brunt of failure if the enterprise becomes unprofitable and enters insolvency.

In line with the economics of risk allocation,[47] shareholders should not be unjustly enriched while creditors suffer losses. As a rule, insolvency law mandates that unless all creditor claims are fully repaid, the value of equity must be written down. This ensures that equity holders, who assume higher risk in pursuit of profit, face the consequences when the risk materializes. Only when the resolution applicant specifically proposes otherwise can this principle be altered. This framework reinforces accountability, making it clear that equity holders cannot benefit at the expense of creditors when a company collapses. By prioritizing creditors' claims and requiring shareholders to absorb the residual risk, insolvency law upholds a fair balance of responsibility within the corporate ecosystem.

2. Impact on the Role of the Resolution Applicant

The IBC is designed to streamline the resolution of distressed companies by empowering resolution applicants to craft and implement effective turnaround strategies. The primary role of a resolution applicant is to rehabilitate a distressed entity by formulating and executing a resolution plan that maximizes value for creditors and ensures the company’s viability. The resolution process often requires difficult decisions and significant restructuring efforts that may not align with the interests of public shareholders. Shareholders are primarily concerned with the preservation of their investments and may resist or complicate necessary restructuring actions. Allowing them to be active participants or mandating them to receive equity shares at the same terms as new investors creates a conflict of interest that can

[47] ibid.

impede the resolution applicant's ability to make swift and effective decisions crucial for the company's turnaround.[48]

Imposing mandatory equity offers to public shareholders at existing terms effectively introduces a form of regulatory overreach.[49] The resolution applicant assumes significant risk and often injects fresh capital into the distressed entity, taking on a substantial burden in return for operational control and the opportunity to implement a turnaround plan. Forcing resolution applicants to offer shares to public shareholders at the same price terms—despite the resolution applicant's assumption of new risk—dilutes the incentive for resolution applicants to engage in the resolution process. Additionally, the constraints of complying with delisting or listing procedures as per the SEBI regulations further complicate his ability to execute a resolution plan efficiently. This regulatory burden can stifle the resolution applicant's strategic flexibility and prolong the resolution process, potentially harming the company's chances of recovery.

Upon the initiation of insolvency proceedings, the equity value of the corporate debtor typically plummets to near zero. In this scenario, the resolution applicant, who steps in to rescue and revive the distressed entity, assumes an enormous financial risk. By infusing capital into a failing business, the resolution applicant and any associated financial backers are betting on the future success of the turnaround strategy, hoping to realize gains through the eventual appreciation of the company's equity. This is the essence of the commercial bargain: high risk, high reward.

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[48] Dhruv Kohli, Sanya Singh, *Shareholder Protection under IBC: A Myth or a Possibility*, IndiaCorp Law <https://indiacorplaw.in/2023/05/shareholder-protection-under-ibc-a-myth-or-a-possibility.html > accessed on Sept 25, 2024.

[49] Pranav Sethi, 'Opportunity for public equity shareholders to acquire shares after CIRP - a measure for protection or an instance of myopia?' (*SSRN Papers,* February 4, 2023) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4451548 > accessed on Sept 25, 2024.

SEBI's Proposal, however, disrupts this delicate balance by proposing that public shareholders be entitled to a significant portion of equity—up to 25%—at the same price at which the resolution applicant acquires equity. While the nominal acquisition price for equity may be low, this does not reflect the true cost and risk borne by the resolution applicant. The resolution applicant's commitment extends far beyond the nominal acquisition price; it encompasses not only the resolution of the corporate debtor's substantial debts but also the capital infusion necessary to restore and improve the company's operations. To offer public shareholders equity at the same price fundamentally misunderstands the nature of the resolution applicant's investment and the risks undertaken.[50]

Moreover, this mandate undermines the statutory order of priority established under Section 53 of the IBC,[51] which explicitly subordinates equity holders to creditors. Public shareholders are, by design, the residual claimants in an insolvency scenario and should not receive benefits disproportionate to their risk profile. Granting them equity at a nominal price effectively shifts the risk-reward calculus in their favour, allowing them to gain from the company's recovery without having contributed to the financial risk of rescuing the business. This not only distorts the commercial logic of insolvency resolution but also disincentivizes potential resolution applicants.

By diluting the reward that resolution applicants might expect from their high-risk investment, the proposal could have a chilling effect on the very market SEBI seeks to protect. Fewer qualified bidders may emerge for distressed companies, reducing the likelihood of successful turnarounds. The result is a weakened insolvency framework that ultimately harms creditors,

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[50] Gagan Bajaj, Abhishek Arya, 'Treatment of Public Equity Shareholders under IBC' (*IBC Laws*, April 4, 2023) <https://ibclaw.in/treatment-of-public-equity-shareholders-under-ibc-by-adv-abhishek-arya-and-cs-gagan-bajaj/> accessed on Sept 27, 2024.

[51] The Insolvency and Bankruptcy Code, 2016 (31 of 2016) s 53.

the economy, and even public shareholders, whose interests are better served by a robust and functioning resolution process. The PHD Chambers of Commerce and Industry correctly warns in its suggestions on the SEBI Proposal— "IBBI has categorically said in the past that not many resolution applicants/acquirers are available in the market. Therefore, SEBI should refrain from taking any action which may discourage the prospective resolution applicants."[52]

3. LEGAL STANDING OF SHAREHOLDERS AS "AFFECTED PARTIES" IN INSOLVENCY PROCEEDINGS

Under Section 30(2) of the IBC, the resolution professional ("**RP**") is tasked with ensuring that a submitted resolution plan satisfies certain legal criteria.[53] Specifically, clause (e) requires the RP to verify that the plan does not violate any prevailing laws. The explanation accompanying this provision stipulates that shareholder approval, as mandated by the Companies Act, 2013 or other relevant legislation, is automatically "deemed" to have been granted, as long as the plan is valid and in compliance with the law.

This concept of deemed approval was notably clarified in the case of ***Dr. Ravi Shankar Vedan v. Tiffins Barytes Asbestos***,[54] where it was held that shareholders do not have the *locus standi* to challenge a resolution plan at any point. The rationale behind this ruling is clear: Section 30(2) effectively eliminates the necessity for explicit shareholder approval, thereby precluding shareholders from raising objections to a resolution plan. This interpretation has been reinforced by a series of decisions, including *ICP Investments v.*

[52] Suggestions on Consultation Paper by SEBI, PHD Chamber of Commerce and Industry (January 2, 2023) <https://www.phdcci.in/2023/01/02/suggestions-on-consultation-paper-by-sebi-framework-for-protection-of-interest-of-public-equity-shareholders-in-case-of-listed-companies-undergoing-cirp-under-the-insolvency-and-bankruptcy-c/ >.
[53] The Insolvency and Bankruptcy Code, 2016 (31 of 2016) s 30(2).
[54] Dr. Ravi Shankar Vedam v. Tiffins Barytes Asbestos and Paints Limited [MANU/NL/0581/2023].

Uppal Housing,[55] *Punit Garg v. Ericsson India Pvt. Ltd.,*[56] and *Anant Kajare vs. Eknath Aher*.[57] In these cases, the courts have consistently ruled that shareholders do not qualify as "aggrieved parties" in CIRP proceedings, asserting that allowing shareholder interventions could jeopardize the entire insolvency process.

However, an exception exists in cases where there is evidence of collusion between creditors in the admission of CIRP. In such instances, shareholders may have a right to contest the initiation of insolvency proceedings. This was underscored in *Ashish Gupta v. Delagua Health India Private Limited*,[58] where the court recognized the *locus* for the majority shareholders to challenge an unjust CIRP admission, but only when creditor collusion is alleged. In cases of such collusion, facts and circumstances must be well-considered to demystify the real picture.

The spirit of the IBC operates under the "debt trumps equity" principle, which inherently places the interests of creditors over shareholders. This approach emphasizes that shareholders, as residual claimants, do not have a say in the resolution process once insolvency begins. Thus, shareholder consent or approval becomes irrelevant, as the IBC prioritizes the efficient and effective resolution of insolvency cases.[59] In this context, any regulatory attempt to facilitate shareholder influence in insolvency proceedings—whether directly or indirectly—would amount to a regulatory overreach.

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[55] ICP Investments (Mauritius) Ltd. v. Uppal Housing (P) Ltd., 2019 [SCC OnLine Del 10604.

[56] Punit Garg v. Ericsson India Pvt. Ltd. & Anr (2019) ibclaw.in 263 NCLAT.

[57] Anant Kajare v. Eknath Aher, 2017 SCC OnLine NCLAT 434.

[58]Ashish Gupta v. Delagua Health India Private Limited (2023) ibclaw.in 87 NCLAT.

[59] Yadu Krishna, Shareholder Intervention in Resolution Proceedings: A Potential Misinterpretation of IBC 2016, HNLU CCLS (October 22, 2023) <https://hnluccls.in/2023/10/22/shareholder-intervention-in-resolution-proceedings-a-potential-misinterpretation-of-ibc-2016/ > accessed on Sept 27, 2024.

The IBC framework intentionally excludes shareholder involvement to prevent disruptions in the resolution process, and introducing by-laws that contradict this design could undermine the entire system. Therefore, regulatory efforts that attempt to provide shareholders an indirect representation, especially in matters where the IBC has explicitly limited their role, can be seen as going beyond the intended scope of the law.

IV. CONCLUSION

As we draw the curtain on this extensive analysis it becomes evident that the SEBI Proposal, while well-intentioned, may prove counterproductive if materialised in its current form, as inferred from the preceding sections. However, should it necessitate advancement, it may be worthily considered that even in major jurisdictions, existing shareholders are afforded the opportunity to acquire shares in newly restructured entities through a process of negotiation and mutual consent with creditors—this is not an automatic safeguard, but rather a carefully orchestrated arrangement. However, the SEBI's proposition imposes strict compliance, thereby undermining the essential latitude for negotiation and the necessary approval of both creditors and resolution applicants. A discretionary, non-mandatory framework would have given the creditors and resolution applicants the leeway to assess shareholder involvement on a case-by-case basis. The rigidity of SEBI's current proposal, however, risks entangling resolution applicants in a web of obligatory compliance, thereby hampering the smooth operation of insolvency proceedings.

As for the question of representation, it is understood that the IBC's rigorous adherence to the creditor-centric paradigm is fundamental to its effectiveness, however, it is also true that the strict exclusion of public shareholders from the formulation of the resolution plan may, in some cases,

actually affect the principles of equity and fairness. A constructive compromise could be providing an opportunity for public shareholders to appoint an authorized representative on the CoC. Although this representative would not have voting rights, their presence would ensure that shareholder concerns are heard and considered. This can also be done on a case-to-case basis (equity committees formed under Chapter 11 proceedings can be used as precedents[60]). To safeguard against misuse of such representation, introducing a "clear abuse" standard, as seen in U.S. bankruptcy law, can reinforce creditor confidence while maintaining equity.[61] While absolute representation for shareholders in the insolvency resolution process may not be feasible, ensuring their voices are heard fosters a spirit of equity and inclusivity.

Finally, rather than disrupting the insolvency resolution framework, investor protection should be primarily taken care of at the ex-ante stage—through proactive, preventive measures taken by both investors and regulators. This approach is well facilitated by stock exchanges like NSE and BSE, which enforce stringent disclosure and reporting requirements for investor awareness.[62] The moment a company is admitted into CIRP, immediate alerts should be issued to investors. By ensuring investor education, real-time information flow, and addressing the underlying issue of information asymmetry, investors can be better informed and more capable of making sound decisions, thus avoiding risky investments or potential financial crises.

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[60] Section 1102(a)(1) of the Bankruptcy Code; Diane Lourdes Dick, 'The Bearish Bankruptcy' (2018) 52 Ga L Rev 437.

[61] Damon P. Meyer, Absent "Clear Abuse," Shareholders Continue to Control Company During Chapter 11 Case, Weil Restructuring (January 26, 2012) <https://restructuring.weil.com/throwback-thursday/absent-clear-abuse-shareholders-continue-to-control-company-during-chapter-11-case/ > accessed on Oct 2, 2024.

[62] BSE, NSE issue guidelines for companies undergoing insolvency proceedings, LiveMint (July 9, 2021) <https://www.livemint.com/market/stock-market-news/bse-nse-issue-guidelines-for-companies-undergoing-insolvency-resolution-process-11625822242634.html > accessed on Oct 2, 2024.

This preventive strategy safeguards investor interests without compromising the efficiency of the insolvency resolution process.

In essence, while preserving the efficiency of the insolvency framework is paramount, acknowledging the concerns of public shareholders through thoughtful, strategic adjustments could enhance the inclusivity of the process without compromising its core objectives. The balance between protecting investor interests and maintaining the integrity of insolvency proceedings is delicate but can be essential for the continued efficacy and fairness of the resolution framework. As rightly encapsulated in the ArcelorMittal judgement,[63]

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

[63] ArcelorMittal (India) (P) Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1.